Lesson No. 1 **AUTHOR: DR.SHAILINDER SEKHON**

THEORATICAL FRAMEWORK OF BUSINESS ENVIRONMENT
(CONCEPT, NATURE AND STRATEGIES)

STRUCTURE

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2.0 OBJECTIVES

After studying this lesson, students would be able to answer:

- Concept and nature of Business Environment
- Various elements/forces of Business Environment
- Interaction of Organisation with the External Environment
- Organisational Strategies to deal with Business Environment

1.1 INTRODUCTION

Successful companies take an outside - inside view of their business. They recognize that ever-changing business environment is full of opportunities and threats and understand the significance of continuously monitoring and adapting to that environment.

Many organizations fail to see change as an opportunity. They ignore or resist changes until it is too late. Even companies like IBM, General Motors etc. have to pass through difficult times due to this fact only.

Bajaj Auto Ltd., a major in automobile industry could not see the threats being passed by its rival 1.441, and in the nineties have to shed more than 28% market share in the scooter segment with its market share coming down to less than 54% in 2001-2002 from 82% in early 1996. Mr. Rahul Bajaj, CMD, Bajaj Auto Ltd. himself admitted that he could not see the environmental changes taking place in his business.

One of the most critical challenges is to cope up with the environmental dynamics of

change which many a time assumes the nature of turbulence. The business environment presents two challenges to the enterprise, viz, the challenge to combat the environmental threats (such as, intensification of competition, declining market etc.) and to exploit the business opportunities.

That the environmental factors have a profound impact on business is indicated by the fact that environmental analysis and diagnosis are among the first steps in the strategic management process. Business dynamics is, in fact, a dependent factor, it depends on, inter-alia, the environmental dynamics. Hence, the importance of environmental analysis and diagnosis.

1.2 DEFINITIONS

(1) Environmental Analysis

It is defined as "the process by which strategists monitor the economic, governmental/legal, market/competitive, supplier/technological, geographic, and social settings to determine opportunities and threats to their firms."

(2) Environmental diagnosis

It consists of managerial decisions made by analyzing the significance of the data (opportunities and threats) of theenvironmental analysis,"

(3) Macro Environment

The term Macro environment refers to "the forces and institutions outside the organisation that can be potentially affecting the organisations' performance."

(4) Micro Environment

The term micro environment refers to "the forces and factors in the company's immediate environment that affect the performance of the company."

(5) Marketing Intermediaries

The marketing intermediaries are those firms that aid the company in promoting, selling and distributing its goods to final users or buyers.

1.3 EXAMPLES ON ENVIRONMENTAL ANALYSIS

As the magnitude of the business increases more and more systematic analysis of the business environment is being carried out by the enterprise, which determines the success or the failure rather survival of the business itself. Just as the life and success of an individual depend on his innate capability, including physiological factor, traits and skills, to cope with the environment, the survival and success of a business firm depend on its innate strength-resources available, including physical resources, financial resources, skill and organization and its adaptability to the environment.

Following the numerous examples:

(1) The mobile companies took into consideration the various demographic factors, before deciding to start their business in the metropolitan and other big cities initially and then slowly capturing the markets in the semi-urban areas and even the rural areas,

(2) The growth of textile industry in the coastal areas is quite obvious, however, the companies like JCT, Phagwara have to spend a few crores to create that type of environment thereby increasing the initial costs of the project.

(3) The same is true for Cement Industry, as for them the geophysical factors are of highest importance.

1.4 NATURE OF BUSINESS

Ross A. Webber has identified three types of environments, that is, stable environment, changing environment and Turbulent Environment.

(1) *A Stable environment* is a simple environment, which has the following characteristics:

(a) No unexpected or sudden changes are there.

(b) Modification about product changes can be planned well in advance.

(c) Minor and predictable changes in market demand.

(d) Same legislation and no possibility for future changes,

(e) Non-existence research budgets due to absence of new technological developments.

(2) In*Changing Environment,* environment innovations may take place in product, market, law and technology. The changes do not surprise the management as the changes in trends are predictable. Generally, such changes are seen in the firms of lawyers, finance banking and other service sectors.

(3) In *Turbulent Environment* some sudden and unpredictable changes are taken place. The factors which contribute to a turbulent environment can be summarised as below:

(a) Rapid technological changes

(b) Frequent changes in Government Economic Policies

(c) Political Uncertainty

(d) Social Changes

(e) Change in Fashions

(0 Increased Competition

(g) Labour Unrest

Only a few organisations face a continuously turbulent environment.

The organisational environments are multinational. The multinational features are as explained below:

1.4.1 Complexity

The external environment of an organisation may range from simple to complex. The degree of complexity refers to the heterogeneity and range of activities which are relevant to an organisation's activities. More diverse the environmental activities and more the number of activities, the higher the complexity and vice-versa. Organisations working in complex environments have to process a large variety of information, so, a special unit monitoring and processing such information is required.

1.4.2 Volatility

The environmental volatility refers to the degree of change that is a function of three variables:

(1) the frequency of change in relevant activities

(2) the degree of difference involved at each change

(3) the degree of irregularity in the overall patterns of change.

By considering these variables there are four types of environmental movements:

— Low-Stable Change

— High-Stable Change

— Low-Unstable Change

— High-Unstable Change

The environmental volatility affects the task performance of the organisations due to uncertainty. And, uncertainty affects the ability of the organisation to preplan or to make

decisions about activities in advance.

1.4.3 Capacity

The capacity of environment refers to the degree to which it can support growth. Rich and growing environment generates excess resources which can buffer theorganisation in times of relative scarcity.

For example, the easy availability of cheap and skilled labour for a firm is favourable whereas scarcity of labour will create problems for it.

Self-Check Exercise - I

1. The degree of _________ refers to the heterogeneity and range of activities which are relevant to an organisation's activities.
2. Which analyst was able to identify three types of environments?

1.5 NATURE OF ORGANISATION ENVIRONMENT INTERFACE

Every organisation has to interact with the external environment, exchange resources with it, influence it and in turn is influenced by the various variables therein. This interaction of the different elements with the sub-systems of the organisation can be studied in three ways:

(1) Organisation may be taken as an *input- output system,*

(2) It may be taken as the *central focus* realizing the contributions of many groups.

(3) It can be treated *as* an *operating unit* in environment presenting opportunities and threats to it.

I. As Input-Output System

The input-output model was originally developed by Leontief in 1930s. Organisation, as input-output model has three basic factors, as discussed below:

(1) Flow of Inputs

No organisation is self-contained but depends upon its environment for various inputs. Basically, there are three types of inputs:

(a) **Material**

This is the first basic input which every organisation must take from its environment. It can be operational material and product material.

(b) Energy

The second type of input is energy which is used for the movement of the work pieces, tools, assembly devices etc.

(c) Information

The third type of input is information which in broad sense includes shape, pattern, arrangement, instruction or knowledge.

The degree of success of any organisation is determined by the quality of various inputs which in turn is determined by the success of the system.

(II) Processes

The input received by the organisation from the environment are processed by it. **The** inputs are converted into various outputs through men and machines. There may be two types of processes, like conversion process and Holding process.

Process relating to conversion of inputs into outputs

These processes are determined by the type of technology being used by the organisation.

(2) Process necessary for holding the various elements of the organisation

These processes provide flow throughout the system and help in achieving system's goals. e.g. Holding processes are like communication, decision making, influence, control and motivation processes.

(III) Outputs

The organisation exports the outputs, created through the process of conversion, to the environment, which in turn gives further inputs to the organisation. Thus, inputs are imported from the environment, transformed into outputs and exported back to the environment.

II. As Central Focus for realising the contributions of many groups

In this case interaction of the environment within subsystems of the organisation has been defined as the contributions of various groups, in the organisation as shown in this Figure.

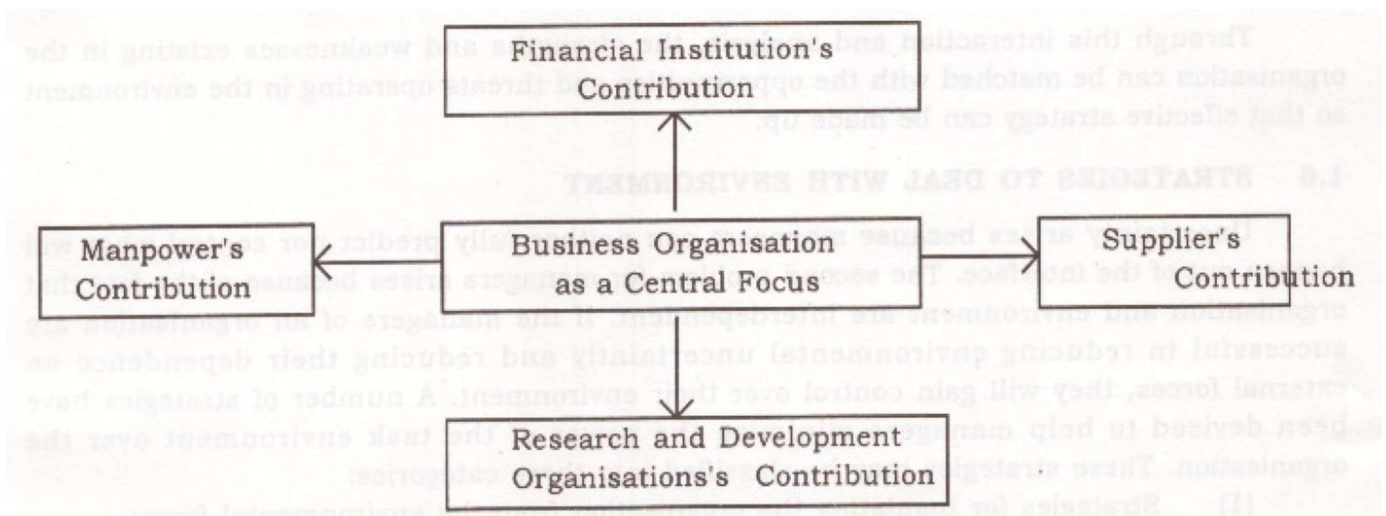


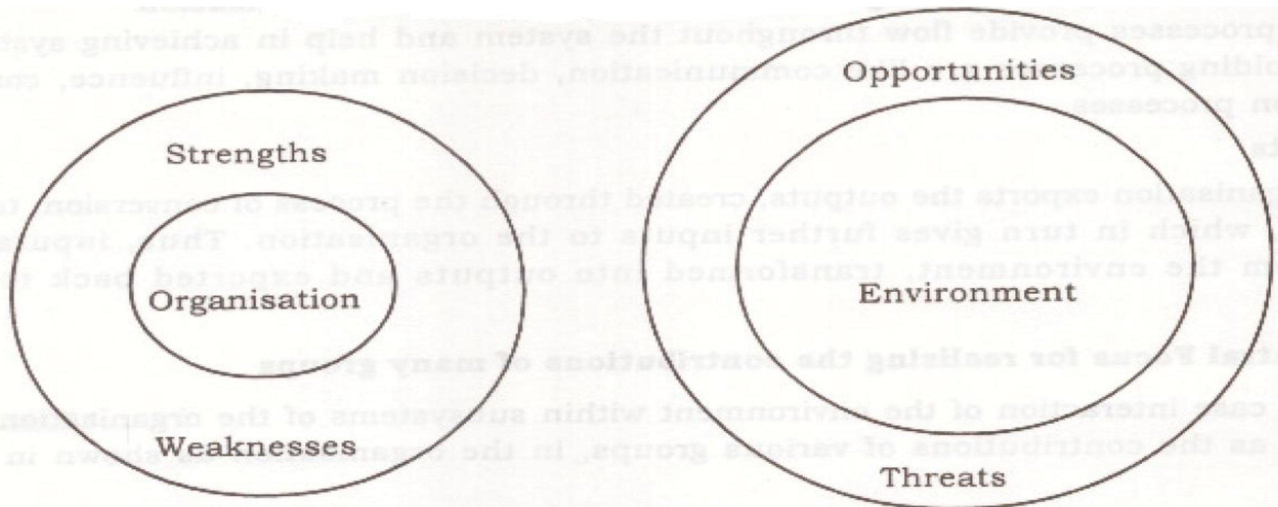
Figure-I: Organisation as a Central Focus for realising contribution

Different elements of the environment interact with the various sub-systems of the organisation in different ways and degrees which made the Business Organisation as a Central Focus for realising the contributions of many groups both within and outside the organisation.

III. As an operating Unit in environment

In this case interaction of an organisation with the internal and external environment has been considered from operating point of view the unit. Before starting the operations, an organisation has to assess its strengths and weaknesses in the light of opportunities and threats of the environment. For this, SWOT analysis is undertaken by the business organisations.

Figure - II: SWOT ANALYSIS



Through this interaction and analysis, the strengths and weaknesses existing in the organisation can be matched with the opportunities and threats operating in the environment so that effective strategy can be made up.

1.6 STRATEGIES TO DEAL WITH ENVIRONMENT

Uncertainty arises because managers can neither fully predict nor control what will happen out of the interface. The second problem for managers arises because of the fact that organisation and environment are interdependent. If the managers of an organisation are successful in reducing environmental uncertainty and reducing their dependence on external forces, they will gain control over their environment. **A** number of strategies have been devised to help managers minimise the power of the task environment over the organisation. These strategies may be classified into three categories:

(1) Strategies for insulating the organisation from the environmental forces,

(2) Strategies for gaining control over certain aspects of external environments.

(3) Strategies for organisational adoption.

1.6,1 Strategies for insulating the organisation from the Environmental Forces

The strategies for insulating the organisation from the environmental forces call for maintaining the organisational boundary so tightly that the environmental forces are not allowed to penetrate freely into the organisation and affect its routine operations. Managers cannot completely insulate themselves from environmental forces, yet it is reasonable for them to engage in strategies that insulate the organisation from erratic and potentially damaging environmental demands. The organisation can adopt the following strategies, based on the environmental anticipation:

I. Buffering

The strategy of buffering can avoid the impact of uncertainty by procuring more raw materials to fulfil the requirements for a longer period, Similarly, it can stock pile the finished products in the lean period and to sell in peak demand period. Thus, this technique enables the management to maintain operations when there are shortages of raw materials and when there are peaks and valleys in demand for its products.

II. Smooting or levelling

This strategy aims at maintaining the sales at a uniform level throughout the year.

During periods of high demand, a premium rate may be charged for the product and during low demand period, some incentives may be given to the customers, like free gifts, discounts, and lucky coupons etc.

III. Rationing

This strategy provides a set of priorities for using the organisation's scarce resources. For example, during summers there is greater demand of electricity and water, so authorities put restrictions on use of water for certain purposes like washing of cars, watering the lawns and make some electricity cuts also,

1.6.2 Strategies for gaining control over Environment

These strategies aim at reducing the organisational dependence on the environment by increasing its power or control over some aspects of the environment.

I. Creation of Prestige

An organisation with a good public image and goodwill can influence the environment to a large extent and organisations have greater influence over their customers, suppliers, public and nation as a whole.

II. Agreements

In order to gain control over the environment, the organisation may enter into agreements with those forces in the environment which may affect the business directly and on which it has dependence. For example, agreements with the suppliers, banks, financial institutions, labour unions, customers and competitors etc.

III. Cooptation

Cooptation strategy is the process of absorbing new elements into the policy making structure of an organisation as a means of averting threats or maintaining its stability in the changed situation. For this reason, many organisations appoint outside directors, employee directors, directors representing financial institutions. It enables the organisation to make them aware about its problems, create common understanding and to find mutually agreed goals.

IV. Procurement of Key Personnel

By alluring knowledgeable individuals from key organisations in the external environment, the organisation can bring into its fold, people with information and knowledge about the operations and policies of competitors. In this way, this strategy will reduce uncertainty and interdependence.

V. Lobbing

Lobbing is the strategy of convincing the various powerful elements (i.e. some members of ruling party) of the environment to act inthe favour of organisation by playing an active role to convince the Government to enact laws and modify its various policies (i.e. monetary policy, trade policy and licensing policy etc.)

VI. Coalesing

In this strategy, two or more organisations may merge their organisations to have better control over the environment as various resources are pooled together.

1.6.3 Strategies for Organisational Adaptation

With information gathered from forecasting, managers can help their organisations adapt internally to anticipated environmental demands. This strategy involves two types of adaptation:

I. Adaptation of Organisational Structure

Organisation adapt their structure according to the need of the environment.

Organisations operating in comparatively stable environment, adopt mechanistic structure and organisations which operate in comparatively dynamic, adopt organic structure.

Adaptation of Systems and Processes

In this strategy organisations design their systems and processes according to the needs of the environment, so that, they are in a better position to cope with the environmental needs and challenges.

SELF-CHECK EXERCISE - II

3. _________ is the process of absorbing new elements into the policy making structure of an organisation as a means of averting threats or maintaining its stability in the changed situation.
4. ________ is the strategy where two or more organisations may merge to have better control over the environment as various resources are pooled together.

1.7 SUMMARY

It can be concluded that the environmental analysis is the cornerstone of new business opportunity analysis. You might be observing in your day-to-day life that even when smallest business is to be started, the small-time entrepreneur is also taking a feel about the business prospects. Ofcourse he may not be considering all the factors into consideration the fact is that he is analyzing the business environment. Thus, today a much greater emphasis is given than in the past to the fact that environmental analysis is an essential prerequisite for the strategic management decision-making. Hence, every business enterprise, consists of a set of internal factors and is confronted with a set of external factors.

1.8 KEYWORDS

Macro environment, Micro environment, Volatility, SWOT, Input-Output System

1.9 GLOSSARY

1. Macro Environment -- External Environment
2. Micro Environment -- Internal Environment
3. Turbulent Environment -- Unpredictable changes
4. Volatility - Degree of Change
5. Input - Out system - Model given by Leontief in 1930

1.10 ANSWER TO SELF-CHECK EXERCISE.

1. Complexity, 2. Ross A. Weber, 3. Cooptation Strategy, 4. Coalesing

1.11 EXERCISES

1.11.1. Short Question/Answers.

Q1. What do you mean by internal and external business environment?

Q2. Define the nature of business environment.

Q3. Give basic factors of input-output system.

Q4. What do you mean by Turbulent Business Environment?

1.11.2. Long Question/Answers.

Q1. Explain the SWOT analysis.

Q2. What are the strategies of an organization to deal with environment?

Q3. Elaborate the nature of the business in detail.

1.12 SUGGESTED READINGS

1. Business Environment (Text & Cases) : By Francis Cherunilam
2. Business Environment : By Rosy Joshi, Sarigam Kapoor (2005) Published by - Kalayani Publishers.

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ENVIRONMENTAL SCANNING AND MONITORING

STRUCTURE

2.0 Objective
2.1 Introduction
2.2 Process of Environmental Analysis
2.3 Approaches to Environmental Scanning
2.4 Sources of Information for Environmental Scanning
2.5 Monitoring the Environment
2.6 Forecasting the Environment
Self-Check Exercise - I
2.7 Environmental Appraisal
2.7.1 Identification of Environmental factors
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2.12 Exercises
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2.13 Suggested Readings

2.0 OBJECTIVES

The main objective of this lesson is to introduce the students with the Environmental Scanning and monitoring techniques. After reading this chapter, you should be able to understand the process, approaches and sources of environmental analysis i.e. Environmental scanning and monitoring,

2.1. INTRODUCTION

The Environment includes factors outside the firm which can lead to opportunities for or threats to the firm. Environmental analysis has three basic goals. First, the analysis should provide an understanding of current and potential changes taking place in the task environment, secondly, environmental analysis should provide inputs for strategic decision making, and thirdly it should facilitate and foster strategic thinking in organisations. Thus, Environmental Scanning is needed because of the following reasons:

1. Effective utilisation of resources
2. Constant monitoring of the Environment
3. Strategy Formulation
4. Identification of Threats and opportunities
5. Useful for the Managers
6. Predicting the Future

2.2 PROCESS OF ENVIRONMENTAL ANALYSIS

The Environmental analysis is a challenging, time consuming and expensive affair. The analysis consists of four basic steps:

1. Scanning
2. Monitoring
3. Forecasting, and
4. Assessment

1. Scanning: Scanning involves general study and collection of all environmental factors and their interaction in order to:

(a) identify early signals of possible environmental change, and

(b) to detect environmental change already under way.

Scanning is ill-structured and ambiguous environmental analysis activity thus, fundamental challenge for analysist in scanning is to make sense out of vague, ambiguous and unconnected data,

2. Monitoring: Monitoring involves tracking the environmental trends, sequences of events or streams of activities. As monitoring progresses, the data turn frequently from imprecise to precise. Three outcomes emerge out of monitoring:

(a) a specific description of environmental trends and patterns to be forecast;

(b) the identification of trends for further monitoring; and

(c) the identification of areas for further scanning.

These outputs become inputs for forecasting.

3. Forecasting: Unlike scanning and monitoring, forecasting is well focused and is much deductive and complex activity, because the focus, scope and goals of forecasting are more specific than the earlier two steps.

Forecasting is concerned with the:

(a) developing possible projections of the directions, scope and intensity of environmental change; and

(b) Layout the evolutionary path of anticipated change.

4. Assessment: The forecasting simply provides 'nice to know' information, and assessment involves identifying and evaluating how and why current and projected environmental changes affect or will affect strategic management of the organisation.

Thus, in the whole process of environmental analysis, the focus of scanning, monitoring and forecasting is to identify what the 'Understanding of Environment means for the particular organisation and then Assessment tells that what are the key issues presented by the environment, and what are the implications of such issues for the organisation.

2.3 APPROACHES TO ENVIRONMENTAL SCANNING

Following different approaches can be there for sorting out information for environmental scanning:

I. Systematic Approach

2. Ad-hoc Approach

3. Processed Form Approach

1. Systematic Approach: In this approach, information for environmental scanning is collected systematically and continuously which generally relates to markets, customers, changes in legislation and regulations, Government policies that have a direct impact on an organisation's activities.

After this continuous updating at such information is necessary not for strategic management but also for operational activities.

2. Ad-hoc Approach: Under this approach organisation may conduct special surveys and studies to deal with specific environmental issues from time to time. These studies may be conducted when the organisation undertakes special projects, evaluate specific strategies or to devise new strategies,

Thus, in this approach changes and unforeseen developments have been investigated with regard to their impact on the organisation on some specific time not continuously.

3. Processed Form Approach: Under this approach the organisations generally use information in processed form i.e. {1) supplied by Government agencies or private institutions; and (2) secondary data available from different inside and outside sources of the organisation.

2.4 SOURCES OF INFORMATION FOR ENVIRONMENTAL SCANNING

Organisations generally use different practical combinations of approaches to monitor the relevant environments. Whatever approach is used, data collection is necessary for deriving information, and sources for scanning remain the same. The important sources of information useful for market and environmental analysis in India are mentioned below:

1. Daily Newspapers
2. Journals
3. Government Publications
4. Institutional Publications
5. Other Publications

I. Daily Newspapers: For Environmental scanning the important Economic trends newspapers are:

- Business standards
- Financial Express
- The Times of India
- The Hindu
- International Herald Tribune
- The Economic Times

2. Journal: For environmental assessment important journals are:

- BusinessIndia
- Business World
- Update
- Fortune India
- Main Stream
- India Today
- Environmental Trends and Scenario's
- Commerce
- Harvard Business Review
- Seminar
- C.M.I.E. Publications
- Long Range Planning Journal
- Sloan Management Journal
- Finance and Development
- W.F. World Economic outlook
- Economist
- The Economic and Political Weekly
- Fortune International

3. Government Publications: The useful governmental publications for the business Environment analysis are:

- Census of India reports
- Five-year Plan reports
- Statistical abstract of India
- Economic Surveys
- Annual Surveys of Industries
- Annual report of ministers
- Occasional reports as guidelines to industries
- Reports on import and export policies
- Reports on policies related to specific industries
- RBI's Department reports
- Monthly Bulletin of RBI
- Annual reports of the development wing, ministry of commerce and industry

4. Institutional Publications: The following are the important institutional publications:

- The Stock Exchange Directory
- The Centre for Monitoring Indian Economy
- Kolhare's Industrial directory of India
- Publications of market research agencies i.e. Operational Research Group (OPR)
- The National Council for Applied Economic Research (NCAER)
- Publications of Trade and Industry federations i.e. FICCI, ATMA etc.
- Annual company reports

5. Other Publications: Among other publications, a mention may be made of the following:

- Indian year book
- Statistical year book
- Annual bulletin of Statistics of Exports and Imports
- Techno-Economic Surveys
- Publications of advertising agencies
- Monthly studies of Production of selected industries
- Weekly bulletin of industrial Licenses i.e. Export Licences and Export licences.
- Studies of State trading Corporation
- Commodity reports and other studies of the Indian Institute of Foreign Trade
- Annual report on Currency and Finance while secondary information is available economically and readily, its reliability, accuracy and relevance for the purpose under consideration must be carefully examined.

2.5 MONITORING THE ENVIRONMENT

Basically, the firm must systematically monitor the environment and assess its competitive abilities to exploit opportunities in the environment by drawing on its competitive strengths.

For monitoring, the business environment may be divided into six broad sectors as given below:

1. Economic Sector:

- State of the economy
- Overall rate of growth

- Growth rate of primary, secondary and tertiary sectors
  Cyclical fluctuations
- Linkage with the World Economy
- Trade surplus/deficits
- Balance of Payment situation

2. Government Sector:

- Industrial Policy
- Government Programmes and Projects
- Tax Framework
- Subsidies, incentives and concessions
- Import and export Policies
- Financing norms
- Lending conditions of financial institutions and commercial banks

3. Technological Sector

- Emergence of new technologies
- Access to technical know-how, foreign as well as indigenous
- Receptiveness on the part of industry

4. Socio-demographic Sector:

- Population trends
- Age shifts in Population
- Income distribution
- Educational Profile
- Employment of women
- Attitudes towards consumption and investment

5. Competition Sector:

- Number of firms in the industry and the market share of the top few firms
- Degree of homogeneity and differentiation among products
- Entry barriers
- Comparison with substitutes in terms of quality, price, appeal and functional performance
- Marketing policies and practices

6. Supplier Sector:

- Availability and cost of raw materials and sub-assemblies
- Availability and cost of energy
- Availability and cost of money

As the monitoring of internal environment is concerned, the broad areas and important aspects of corporate appraisal can be considered as mentioned below:

1. Marketing and Distribution:

- Market image
- Market share
- Distribution network
- Customer Loyalty

- Marketing and distribution costs

2. **Production and Operations**
   - Condition and capacity of plant and machinery
   - Availability of raw-materials, sub-assemblies and power
   - Degree of vertical integration
   - Locational advantage
   - Cost structure
3. **Research and Development:**
   - Research capabilities of the firm
   - Track record of new product developments
   - Laboratories and testing facilities
   - Coordination between research and operations
4. **Corporate Resources and Personnel:**
   - Corporate image
   - Output with governmental and regulatory agencies
   - Dynamism of top management
   - Competence and commitment of employees
   - State of industrial relations
5. **Finance and Accounting:**
   - Financial leverage and borrowing capacity
   - Cost of capital
   - Tax situation
   - Relations with shareholders and creditors
   - Accounting and Control system
   - Cash flow and liquidity

2.6 FORCASTING OF ENVIRONMENT

Forecasts of important business environments, viz; economic, social and political environment etc, would be useful in formulating plans and strategies. The steps in environmental forecasting are also similar to the steps as in formulating and executing a research project. There are number of quantitative and qualitative techniques used in environmental forecasting. Some important techniques are mentioned below :

1. Econometric Techniques
2. Trend Extrapolation
3. Scenario Development
4, Judgemental Models
5. Brain Storming
6, Delphi Method
7. Strategic Issues analysis

1. Econometric Techniques: This technique involves casual models topredict major economic indicators. When there is a well-established relationship between two or more variables, that causal relationship can be used to forecast the future.

For example, if demand is a function of consumer income, the impact of an increase in consumer income on demand can be predicted using the equation representing the relationship between these two key variables.

(1) Multiple regression analysis, and

(2) Time series regression models.

2. Trend Extrapolation: Under this technique, time series models assume that the past is aprologue to the future and extrapolate the historical data to the future.

This technique uses simple linear relationship or more complex non-linear relationships to forecast trends.

3. Scenario Development: Scenario development is a technique used to forecast the occurrence of complex environmental events in which many variables play a role. Scenarios allow the integrated consideration of these multiple variables in explaining the emergence of future conditions. A scenario is a detailed description of how certain events may occur in the future and their consequences for the organisation.

According to Shrivastava, following are the steps to develop scenarios:

1. Identify strategic environmental issues
2. Select the most important issues
3, Prepare a preliminary description of these issues and how they evolved
4. Draw out the implications of the issue for organizational performance
5. Develop detailed descriptions of the future in the forms of scenarios
6. Discuss the scenarios with top management and refine them
7. Develop contingency action plans for each scenario.

Following are the methods of Scenario Buildings:

(1) Premising Method

(2) Systems Diagram Method

(3) Critical Site Method

(4) The Newspaper Headline Method

(5) Logical Possibilities Method

4. Judgemental Models: The Judgemental models involve the use of opinion of people who have intimate knowledge of relevant factors. Another method is 'juries executive opinion' which combine estimates made by executives from marketing, production, finance and purchasing and then average their views.

5. Brain Storming: Under this method, a group of knowledgeable people are encouraged to generate ideas, discuss them and to make forecasts on the basis of that. With a view to encouraging throwing up new ideas without any reservation, the discussion and evaluation of the ideas generated is often done only after the idea generation process is over.

6. Delphi Method: The Delphi method is a more systematic technique than brain storming. This method uses a panel of experts on the subject from whom opinions are gathered, may be by using a semi-structured questionnaire and/or interview. The opinions of the experts are documented and consolidated and circulated among the panel members, preferably anonymously, for their evaluation and comments. The experts are requested to review their opinion in the light of the feedback. This process may be continued until a consensus view is arrived at.

7. Strategic Issues Analysis: Strategic issue analysis is a qualitative technique that can be used for assessing emerging strategic environmental issues. It consists of systematically monitoring of social, regulatory and political changes that can affect corporate performance and identifying their impact on the company.

Generally abovementioned techniques are popular in forecasting, but dependability and usefulness of the forecast depend a lot on the appropriateness of the forecasting technique used.

Self-Check Exercise – I

Q1. Under this technique, time series models assume that the past is a prologue to the future and extrapolate the historical data to the future. What is the name of the technique?

Q2.A group of knowledgeable people are encouraged to generate ideas, discuss them and to make forecasts on the basis of that. Name this forecasting technique.

2.7 ENVIRONMENTAL APPRAISAL

Under the process of Environmental analysis, it is required to appraise the environment of an organization also to find out the opportunities, treats, strengths and weaknesses of the organization. To appraise the environment following steps are involved:

(1) To be aware and identify the factors

(2) To structure the results of the environmental appraisal by using STOP and SWOT analysis techniques.

2.7.1 IDENTIFICATION OF ENVIRONMENTAL FACTORS

The major factors which affect the environmental appraisal of the different organizations are given as below:

(a) Environmental Factors: Factors relating to environment will depend upon the nature of the environment which in turn would depend upon its complexity, flexibility, disturbances, hostility and diversity. These factors may emerge from Economic, Political, Legal, Social, cultural and international changes.

(b) Organisational Factors: These factors will depend upon the characteristics of the organization, that is,

(i) Nature of the business of the organization

(ii) Age of the organization

(iii) Size of the organization

(iv) Nature of its markets

(v) Nature of the products or services provided.

(c) Factors relating to strategies: The factors affecting the strategy, which is adopted by the organization play an important role in the appraisal. Generally, there are three level-based strategies as mentioned below:

(i) Corporate level strategies

(ii) Strategic business unit (SBU) level strategies

(iii) Functional level strategies

(d) Factors relating to the strategists: The persons who formulate, implement andevaluate the strategy can play a central role in the appraisal. Thus, factors affecting the strategists are also important as given below:

(i) Age, education and experience of the strategist

(ii) Motivational level

(iii) Ability to withstands the time pressure and strain Interpersonal relations amongst different strategists involved in appraisal.

To identify the important environmental factors, strategists have to test each factor with regard to:

(i) its impact on the business of the organization, and

(ii) the relative probability of their impact on the identification of many issues. This could be classified as per undermentioned categories:

- Critical Issues

- High Priority Issues
- Low Priority Issues

By classifying the impact in such a way, the strategists could limit the range of environmental issues they have to focus their attention upon.

2.7.2 ETOP (ENVIRONMENTAL THREAT AND OPPORTUNITY PROFILE)

The ETOP technique of structuring the environmental appraisal is suggested by Cilueckwhich involves the following steps:

1. Divide the environment into various sectors as already mentioned while monitoring the environment.
2. Analyse the impact of each sector on the organization in the form of a statement.
3. Subdivide each environmental factor into subfactors.
4. Analyse the impact of each sub-factor on the organization in the form of a statement.
5. Prepare a summary to show the major factors for the stake of simplicity.

It is a difficult process as the environmental issues do not always lend themselves to a straight forward classification. To have a clear picture of the threats and opportunities facing an organization, a lot of expertise and judgment is needed.

2.7.3 SWOT (STRENGTHS, WEAKNESSES, OPPORTUNITIES AND THREATS) ANALYSIS

Under thistechnique, strategists have to assess whether the organization has the required strength or whether it has the weakness which can affect its capabilities of taking advantage of the opportunities.

This assessment relates to the internal and external environment-based factors through the analysis of the strengths, weaknesses, opportunities and threats ofthe organization.

Internal Environment: The internal strengths and weaknesses of an organization may relate to the following factors:

- Finance
- Technology and Skill
- Production facilities
- Personnel capabilities
- Marketing Capabilities

These factors are also considered indetail while doing an appraisal of corporate strengths and weaknesses under environmental monitoring process.

External Environment: The external environment highlights the opportunities and threats present in the environment forSWOT analysis as explained below:

- The environment might present many opportunities but a company might not have the strengths toexploit all those opportunities.
- Similarly, sometimes the environment may be posing a threat but a company will not havethe strength tomeet the threats.
- The task of SWOT analysis is to make best use of its strategic strengths.

Self-Check Exercise – II

Q3. In SWOT, 'O' stands for ___________.

Q4. Nature of the market is related to _______ factor with respect to environmental factors.

2.8 SUMMARY

Business decisions, particularly strategic ones, need a clear identification of relevant variables and a detailed and in-depth analysis of them. A good amount of information is available from various sources (as mentioned in this lesson) about the past, recent, current future events, which are analysed through various techniques of environmental analysis, such as, scanning, monitoring, forecasting and assessing. For the assessment of internal as well as

external environment the identification of the threats and opportunities in the environment and the strengths and weakness of the firm is essential in the form of ETOP and SWOT analysis for strategic policy formulation.

2.9 KEYWORDS

Environment Analysis, Forecasting, Environment Appraisal, SWOT, ETOP.

2.10 Glossary

1. Environmental Analysis = Evaluating factors outside the firm
2. Environmental Scanning = Studying and collecting information about the factors
3. Strategic Thinking = The ability of organization to anticipate changes
4. Resource Utilization = Efficient allocation and use of resources
5. Strategy Formulation = Process of developing strategies to achieve goals

2.11 ANSWERS TO SELF-CHECK EXERCISE

1. Trend Extrapolation; 2. Brainstorming; 3. Opportunities; 4. Organizational

2.12 EXERCISES

2.12.1 Short Question/Answers.

Q1. What do you understand by Environmental Scanning?
Q2. Write a detailed note on the various sources of information for Environmental Scanners.
Q3. Discuss the term forecasting.
Q4. Describe briefly the aspects of a business environment that need to be monitored as well as the dimensions along which a firm may appraise its strengths and weaknesses for identifying investment opportunities.

2.12.2 Long Question/Answers.

Q1. Write short notes on following terms:

(a) Monitoring (b) Assessment (c) SWOT (d) ETOP (e) Brain Storming

Q2. Explain the various types of environmental factors.

Q3. Explain the various techniques of forecasting the environment.

Q4. What is the process of environmental analysis?

2.13 SUGGESTED READINGS

1. Projects Planning, Analysis, Financing, Implementation and Review — Prasanna Chandra, Tata McGrow Hill Publication
2. Business Environment — Rosy Joshi &Sangarn Kapoor, Kalyani Publishers
3. Business Environment — Francis cherunilam, Himalaya Publications
4. Essentials of Business Environments — K. Asawathappa, Himalaya Publishing House.

INTERNAL AND EXTERNAL BUSINESS ENVIRONMENT

STRUCTURE

3.0 Objectives
3.1 Introduction
3.2 The Micro Environment of Business
- 3.2.1 Suppliers
- 3.2.2 Customers
- 3.2.3 Labour
- 3.2.4 Business Associates
- 3.2.5 Competitors
- 3.2.6 Regulatory Agencies
- 3.2.7 Marketing Intermediaries
- 3.2.8 Public Pressure Groups
- Self-Check Exercise - I

3.3 The Macro Environment of Business
- 3.3.1 Economic Environment
- 3.3.2 Political and Government Environment
- 3.3.3 Sado- Cultural Environment
- 3.3.4 Natural Environment
- 3.3.5 Demographic Environment
- 3.3.6 Technological Environment
- 3.3.7 International Environment

3.4 Business Environment Model
Self-Check Exercise - II
3.5 Summary
3.6 Keywords
3.7 Glossary
3.8 Answer to Self-Check Exercise
3.9 Exercises
- 3.9.1 Short Question/Answers
- 3.9.2 Short Question/Answers

3.10 Suggested Readings

3.0 OBJECTIVES

A business organisation does not exist in a vacuum. It exists in a world of concrete places and things, natural resources, important abstractions and living persons. The sum of all these factors and forces are called Business Environment. The main objectives of this lesson are

1. To highlight the micro environment of the business;
2. To highlight the macro environment of the business; and
3. To introduce the business environment model of an organisation.

3.1 INTRODUCTION

It is now unquestionably accepted that the prospects of a business depend not only on its resources but also on the environment. As the examples given in this lesson show, there are forces in the environment that play a major role in shaping managers' actions. An analysis of Strengths, Weaknesses, Opportunities and Threats (SWOT) is very much essential for the

business policy formulation.

The external business environment consists of a micro environment and a macro environment. Both the components of business environment are sometimes referred to as specific environment and general environment respectively.

3.2 THE MICRO ENVIRONMENT OF BUSINESS

The micro environment consists of the factors in the company's immediate environment that affect the performance of the company. These include the suppliers, marketing intermediaries, competitors, customers and the public or pressure groups. These constituencies have a direct and immediate impact on manager's decisions and actions and are directly relevant to the achievement of the organization's goals. Each organization's specific environment is unique and changes with conditions. The specific environment of car manufacturers like Daimler Benz and Maruti Udyog is different as they are operating in distinctly different market niches, the first one catering to the luxury segment only and the second to the lower and to some extent middle segment only. Following are the elements of Micro Environment:

3.2.1 Suppliers

An important force in the micro or specific environment of a company is a component to the company. The importance of reliable source/sources of supply or other supply to the smooth functioning of the business is obvious. Uncertainty regarding the supply or the supply constraints often compels companies to maintain high inventories causing cost increases. It has been observed that factories in India maintain indigenous stocks of 3-4 months and imported stocks of 9 months as against an average of a few hours to two weeks in Japan.

In addition, the term supplier also includes providers of financial and labour inputs. Stockholders, banks, insurance companies and other similar organizations are required to ensure a continuous supply to money. The same is true for the manpower supplies also. The inadequate money and manpower supply can significantly hamper the organization's performance. In any manufacturing concern, say automobile industry, the tools and dies are of critical importance and if skilled labour is not available then operations of the company can be severely affected. The same is true for all the operations in the firm. As per a recent survey carried out by Hewitt Management consultancy, 36% of the Indian companies are not able to get the right manpower and 45% of Indian organizations are finding it difficult to retain them.

Because of the sensitivity of the supply, many companies give high importance to vendor development. Vertical integration, where feasible, helps in solving the supply problem.

Itis very risky to depend on a single supplier because a strike, lock out or any other production problem with that supplier may seriously affect the company. Hence, multiple sources of supply often help reduce such risks.

Managers always seek to ensure a steady flow of all the inputs at the lowest price available. As the inputs represent the uncertainties so unavailability or the delay can significantly reduce the effectiveness of the organizations, so a lot of efforts on the part of management are required for steady and reliable flow.

3.2.2 Customers

A business exists only to meet the needs of the customers. It is the customer or the client who absorbs the organization's output. This is true even for the governmental

organizations. They exist to provide services and especially at election time, that we indicate by our votes how much satisfied we are as customers. Monitoring the customer sensitivity is, therefore, a prerequisite for the business success. A company may have different categories of consumers like individuals, households, industries and other commercial establishments, and government and other institutions. For example, the customers of a tyre company may include individual automobile owners, automobile manufacturers, public sector transport undertakings and other transport operators.

Customers obviously represent potential uncertainty to an organization. Their tastes can change, they can become dissatisfied with the organization's products and services. As we are watching a shift in the scooter purchase with more and more people preferring LW. over the Bajaj. The Texla TV is no more able to satisfy the customers due to its monotonous products.

3.2.3 Labour

In bigorganisations, where hundreds of workers are employed, the labour force is organised in the form of trade unions. They pressurise the management for the fulfilment of their demands and even resort to go slow tactics, strikes and gherao etc. Thus, labour factor is also important factor of business environment,

3.2.4 Business Associates

The business associates offer strength to an organization by offering capital during the period of emergency, and similarly, arrangements with business associates could be entered into for the supply of raw materials or for the role of finished products. Hence, their presence and non-cooperation have significant impact on business.

3.2.5 Competitors

All organizations have one or more competitors. A firm's competitors include not only the other firms which market the same or similar products but also all those who compete for the discretionary income of the consumers. The organizations cannot afford to ignore the competition. When they do, they pay dearly. Prior to the privatization in India, there was only Doordarshan, Now, with private channels having superior technologies customers have a broader choice. With competition all around now the Doordarshan is also trying to provide the best services to the users. As in the case of Maruti, due to the increased competition, the company has to slash the prices of all of its products. The same holds true for White goods markets, with prices touching the lowest be it TV, Refrigerator, Ovens, Mobiles or for that matter any product, In the era of competition, customer is the biggest beneficiary getting high quality products at the lowest possible price. The organizations are always under pressure as a little complacency may be to advantages of your competitors, who are always watching your actions for grabbing the opportunity.

Literally, all the products are available with some attractive offers, which is all due to fierce competition every business is facing. A few years back you could never have imagined to get the Maruti car on discount. Rather the customer had to pay premium, in addition a wait period varying from one month to few months. They were paying the whole amount in advance, it was only because at that time the company was virtually in a monopoly having more than 82% market share coupled with lesser production capacities.

3.2.6 Regulatory Agencies

The regulators include government departments and other departments which monitor the activities of business. For example, income tax department, other

revenue departments, quality control departments etc. Besides this, other institutions such as Institute of Chartered Accountant of India may also prescribe certain standards and practices for the business in their respective areas. So, the study of their standards, norms, rules and regulations is required for every business.

3.2.7 Marketing Intermediaries

The immediate environment of a company may consist of a number of marketing intermediaries, which are "firms that aid the company in promoting, selling and distributing its goods to final buyers.'

Marketing intermediaries are vital links between the company and the final consumers. A dislocation or disturbance of this link, or a wrong choice of the link, may cost the company very heavily. The marketing intermediaries include middlemen such as agents and merchants who "help the company find customers of close sales with them,"

(1) Physical distribution firms which assist the company in stocking and moving goods from their origin to their destination such as warehouses and transportation firms.

(2) Marketing service agencies which assist the company in targeting and promoting its products to the right markets such as advertising agencies, marketing research firms, media firms and consulting business risks. The business growth prospects of the intermediaries should always be kept in mind. In addition, it is better to go for more than one option so that one does not become dependent on a single intermediary.

Their impact can be gauged from the fact that the recent strike by the transporters in Punjab was the cause of all the petrol pumps going dry in the state, thereby causing huge losses to the organizations.

3.2.8 Public Pressure Groups

A company may encounter public in its environment. "A public is any group that has as actual or potential interest in or impact on an organization's stability to achieve its interests" Media public citizens action public and local public are some examples. Such public seriously affect some companies. For example, one of the leading companies in India was frequently under attack by the media public, particularly by a leading daily, which was allegedly bent on bringing down the share prices of the company by affecting its image. Such exposures or campaigns by the media might even influence the government decisions affecting the company. Local public also affect many companies. Actions by local public on this issue have caused some companies to suspend operations and/or take pollution abatement measures.

Growth of consumer public is an important development affecting business. The closing down of the slaughterhouse in Punjab was due to influence of the public pressure groups. The same is true in case of Andhra Pradesh where a strong group of women pressurized the men to give up alcohol.

SELF-CHECK EXERCISE - I

Q1. _______ factors are in the company’s immediate environment that effect the organization in a short term.

Q2. _________ agencies are engaged in monitoring the activities of the business.

3.3 THE MACRO ENVIRONMENT OF BUSINESS

The macro/external term refers to "the forces and institutions outside the organisation that can potentially affect the organisation's performance. The macro environment consists larger societal forces that affect all the factors in the company's macro environment namely, the demographic, economic, natural, technological, political and cultural forces.

3.3.1 Economic Environment

Economic conditions, economic policies and the economic system are the important external factors that constitute the economic environment of a business.

The factors/elements of economic conditions of a country are as given below:

(1) the nature of the economy

(2) the stage of development of the economy

(3) economic resources

(4) the level of income

(5) the distribution of income and assets

(6) interest rates

(7) inflation etc.

The management have to go into the depth of such factors to formulate their strategies.

In a developing country, the low income may be the reason for the very low demand for a product The sale of a product for which the demand is income-elastic naturally increases with an increase in income. But a firm is unable to increase the purchasing power of the people to generate a higher demand of its product. Hence, itmay have to reduce the price of the product to increase the sales. The reduction in the cost of production may have to be affected to facilitate price reduction. It may even be necessary to invent or develop a new low-cost product to suit the low-income market.

The economic policy of the government has a very great impact on business. Some types of categories of business are favourably affected by government policy, some adversely affected while it is neutral in respect of others. For example, a restrictive import policy or a policy of protecting the home industries may greatly help the import competing industries while a liberalization of the import may create difficulties for such industries. Similarly, an industry that falls within thepriority sector in terms of the government policy may get a number of incentives and other positive support from the government whereas those industries which are regarded as inessential may have the odds against them. For example, the Reliance industries, now the largest private sector organization in India was favourably affected as in spite of earning huge profits. The organization was not paying any income tax till 1997 to the government as it was in the priority sector. Afterwards the government imposed a minimum alternate tax. Even now this organization is greatly benefitting from the government policy.

The old economic policy, that is, prior to July 1991, the development was to take place with important role played by the government owned organizations. In the remaining industries, cooperative enterprises, joint sector enterprises and small-scale units were to get preferential treatment over large entrepreneurs in the private sector. The government policy, thus, limited the scope of private business. The new economic policy started in since July 1991 has wide opened many of the industries for the private sector. Now all the industries have been opened up for the private sector. The LPG policy (Liberalization, Privatization and Globalization) of the government has opened new avenues for the private enterprises. With the process of Disinvestment, the government is limiting its scope to that of a facilitator.

In the recent times, in India, the interest rates have been brought to new low and the regime of subsidies is at its last stage. The economic system, even though passing through the recessionary phase, is at a take off stage. The process is already being regarded as irreversible.

The government is trying to build an expenditure economy, which gives ample opportunities to the growth of business. Certain changes in government policies such as the industrial policy, fiscal policy, tariff policy etc. may have profound impact on business. Some policy developments create opportunities as well as threats. In other words, a development which brightens the prospects of some enterprises may pose a threat some others.

3.3.2 Political and Government Environment

Political and Government Environment has close relationship with the economic policy. For example, the communist countries had a centrally planned economic system. The organizations spend a great deal to time and money to meet governmental regulations, but the effects of these regulations go beyond time and money.

Some governments specify certain standards for the products (including packing) to be marketed in the country; some even prohibit the marketing of certain products. In a number of countries including India, the advertisement of alcoholic liquor is prohibited. Advertisements, including packaging of tobacco and liquor must carry the statutory warning that "cigarette smoking is injurious to health.'

In addition, there are a host of statutory control on business in India. If the MRTPcompanies wanted to expand their business substantially, they had to convince the government that such expansion was in the public interest. Indeed, the Government in India has an all pervasive and predominantly restrictive influence overvarious aspects of business, e.g. industrial licensing which decides location capacity and process; import licensing for machinery and materials; size and prices of capital issue; loan finance; pricing; managerial remuneration; expansion plans; distribution restrictions and a host of other enactments. Therefore, a considerable part to the attention of the top management has to be devoted to a continuous dialogue with various government agencies to ensure growth and profitability within the framework of controls and restraints.

The trend of taking the cases to the court has made it difficult for the organizations to check poor performers and to dismiss employees for off duty conduct.

Other aspects of the political and legal sector are political conditions and the general stability in which an organization operates and the attitudes that the government official hold towards business. In India the situation is alarming as the governments in the recent past have not remained stable. A little bit of uncertainty in the government can lead to volatile and crash the conditions in the stock market.

3.3.3 Sado-Cultural Environment

The socio-cultural fabric is an important environmental factor that should be analysed whileformulating business strategies. The cost of ignoring the customs, tradition, taboos, tastes and preferences, etc. of people could be very high. The organizations must adapt their practices to thechanging expectations of the society in which they operate.

The buying and consumption habits of the people, their language, beliefs and values, customs and traditions, tastes and preferences, education are all factors that affect business. For a business to be successful, its strategy should be the one that is appropriate in the socio-cultural environment. The marketing mix will have to be designed in a way as best to suit the environment characteristics of the market.

Nestle, a Swiss multinational company, today brews more than forty varieties of instant coffee to satisfy different national tastes. Even when people of different cultures use the same basic product, the mode of consumption, condition of use, purpose of use or the perceptions of the product attributes may vary so much so that the product attributes, method of presentation,positioning, method of promotion the product may have to be varied to suit the characteristics of different markets. For example, the two most important foreign markets for Indian shrimp are the U.S. market, correct weight and bacteriological factors are moreimportant rather than eye appeal, colour, uniformity of size and arrangement of the shrimp which are very important in Japan. A very interesting example is that of the Vicks Vaporub, the popular pain balm, which is used as a mosquito repellent in some of the tropical areas.

The differences in language sometimes pose a serious problem even necessitating a change in the brand name. Chevrolet's brand name 'Nova' in Spanish means "it doesn't go." In Japanese, General Motors "body by Fisher" translates as "corpse by fisher." In Japanese, again,3M'sslogan "sticks like crazy" translates as "sticks foolishly." In some languages, Pepsi Cola's slogan "come alive" translates as "come out of the grave."

The values and beliefs associated with colour vary significantly between different cultures. Blue considered feminine and warm in Holland, is regarded as masculine arid cold in Sweden. Green is a favourite colour in the Muslim world; but in Malaysia, it is associated with illness. White indicates death and mourning in China and Korea. But in some countries, it expresses happiness and is the colour of the wedding dress of the bride. Red is a popular colour in the communist countries; but many African countries have a national distaste for red colour.

If an organization does business in some other countries, then it has to be familiar with those countries values and culture and manage in ways that recognize and embrace those specific socio-cultural aspects.

3.3.4 Natural Environment

Geographical and ecological factors such as natural resource endowments, weather and climatic conditions, topographical factors, location aspects in the global context, port 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 influence the location of certain industries, for example, industries like cement manufacturing with high material index tend to be located near theraw material sources. Climatic and weather conditions affect the location of certain industries like the cotton textile industry. Topographical factors may affect the demand pattern. For example, in hilly areas with a difficult terrain, jeeps may be in greater demand than cars, e.g., textile industry located near coastal area.

Ecological factors have recently assumed great importance. The depletion of natural resources, environmental pollution and the disturbance of the ecological balance have caused great concern. Government policies aimed at the preservation of environmental purity and ecological balance, conservation of non-replenishable resources, etc. have resulted in additional responsibilities and problems for business, and some of these have the effect of increasing the cost of production and marketing. Externalities have become an important problem the business has to confront with.

In addition, the pollution control has now become an area of concern, it is due to this factor that a separate crusher zone has been earmarked, where all the stone crushers are

located, by considering two factors, i.e. proximity to natural resources and far away from the population in Himachal Pradesh. Reliance Industries has discovered natural gas, in excess of 7 trillion cubic feet equivalent to 1,2 billion barrels or 165 million tonnes of crude oil, in the deepwater block in Krishna Godavri Basin off Andhra Pradesh coast. The reserves would catapult Reliance into the league of integrated global energy companies.

3.3.5 Demographic Environment

The demographic conditions encompass trends in the size, growth rate, agecomposition, gender composition, etc. of the population, level of education, income, life expectancy, family size spatial dispersal, occupational status, employment pattern, languages, caste, religion etc. and so forth. These factors affect the demand for goods and services significantly. Markets with growing population and income are growth markets. But the decline in the birth rates in countries like the United States have affected the demand for baby products like baby shampoo and baby soap, promoting them also the adult segment, Johnson and Johnson have overcome this problem by repositioning their product, particularly to the females.

A rapidly increasing population indicates a growing demand for many products. High population growth rate also indicates an enormous increase in labour supply. The population growth rate, thus, is an important environmental factor, which affects business. Cheap labour and a growing market have encouraged many multinational corporations to invest in developing countries such as India. The occupational and spatial mobility of population have implication for business. If labour is easily mobile between different occupations and regions its supply will be relatively smooth and this will affect the wage rate. The increasing levels of income have shown a greater demand for cars. The same can be said of the people shifting to ACs. A trend of having the generators in the residences can also be attributed to the same factor. While for the ever-growing demand for the bicycles, a greater emphasis may be due to increasing population.

3.3.6 Technological Environment

In terms of general environment, the most rapid changes have taken place in the past century, in the technology. Information gadgets are getting smaller and more powerful. We have automated offices, electronic meetings, robotic manufacturing, lasers and faster and more powerful microprocessors. We are now living in the internet age and E-business has become a buzzword. The organizations that capitalize on technology like Microsoft prosper. Similarly, hospitals, universities, institutions, airports and other departments like the Army and police that adapt to major technological advances have a competitive advantage over those who do not.

Business prospects depend also on the availability of certain physical facilities. Some products, like many consumer durables, have certain use facility characteristics. The sale of television sets, for example, is limited by the extent of the coverage of telecasting. Similarly, the demand for refrigerator and other electrical appliances in different markets or countries may call for product modifications.

Advancements in the technologies of food processing and preservation, packaging etc. have facilitated product improvements and introduction of new products and have considerably improved the marketability of products. Now a days they ready to use packed food is available due to the technology upgradation.

The colour television has added a new dimension to product promotion, but has been instrumental in cutting short the life cycle of Black and White T.V. The

advent of TV and VCP/ VCR has, however, adversely affected the cinema theatres. Similarly, the DVD and CD players have decreased the demand for VCR/VCP. Another important example is that of Pager and Mobile phones. The pagers, which were launched only in the year 1995-96, have to give way to superior technology mobile, with the later having two-way communication as compared to Pagers one-way communication.

The whole area of technology is radically changing the fundamental ways that organizations are structured and hence it is very important to keep a watch on these and wherever and whenever possible, the organization must adapt to the technological changes, to itself in the competitive advantage over the others.

3.3.7 International Environment

In the era of globalization, the business boundaries have vanished and the organizations are no longer constrained by national borders. The companies like Pepsi and Coca Cola are operating in almost all the countries. The international environment is very important from the point of view of certain categories of business. It is particularly important for industries directly depending on imports or exports and import competing industries. For example, the Indian economy was not suitable for the MNCs only around one decade back. Then in 1991 the Indian economy was opened up in phases, giving, ample opportunities for MNCs and during the past ten years majority of MNCs have set up facilities in India due to the changed environment. It can be concluded that these organizations were always on the look-out for business expansion in this country.

Further, the organizations should give a lot of emphasis to two important factors. They must understand regional trade alliances and the type of global organizations operating in that region. Some significant agreements are being signed through the regional trade alliances like North American Free Trade Agreement (NAFTA), Association of Southeast Asian Nations (ASEAN) and European Union (EL1). The Indian government recently advocated the setting up of Free Trade Area and likely to sign agreement with Thailand for the purpose.

A good export market enables a firm to develop a more profitable product mix and to consolidate its position in the domestic market. Many companies now plan production capacities and investment taking into account also the foreign markets. Export marketing facilitates the attainment of optimum capacity utilization; a company may be able to mitigate the dependence on the export market to a considerable extent has also to face the impact of adverse development in foreign markets.

Further, while studying the global environment, it is prudent to go in depth for the other factors of the specific and general environment mentioned above. Such analysis will be detrimental in the success or failure of any organization.

3.4 BUSINESS ENVIRONMENT MODEL

The Business Environment Model as shown in Figure-I highlights the two categories of environment

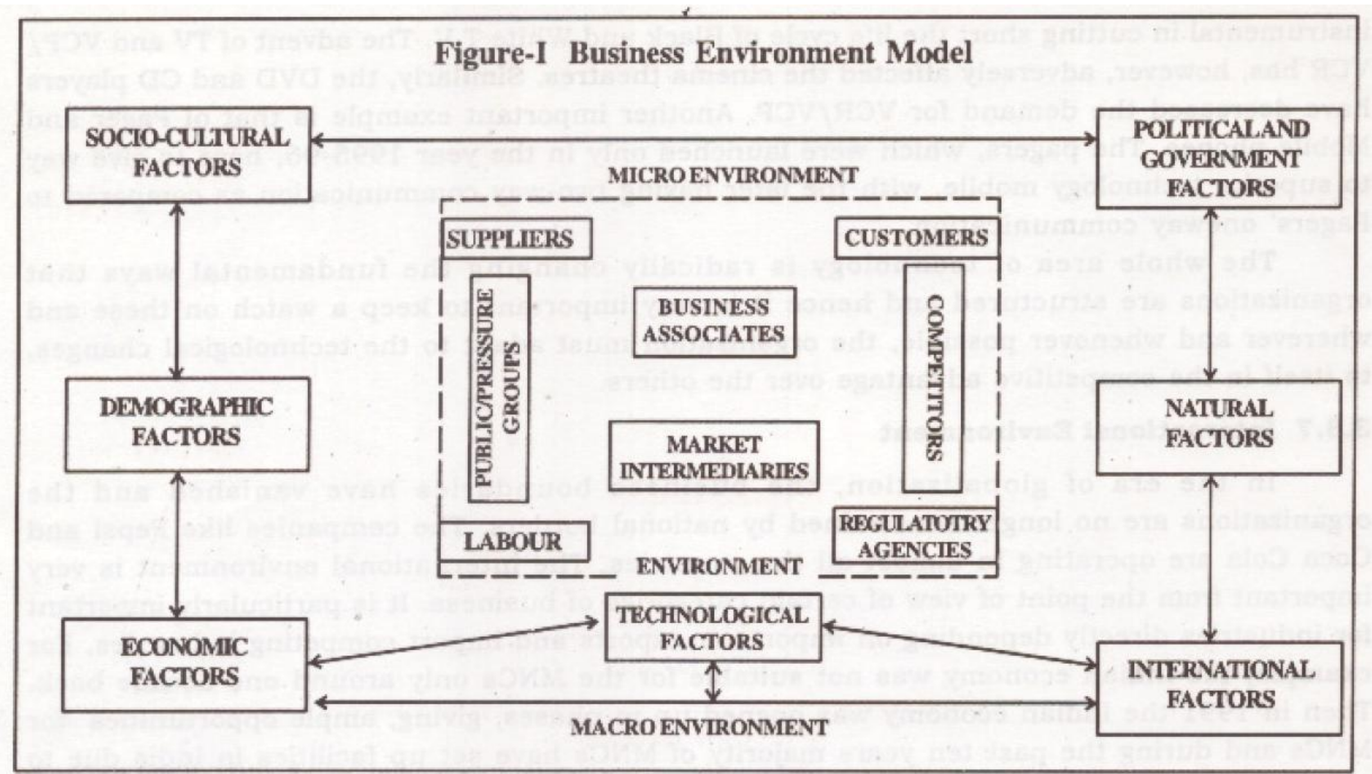
(A) The Micro Environment of Business and

(B) The Macro Environment of Business

This model includes those people who are capable of influencing an organisation and its management system as well as those who might be affected by the organisation's actions.

This environment is made up of many different individual (i.e. customers, local citizen

Figure-I Business Environment Model



etc.), organisations (i.e. suppliers and labour unions) and Governmentbodies (i.e. Regulatory agencies and legislators.

Self-Check Exercise - II

Q3. LPG policies are the example of what type of macro environment?

Q4. North American Free Trade Agreement (NAFTA) is an example of what type of environment?

3.5 SUMMARY

The environment refers to all forces (internal or external) whichhave a bearing on the functioning of the business which are uncontrollable in nature and affects the business decisions of a firm or company. It refers tothose aspects of the surroundings of business enterprise and circumstances of business unit which affect or influence its activities and operations and decide its effectiveness becauseenvironment of the business is always changing and uncertain. And uncertainty affects the ability of the organisation to prepare or to make decisions about activities in advance of their execution. Thus, carefully analysis of the various factors influencing the business is must require which is termed as Environmental scanning.

3.6 KEYWORDS

Micro environment, Macro environment, Scanning, Volatility, Strategy

3.7 GLOSSARY

1. Micro environment	Immediate environment in which an organisation conducts its business.
2. Macro environment	The indirect action environment.
3. Scanning	Analysis of various factors or business forces.
4. Volatility	Rate of change in environment.
5. Strategy	An action plan.

3.8 ANSWER TO SELF-CHECK EXERCISES.

1. Micro; 2. Regulatory; 3. Economic Environment; 4. International Environment

3.9 EXERCISES

3.9.1 Short Question/Answers

Q1. Give various types of competition and customers,
Q2. What are the main components of Political Environment?
Q3. State the list of various economic policies.
Q4. Examine the nature of external environment.

3.9.2 Long Question/Answers

Q1. Explain the factors that affect the micro environment of the organization.
Q2. Explain the factors that affect the macro environment of the organization.

3.10 SUGGESTED READINGS

1. Business Environment : Rosy Joshi Sangam Kapoor
2. Business Environment (Text and Cases) : Francis Cherunilarn

MBA- DISTANCE EDU.(First Year) **BE 106**

Semester-I **BUSINESS ENVIRONMENT**

Lesson No. 4 **AUTHOR: KARAMBIR SINGH**

BUSINESS AND SOCIETY

STRUCTURE

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4.0. OBJECTIVES

The Existence of Business is totally dependent upon the society. Without understanding the social structure, theBusiness cannot progress rapidly. This chapter aims at having a view about the various social institutions and systems which exists in the environment like family, religion, political system, economic system etc. Further by reading this chapter, the reader will be able to have an idea about the important role these social institutions and systems play in the success and failure of any business.

4.1. INTRODUCTION

Society can be defined as a complex of groups in reciprocal relationship, interacting upon one another, enabling human organisms to carry on their life activities and helping each person to fulfil his wishes and accomplish his interests in association with his fellows. But from the structural point of view society is the total social heritage of folkways mores and institutions; of habits, sentiments and ideals.

Social structure is the basic concept for the proper understanding of society. Basically, social structure is an abstract and intangible phenomenon. As individuals are units of associations and institutions, so these associations and institutions are the units of social structure. Moreover, these institutions and associations are interrelated in a particular arrangement and thus create the pattern of social structure. At the most the social structure refers to the external aspect of society, which is relatively stable as compared to the functional orinternal aspect of society.

Social institutions are the integral part of the society. The social institutions are essential to maintain the ordered arrangement of social structure. The institutions are collective modes of behaviour. They prescribe away of doing things. They bind the members of the group together. Some thinkers have distinguished between Institution and Institutional

agencies. According to them the term 'institution refers to the normative pattern of behaviour, whereas the institutional agencies are the social system through which these express themselves, but since there is a close integration of these normative complexes and the systems through which they are made effective, therefore, most of the writers do not distinguish between them.

4.2. KINDS OF INSTITUTIONS

There are five kinds of institutions, these are (i) family, (ii) economy, (iii) religion (iv) education and (v) state. There are a number of secondary institutions derived from each of the five primary institutions. Thus, the secondary institutions derived from family would be the marriage, divorce, monogamy, polygamy etc. The secondary institutions of economics are poverty, trading credit, banking etc. The secondary institutions of religion are church, temple, mosque etc. The secondary institutions of education are school, college, university etc. The secondary institutions of state are interest groups, party system, democracy etc.

Institutions may grow as do the folkways and mores or they may be created just as law are enacted. For instance, monogamy or polyandry grew in response to some felt needs of the people. Bank grew as the needs for borrowing and leading money was felt, School and colleges are created by deliberate choice and action. An important feature that we find in the growth of institutions is the extension of power of the state over the other four primary institutions. The state now exercises more authority by laws and regulations. Today the family is being regulated and controlled by the state in scores of ways. A number of traditional functions of family have been taken regulating marriages, divorce, adoption and inheritance. The authority of the state has similarly been extended to economics, to education and to religion.

4.3. INTER-RELATIONSHIP OF INSTITUTIONS

A social structure owes its stability to a proper adjustment of relationship among the different institutions. No institution works in vacuum. Religion, education family, government and business all interact on each other. Thus, education creates attitude which influences the acceptance or rejection ofreligious dogmas. Religion may exalt education because it enables one to know the truth of God or denounce it because it threatens the faith. Business conditions may influence the family life. An unemployed person may postpone his marriage till he gets employed in a suitable job. Postponement of marriage may affect the birth rate. The state influences the function of institutions. It may take over some of the functions and determine their institutional norms. The business, educators, clergymen and the functionaries of all other institutions also seek to influence the acts of state, since any state action may obstruct or helpthe realization of their institutional objectives.

The social institutions are closely related to each other. The inter relationship of the various institutions can be compared to a wheel. The family is the hub while education, religion, government and economics are the spoke of the wheel. The rim would be the community within which the various institutions operate.

All institutions face the problem of continuously adjusting themselves to a changing society, Changes in the social environment may bring changes in all the institutions. Inflation may have a great influence on marriage, death, crime and education. Breakdown of economic institutions may have radical effects upon political institutions. Any change in an institution may lead to change in other institutions. These may also take place a shifting of functions from one institution to another. Child care formerly a function of family has now shifted to state. When one institution fails to meet a human need, another institution will often assume the functions. No institution can avoid affecting

other institutions or avoid being affected by others,

4.4. FAMILY

Of all human groups, the family is the most important primary group. It is a small social group consisting ordinarily Parents and Children. It is a universal institution found in every age and every society. It is the primary cell out of which the community develops.

Although family is one of most limited groups of the society, it differs from all of them in being a distinct type of group. It is the smallest kinship group. It usually begins when partners marry; it changes when the son marry, it ends when one of the partners dies, when the children are small and entirely dependent upon parents, the family looks like a compact human group. When the children begin to grow in age, this compactness begins to become loose and when they marry, the old family disintegrate and new families rise up. The original relations are reversed, the parents become dependent upon the children.

Following are the basic functions of family institution:

- The regulation of sexual behaviour and reproduction.
- Care and training of children.
- Co-operation and diversion of Labour.
- Primary group satisfaction.

Joint family system prevalent from time immemorial deserves special attention. This system differs in material respects from the western family system. The family in India does not consist only of husband, a wife and their children but also of uncles, aunts, cousins and grandsons. This system, called Joint Family system or Extended Family system, is a peculiar characteristic of Indian social life. A son after marriage does not usually separate himself from the parents but continues to stay with them under the same roof messing together and holding property in common. The family has joint property and every person has his share in it, since the time he is born. The earnings of all the members are put in common fund out of which family expenses are met. Non-earning members have as much share as the earning members. The Indian family system is thus like a socialistic community in which everyone earns according to his capacity and receives according to his needs.

The joint family system prevalent in India, ensure economic progress and social insurance to all the members of the family. The family members can work according to their capabilities and will have the time for leisure. Despite all the benefits, joint family system is breaking up. There are various reasons for it like industrialization, western impact, new social legislation etc. It is, however, to be remembered that joint family system in India has not completely died out. Although nuclear families are finding its place in the society.

Due to shifting of focus joint family system to nuclear family system. There is great change in the functions of family whereas about a hundred years back the family was more of a community. It has become today more of an association. It has completed the transition from institution to companionship. The very importance of the family has been loosened. The functions of a modern family are much limited. But despite its structural and functional changes, the family still plays a significant role in social strength and social solidarity. The family satisfies not only the Physical needs of the male and female but it also satisfies their psychological needs, the desire to love and to be loved. It is the foundation of all social life. It is an inseparable part of man's nature. Burgess and Locke write, "it seems safe to predict that the family will survive, both because of its long history of adoptability to changing conditions and because of the importance of its functions of affection-giving and receiving in personal satisfaction and in personality development."

Self-Check Exercise - I

Q1. The social system through which the institutions express themselves are known as?
Q2. Cooperation and diversion of labour is the basic function of which type of institution?

4.5. ECONOMIC SYSTEM

In the modern society, to meet the basic needs of food, clothing and shelter of the members of society, it is not sufficient that there must be a system of production in society, equally important is its distributive system. The more complex the society, the more its welfare ruts on the distributive system. In a simple society, the problem of distribution is simple because the society is usually self-supporting. The family in the simple society satisfies its needs directly. But in a Complex society, goods pass hands until they reach the consumers. In our country, one of the major causes of economic ill is the mal distribution of goods, Economic institutions arise out of the determinations we make with respect to the goods we need. They are the basic ideas, norms and statuses which govern our economic life. There are three important types of economic systems which are mainly prevalent.

(1) Capitalism

(2) Socialism

(3) Mixed Economy

4.5.1 CAPITALISM

In modern times the capitalism system exists in a large number of countries. The countries like U.S.A. are following these types of economic system are leading the world in terms of the level of the economic development.

Adam Smith has enunciated four main principles of capitalism

(i) The doctrine of self-interest.

(ii) Laissez faire policy.

(iii) The theory of competition.

(iv) Profit motive.

Free enterprise, competition and private ownership of property plays an important role in the capitalist economy. The capitalist system is also known as "Free enterprise economy'. It implies a policy of non-interference by the government in the economic life of the country. Here, the state confines its activities to the maintenance of law and order with in the country, defending the country from foreign war and provides fair justice to the people was and provides fair justice to the people, leaving trade and industry to take their own course.

4.5.2. SOCIALISM

Socialism is a such type of economic system where the state totally owns or control the resources and means of Production. In Socialism, the basic stress is on the use of states resources for the overall welfare of the all the members of society. For the purpose, state also regulate and control the process of allocation and distribution of income, variety may exist in the socialistic system on the one hand, there may be communist countries characterized by state capitalism and on the other hand, there are the democratic socialist nations with a dominant private sector.

Under socialism system the workers of industry agriculture, transport and other sectors of the economy themselves becomes the joint owners of the means and results of production. As the non-human production resources are mainly society or state owned, it ensures better allocation and utilization of resources, elimination of unemployment, elimination of class struggle, reduction in inequality of income etc. while socialism may also result in increase in Red-Tapism and Bureaucratisation, increase in corruption etc.

4.5.3. MIXED ECONOMY

Both the system i.e. capitalism and socialism have certain advantages and disadvantages. On certain countries like India have developed a mixed economic system by collaborating the good features of capitalist and socialist economic system. In a mixed economy like India there is a co-existence of Public and Private sectors with the overall government regulation of the economy.

Broadly speaking, mixed economy is an economy in which the public ownership over the means of Production co-exists with the private ownership. In this type, the economy can be seen as an amalgam of two sectors, viz, the public sector and the private sector. The public sector consists of those entrepreneurial unit which are owned and run by private enterprises. There may also be found at times, those units which are jointly owned by the state and the private enterprises. Such entrepreneurial units constitute what has come to be known as the 'joint sector'. In a country like India, given the stupendous nature of task an underdeveloped economy is faced with when it tries to break free of the shackles of foreign rule and colonialism it is not surprising that the public sector takes the lead in the growth process and aims at gaining the commanding heights of the economy.

4.6. RELIGION

Religion may be defined as, Institutionalized systems of belief, symbol's values and practices that provide groups of men with solution to their Question of ultimate being. At present, there are number of religions which are prevalent in all over the world. But according to Anderson and Parker, each religion consists of four primary things:

(i) Belief in Supernatural forces: Each religion believes in some supernatural forces powers outside of man and his observable world. These powers and believed to influence human conditions and events. Some calls them forces of God; some calls them God; and yet others leaver them nameless.

(ii) Man's adjustment to supernatural powers: since man is dependent on these powers; he must adjust himself to them. Consequently, each religion provides for some outward acts like prayers, hymns, kirtans, yoga and other forms of reverence. Failure to perform these acts is regarded as sinful.

(iii) Acts defined as sinful: each religion defines certain acts as sinful. Such acts destroy man's harmonious relationship with God or the Gods and he suffers the wrath of God.

(iv) Method of salvation: Man needs some method by which he can regain harmony with the Gods through removal of guilt. Thus, Buddhism provides for Nirvana and Hinduism provides salvation in the release from the bondage of karma.

Religion pervades practically in all the societies but there is an endless diversity of the forms of religious beliefs and practices. The form which it assumes in a society is determined by the host of complex factors. Some assigns greater importance to ceremonialism. Thus, Hindu society attaches greater importance to ceremonies. The mantra s must be recited at the time of birth marriage and death, whether or not one understands their meaning. Other religions are simple culture, with little rituals, and less dogma and without professional mediators between worshipper and divine authority. In some societies the connection between the religion and other institutions is closer than in others. Thus, among the Chinese than the among the American, this connection is much closer. Moreover, there is a great deal of variation in the selection of those phases of life which will come under the jurisdiction of religion or which will remain secular.

Marriage may be regarded either a religious functions as among Hindus or secular function as among westerns. Religions have their own control themes which are determined by the life interest of the peoples. Thecontrol theme of western Religions has been altered because of the change from an agricultural economy to an industrial one and the consequent modification of man's outlook upon life.

The Social role of Religion: Through religion is a highly personal thing, yet it has a social aspect and social role to play. It has been a powerful agency in society and performed many important social functions. As Selbie puts it: "lt is not that the sacred society or church becomes or takes the place of God, but rather than man finds that he can best approach his God as he does so in fellowship, with others, as a member of a community which exists to secure the end for which God stands."

According to Arnold W.Green, religion has three universal functions :

(i) it rationalizes and makes bearable individual suffering in the known world.

(ii) It enhances self-importance.

(iii) It helps to knit the social values of a society into a cohesive whole.

In reality, Religion is a complex institution, the social functions it for perform are quite diverse. If the religious functions produce beneficial consequences, then we normally refer to it as a positive function as for example, when religion stimulates tolerance, peaceful cooperation or love, Religion can also generate harmful or dysfunctional effects. The religiously approved human sacrifices practiced by some tribes are an obvious example. Thus, religion can exert both a positive, cohesive and comforting influence and a negative, disintegrating influence.

4.7. EDUCATION

In our Traditional society, education was a preserve of the Brahmins and it was unfortunate that people of other castes were denied the facility. The economic environment of the day also supported the prevailing system, our economy was primitive, and occupations were based on heredity. No education was needed for a cobbler to stich footwear, for a barber to shave, for an agriculturist to till land or for a goldsmith to make a piece of gold ornaments. All these and other crafts were passed down from one generation to the other.

Things changed over the passage of time. Economy gradually shed its primitiveness and almost turned into an industrialized one demanding technical education at all levels and of all castes. Educational institutions sprang up in all corners of the country and it is estimated that we have a greater number of primary schools, than the USSR and USA put together. Vast sums have been spent on education in successive plans and a staggering sum of more than Rs. 29,000 crores had been allocated to education in the seventh plan alone.

Education benefits business. Business in turn has responded and started supporting education. This support is manifested in the starting and maintaining of educational institutions, sponsoring employees for continuing education and bearing the cost of the education of employee's children.

The close interface of business and higher education is rather a new development. Centuries ago, each had a somewhat hand of attitude towards the other. A relatively small section of the intellectual elite maintained their seclusion in university halls, educating a few selected students to becomes intellectual and social leaders of their nations. Education was not for the masses who laboured in factories, fields and stores. University education hadlittle interest in business and businessmen had little interest in education. Each lived in a different world.

The separation of business from education gradually waned as higher education expanded in accordance with the democratic ideals of equal opportunity, put the real breakthrough came with the rapid trend towards a knowledge-oriented society.

Industrial societies of today are knowledge oriented and educated and education is considered as one of the social overheads that has been accorded due priority among the development activities. But there are variations. A society without too many constraints on social mobility may accord prestige to the teaching profession and large part of the national income will be spent on educational equipment than in a society which is more rigidly stratified. Educational institutions are sometimes resented in countries where children are regarded as a source of income. Other countries by no means always the same one, will be opposes to welfare support for adults.

4.8. POLITICAL SYSTEM

Political System is that system of interaction in any society through which binding of authoritative allocations are made and implemented. Force or physical coercion forms on essential element of a political system. Although all other systems like churches or families or business firms employs authority of one kind or the other but what distinguish political systems from other types of social sub systems that the latter do not have absolute coercive powers over the life and death of individuals. It is the monopoly of coercive power which characterizes the relationship between the political systems and non-political systems.

State is the most powerful political organization which regulates the social relationship of man and is the overall control institution of society, state, basically consists of four elements i.e. population, territory, government and sovereignty. The importance of state to society is brought about by barker when he says, "Society is held together by the state; and if it were not thus held together it could not exist."

4.8.1. FUNCTIONS OF STATE

Although there is no unanimity among the political thinkers as to what the state should do. But from the opinion of different experts, we can conclude that there are certain functions which only the state can perform; others which it is usually incapable of performing and those which it can with advantage perform and for which it is well adapted. The following points will enable us to understand the role performed by the state in the society.

Maintenance of order: The primary function of the state is the maintenance of order in society. The state is possessed of peculiar attributes which enable itto perform this function. The state is the guarantor and the guardian of the public order. But order is not for its own sake, but for the sake of Protection and of conservation and development. It is justified only to the extent to which it serves the needs of the Community in Conformity with and limited by the ideals of Community. Particularly by the ideal of justice and liberty.

Conservation and development: The next thing after the primary function, the state has an obligation to conserve and develop human capacities as well as Economic resources. The state is well adopted to regulate. The exploitation of natural resources in the interest of present and of future generations of the entire community. If the exploitation of natural resources is left in the hands of private individuals, then they will seek their own gain at the cost of communal gain. The state can better uphold the interest of the whole and the interest of the futures against the competitive interests. So, conservation of forests, fisheries and exploitation of mineral resources are functions which the state should undertake.

The conservation and development of human capacities are no less important than that of the natural resources. The state should provide for education, public parks, museums, playgrounds and

contribute to the development of science and to the encouragement of art. Though other agencies can perform these tasks but none so efficiently and on so great a scale and with such authority as can the state.

The sphere of the state action is undoubtedly vast, still it is not omni competent. Is should refrain from the futile or pernicious efforts to do those things which it is unqualified to do like controlling public opinion, enforcing morality, interference with custom and fashions etc. rather it should grid itself more resolutely more nobly to the fulfilment of those function it is well qualified to do.

Self-Check Exercise – II

Q3. In what type of economic system, all the control of means of production is held by the government?

Q4.______ is defined as, Institutionalized systems of belief, symbol's values and practices that provide groups of men with solution to their Question of ultimate being.

4.9. SUMMARY

Business cannot exist in vacuum. Business is an integral part of the society. Without society, the Existence of Business cannot be envisaged. There are various social institutions and Systems, like family, religion, education, economic and political system, which effects the working of the Business. Without the study of these institutions and systems, the success of business cannot be ensured. The Prevailing condition of these social institutions and system effects the operational success of the Business undertaking and moreover, these institutions and systems are also being affected by the development on the business front.

4.10 KEYWORDS

Political System, Economic System, Education, Religion, Family

4.11 GLOSSARY

1. Society = Complex groups interacting with each other

2. Social Structure = Social heritage of folkways, habits, institutions etc.

3. Institutional Agencies = Social patterns through which normative patterns of behaviour express themselves.

4. Social Institutions = Parts of society that maintains the ordered arrangement of structure.

5. Joint Family System = Community where resources and properties are shared.

4.12 ANSWERS TO SELF-CHECK EXERCISE

1. Institutional Agencies; 2. Family Institution; 3. Socialism; 4. Religion

4.13 EXERCISES

4.13.1 Short Question/Answers

Q1. Define the Social structure in which the Business Exist.
Q2. Discuss the different kinds of social institutions and System.
Q3. How the functions of state affect the business of any organization?
Q4. Explain the social role of a religion.

4.13.2 Long Question/Answers

Q1. Elaborate the kinds of institutions that affect any organization.
Q2. What are the types of economic systems? How are they different from each other?
Q3. Explain, how religion, education and political system interrelated to each other?

4.14 RECOMMENDED READINGS

(i) Business Environment : Francis Cherunilam
(ii) Essentials of business Environment : K. Aswathappa

Lesson No. 5 **AUTHOR: KARAMBIR SINGH**

SOCIAL RESPONSIBILITY OF BUSINESS

STRUCTURE

5.0. Objectives
5.1. Introduction
5.2. Meaning of Social Responsibility
5.3. Points in favour of Social Responsibility
- 5.3.1 Changed public expectations from business
- 5.3.2 Better environment for Business
- 5.3.3 Public Image
- 5.3.4 Avoidance of government Regulations.
- 5.3.5 Problems can become profits
- 5.3.6 Balance of responsibility with power.
- 5.3.7 Business has useful resources.
- 5.3.8 Business has contributed to social problems.
- Self-Check Exercise - I

5.4. Points against Social Responsibility
- 5.4.1 Profit maximization
- 5.4.2 Costs of social involvement
- 5.4.3 Lack of Social skill
- 5.4.4 Dilution of business goals
- 5.4.5 Undermines the free enterprise systems
- 5.4.6 Corporation are not moral agents
- 5.4.7 Reduced international competitiveness.
- Self-Check Exercise - II

5.5. Social Responsibility towards different interest groups,
- 5.5.1 Towards Natural Environment
- 5.5.2 Towards Consumers
- 5.5.3 Towards Employees
- 5.5.4 Towards Government Agencies
- 5.5.5 Towards Community
- 5.5.6 Towards Media
- Self-Check Exercise - III

5.6. Summary
5.7. Keywords
5.8. Glossary
5.9. Answers to Self-Check Exercise
5.10. Exercises
- 5.10.1 Short Question/Answers
- 5.10.2 Long Question/Answers

5.11. Recommended Readings

5.0. OBJECTIVES

Business is an integral part of the society. The existence is totally dependent upon society. TheBusiness takes so much from thesociety and it is the responsibility of the business to return it back to the society. This chapter aims at rediscovering the role of business towards different segments of society. In this chapter, those points have also been discussed which have forced the business to change its priorities and look towards the society through different angle.

5.1. INTRODUCTION

Business is one of the critical organs of Society. And it draws its strength from that. In thelong run a successful business can be built onthe foundation of happy community around and a motivated and satisfied work-force, Moreover the economic objectives of a business could be better achieved by serving the society in a meaningful manner. And in the present time, this has been recognized by some of the big companies. For example: in 1970, the Article of Association of the major Tata companies were formally amended to read that the 'Company shall be mindful of its social and moral responsibilities to the consumers, employees, shareholders, society and the community.

3.2. MEANING OF SOCIAL RESPONSIBILITY

In general, the concept means many things such as:

(i) A private enterprise has responsibility towards society that goes beyond the production of goods and services at profit.

(ii) A corporation has a broader constituency to serve than that of stockholder alone;

(iii) The corporation relate to society through more than the market place alone;

(iv) They serve a wider range of human values than the traditional economic values that dominate the market place.

Corporate social responsibility means that corporations are more than simply economic institutions, and thus they have a responsibility to help society in some of its most pressing social problems (many of which are caused in part by corporations) by devoting even some of their resources. According to Howard R. Bowen, "Social responsibility refersto the obligations of businessmen to pursue their policies, to make their decisions, or to follow those line of action, which are desirable in terms of the objectives and values of our society,"

Similarly, According to Joseph W. Meguire, "The idea of social responsibilities supposes that the corporations has not only economic and legal obligations, but also certain responsibilities to society, which extend beyond those obligations."

The concept of social responsibility received increasing attention during 1960sbecause of the need for corporations to respond to the changing social environment of business. This change was often described as a change in terms of the understanding between business and society that reflected changing expectations regarding the social performance of business. The old understanding between business and society was based on the view that economic growth was the source of all progress, social as well as economic. The engine providing this economic growth was considered to be the drive for profits by comparative private enterprises. The basic missions of business were thus to produce goods and services at a profit, and in doing this business was making its maximum contribution to society, and in fact, being socially responsible.

The new understanding between business and society is based on the view that the single-minded pursuit of economic growth produces some detrimental side effects that impose social costs on certain segments of society, or a society as a whole. The Pursuit of economic growth, it is believed, does not necessarily lead automatically to social progress. In many cases, it has actually led to a deteriorating Physical environment, an unsafe work place, needless exposure to toxic substances on the part of the workers and consumers, discrimination against certain groups in society, urban decay and other social problems. This new under-standing between business and society involved the reduction of these social costs of business by impressing upon business the idea that it has an obligation to work for social as well as economic betterment. This new understanding does not invalidate the old one but it simply adds new terms or additional clauses to that understanding. The new understanding

includes a responsibility for both economic, and social impacts.

The concept of social responsibility is fundamentally an ethical concept. It involves changing notions of human welfare and emphasizes a concern about the social dimensions of business activity that have a direct connection with quality of life in society. The concept provides a way for business to concern itself with these social dimensions and pay some attention to its social impacts. The world responsibility implies that business organizations have some kind of obligation toward the society in which they function to deal with the social problems and contribute more than just economic goods and services.

5.3. POINTS IN FAVOUR OF SOCIAL RESPONSIBILITY

In spite of the dominant role of profit in the running of business, today, businessmen are more conscious of their social responsibility on account of the following factors:

5.3.1. Changed Public expectations from business

One of the most important arguments for social responsibility is that public expectation, for social responsibility is that public expectation from business has changed. It is reasoned that the institution of business exits only because its charter to exit; and that charter can be amended or revoked at any time that business fails to live up to society's expectations. Therefore, if business wishes to remain viable in the long run, it must respond to society's needs and give society what it wants,

5.3.2. Better environment for Business

The second argument favouring social responsibility is that it creates a better environmental condition more favourable for business operations. The firm, which is the most responsive to improve people's quality of life, will be easier, and the labour will be of a better quality. The turnover and absenteeism will be easier, and the labour will be of a better quality. The turnover and absenteeism will be reduced. As a result of social improvements, crime will decrease, with the consequence that lesser amount would be spent to protect properly, and less taxes have to be paid to support police force.

5.3.3. Public Image

Another argument is that social responsibility improves the public image of business. Each individual firm seeks an enhanced public image so that it may gain more customers, better employees, and other benefits. This type of expectation is traditional with business; therefore, it is easy to extend this public image concept to the accomplishment of various types of social goals,

5.3.4. Avoidance of Government Regulation

A related argument is that business should engage in socially responsible behaviour to avoid regulation by government. Regulation is costly to business and restricts its flexibility of decision making. From the businessman's point of view, it is desirable to retain freedom in decision making so that initiative can be maintained in meeting market and social forces. This view is also consistent with political philosophy, which wishes to keep power as decentralised as possible in our democratic system,

5.3.5. Problems can become Profits

It may be also argued that if the innovative ability of business can be turned to meet social problems, many problems can be handled profitably according to traditional business concepts. It is recognised that not all problems can be handled in this way, but the fact that some can be so handled should encourage business to become more active in social areas.

For example, Phosphate strip mining companies in Florida have found that after mining they can convert the land to home sites on lakes, resulting in better land than it was originally all with a profit chemical company have found that they can reclaim some wastes at a profit, and other firms are examining similar profit possibilities.

5.3.6. Balance of responsibility with Power

Another reason underlying the nation of social responsibility relates to the balancing of power and responsibility. Because business enjoys considerable social power. In that its activities and decisions affect the environment, consumers, employees, community conditions and many other areas of society. It has a corresponding responsibility in relation to society. Responsibility is a necessary reciprocal of Power, and any imbalance opens to door to irresponsible behaviour that may negatively affect the welfare of society. Responsibility, thus arises from power, and if business insists on avoiding its social responsibilities, then some of its powers may be gradually taken away by other societal groups or institutions suchas government, which will then shape business behaviour through Legislation and regulation.

5.3.7. Business has Useful Resource

Further, one may argue that business has enormous resources that could be useful in solving social problems. Business has managerial talent, experience in many technical areas, and Physical and Financial resources, some of which can be very helpful to society to alleviate its problems. Business is also known for its innovational ability and its concern of efficient use of resources, which are also required in the social realm. Thus, business ought to be encouraged or even required to try its hand at solving social problems.

5.3.8. Business has contributed to Social Problems

There is more argument that business has an obligation to help solve social problems because it created or at least perpetuate them in the first place. Business causes pollution, it creates unsafe workplaces, and it helps to perpetuate discrimination through its thriving and promotion practices. Therefore, business has a moral responsibility to deal with the negative impacts on society rather than leaving them for someone else to solve. Many social problems are the direct result of business operations, and hence, it is quite appropriate for business to take initiative in solving them.

Self-Check Exercise – I

Q1. ______ is an ethical framework in which a person works and cooperates with other people and organizations for the benefit of the community.

Q2. Problems can become _______ if innovative methods are chosen to fulfil social responsibility.

5.4. POINTS AGAINST SOCIAL RESPONSIBILITY

Despite the supporting arguments, the concept of social responsibility has been criticised by those who do not support the concept wholeheartedly or simply oppose it onideological grounds. Some of the arguments given against assumption of social responsibility by business persons are given below:

5.4.1. Profit maximisation

Since business operates in a world of opportunities the economic efficiency of business is a matter of top priority and should be the role mission of business. Its function is economic not social, and economic values should be the only criteria used to measure the success of business. Managers are the agents of owners (shareholders), and all the decisions in business are governed by the desire to minimise profits while reasonably complying with law and social customs.

5.4.2. Costs of Social involvement

Another argument against social responsibility is the excessive cost of social involvement. Business has very substantial economic resources, but it must use them wisely, otherwise these resources will quickly dwindle into economic redundancy if they

are not self-renewing. Although business can invest small amounts in meeting social obligations, as it has done in the past, it cannot really commit economic resources for social responsibility unless government or other ills institutions bear the costs involved.

5.4.3. Lack of Social Skill

An additional argument against business assuming social responsibilities is that many businessmen and managers my lack the perception and skills to work effectively with social issues. Their outlook is primarily economic and that their skills are best suited for handling business operations. They really may not feel at home in social matters.

5.4.4. Dilution of Business Goals

Involvement of business in social activities may dilute its emphasis on economic productivity, divide the interest of its leaders, and weaken business in the market place, with the result that it may accomplish poorly in both its economic and social roles. This implies that society would be a loser in productivity and the economic role of business in society would become confused.

5.4.5. Undermines the free enterprise system

It is argued that the concept of social responsibility is a subversive doctrine that would undermine the principles upon which a free enterprise system is based. For managers to held accountable for the use of corporate resources to solve problems, people affected by these decisions would have to making Process. This could mean that consumers, minorities, women, environmentalists and so only would all have to be represented on the board of directors, for example, such adiversity of interest mean that decision making in the corporation would be political rather than economic in nature. Decisions would reflect the political power of these various interest rather than the single objective of economic Profitability.

5.4.6. Corporations are not moral agents

It is sometimes argued that social responsibility is fundamentally a moral concept, and it is difficult if not impossible for organisations to respond to the moral imperatives inherent in such a concept. People can have moral responsibilities, but not organisations, which are structural to attain certain practical objectives and are basically immoral in their operations. A moral concept such as social responsibility does not apply to organisation because corporations are not moral agents and thus, they cannot be expected to act on moral grounds.

5.4.7. Reduced International Competitiveness

Social responsibility must also be looked at in an international context. If business organisations in India spends significant sum of money to be socially responsible, other expenditures will increase their costs and undoubtedly be added to the costs of their products. If these firms are competing in an international market with firms from other countries that do not have these social costs added to their products, these foreign firms will enjoy an even greater competitive advantage than they already do because of their lower wage levels and other factors.

The Arguments put forward by the critics of social responsibility suffer from two limitations. Firstly, they require business firms to do something, which they cannot do, i.e. to ignore social demands on them. Secondly, they are over apprehensive of the influence and power which business of the influence and power which business may

exercise through the voluntary assumption of social obligations. In fact, the assumption and discharge of social responsibilities cannot be avoided. Business is no longer a more economic institution but also a social institution and business persons are trustor of different social groups.

Self-Check Exercise – II

Q3. It will be difficult for an organization to fulfil social responsibility if they lack ______ skill.

Q4. Focus on ______ makes the organization cash machines and destroys the society.

5.5. SOCIAL RESPONSIBILITY TOWARDS DIFFERENT INTEREST GROUPS:

Even though corporate responsibility for increasing the wealth of owner (Shareholders) is well recognised other social responsibility are only beginning to be accepted. A brief list of the many areas is given here in which corporation have acknowledged their social responsibility and established programmes to deal with them.

5.5.1. Natural Environment

Responsibility for protecting the natural environment includes judicious use of natural resources includes:

- Judicious use of natural resources.
- Energy conservation.
- Abatement of polluting emissions.
- Waste Management.

5.5.2. Consumers

Responsibility towards consumers includes:

- Production of safe items.
- Using biodegradable packages.
- Educating consumers on product use and disposal.
- Being truthful in advertising.
- Establishing a procedure for dealing with consumer complaints.

5.5.3. Employees

Responsibility towards employee's welfare includes:

- Providing Fair compensation and Benefits.
- Providing Safe work environment
- Eliminating discrimination
- Providing opportunities for Personal and Professional development
- Having progressive human resource policies

5.5.4. Government Agencies

Responsibility towards local, State and Central Government agencies include:

- Fulfilling obligations under regulations and statutes of these agencies.
- Co-operating in planning and investigation, and
- Co-ordinating administrative activities with these agencies.

5.5.5. Community

Responsibility to the Public or community where the corporation have operation includes:

- Progressive economic stability.
- Safeguarding Public Safety.
- Protecting the environment, and
- Aiding in the development of Social and Cultural resources of the community through corporate Philanthropy.

5.5.6. Media

Responsibility towards the media includes being cooperative and truthful about issues that affect public welfare.The above discussion reveals that business is under tremendous pressure from several social groups. And the interest of these groups is not identical but conflicting. However, business Persons have proved beyond doubt that they have the required skills and will to reconcile the conflicting interests of all stockholders and serve through them to the best of their satisfaction.

Self-Check Exercise – III

Q5. Production of safe items and using biodegradable packages can be a social responsibility towards which interest group?

Q6. Providing fair compensation and eliminating discrimination can be a social responsibility towards which interest group?

5.6. SUMMARY

In the earlier times, the business was solely existing for earning profits, but with the passage of time, the awareness among the different segment of society increased and it forced the business to recognize. The fact that business is a solely because of the society.

Business has its social responsibility towards different segments of the society like towards customers, employees, Government, nation and society as a whole. But still there are a few legal provisions which forces a business enterprise to recognize its responsibilities towards society and to take effective steps to perform it. The Government has to make stringent provisions to force a business enterprise to return something in compensation what it got from the society.

5.7. KEYWORDS

Social Responsibility, Interest Groups, Profit Maximization, Wealth Maximisation

5.8. GLOSSARY

1. Business = Entity engaged in economic activities
2. Social Responsibility = Ethical framework addressing social issues
3. Social Environment = Cultural and social conditions that effect the life of an individual
4. Quality of life = The standard of health, comfort and happiness experienced by an individual
5. Government Regulation = Rules set by the government to control various aspects of business

5.8. ANSWERS TO SELF-CHECK EXERCISES

1. Social Responsibility; 2. Profits; 3. Social Skill; 4. Profit Maximization; 5. Customers; 6. Employees

5.9. EXERCISES

5.9.1. Short Question/Answers

Ql. Discuss the concept of 'Social Responsibility of Business'.

Q2. List the interest groups for which the company have social responsibility.

Q3. Elaborate the role of media in relation to social responsibility.

Q4. Explain the role of government agencies with respect to social responsibility.

5.9.2 Long Question/Answers

Q1. Elaborate the points in favour of social responsibility.

Q2. Explain the points against social responsibility.

Q3. How social responsibility is significant for different interest groups?

5.8. RECOMMENDED READING

(i) Business Environment : Francies Cherunilam

(ii) Essentials of Business Environment : K. Aswathappa.

(iii) Business Environment : Rosy and Joshy

Lesson No. 6

POLITICAL AND LEGAL ENVIRONMENT OF BUSINESS

STRUCTURE

6.0 Objectives of the Chapter
6.1 Introduction
6.2 Elements of Political Environment
6.3 Economic Role of Government
6.4 Effect of Political Philosophies on Economics
Self-Check Exercise - I
6.5 Relationship Between Government and Business
6.5.1 Business Responsibilities to Government
6.5.2 Government Responsibilities to Business
6.6 Legal Environment and The Economy
6.6.1 Pre-Independence Era
6.6.2 Post Independence Era
6.7 Rationale for Government Intervention
Self-Check Exercise - II
6.8 Summary
6.9 Keywords
6.10 Glossary
6.11 Answers to Self-Check Exercise
6.12 Exercises
6.12.1 Short Question/Answers
6.12.2 Long Question/Answers
6.13 Suggested Readings

6.0 OBJECTIVE OF THE CHAPTER

The present chapter aims to given idea of the impact of political environment on the economy of a country. This chapter focused on the interdependence of business and government of a country and how the legal system of a country can guide the development on a right track.

6.1 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. The dominated role of publicsector in our country is outcome of 'socialist pattern of society' adopted by theCongress Party. In short, 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 & legal environment on the business houses. A stable and dynamic political environment is indispensable for business growth.

6.2 ELEMENTS OF POLITICAL ENVIRONMENT

The political institutions i.e. legislature, Executive and Judiciary plays important role in economic policies as well as in 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 each and every 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 thelegislature 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.

6.3 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.

6.4 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 mean while the one of the partners 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.

Self-Check Exercise – I

Q1. The government establishes the enterprise and bears the risk, what kind of economic role it is playing?

Q2. ________ system of the country can guide the development of the business on the right track.

6.5. 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.

6.5.1. BUSINESS RESPONSIBILITY 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 sustenance, 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.

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.
2. **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.
3. **Providing Information:** Sometimes 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-makes, the facts and problems, individually or though forums and argue for the modification or change of decisions.
4. **Government Contracts:** Many business firms bid for Government contracts and if successful, carry out the resulting projects with the required specifications and standards.
5. **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.
6. **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.

6.5.2. 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.

1. **Establishment and Enforcement of Law**: Government establishes and enforces laws and regulations under which the business functions. Governments are responsible for providing the (rule of the game) which make the business systems function smoothly and which help to maintain competition.
2. **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.
3. **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.

6.6 LEGAL ENVIRONMENT AND THE ECONOMY

Introduction

The impact of political environment on the development of economics is irresponsible are 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 Le. the Consumer Protection Act, 1986, MRTP Act etc. Various laws have also been enacted in favour of labourers pertaining to labour reform Le, to control working hours, working conditions, labour charges, child labour etc, these laws named was 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 does 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 entrepreneur 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 on business in each and every aspect of the economy is very important. The relationship between business and business laws in that of mutual benefits. The important statutes relating to business as follows in two broader parts

6.6.1. Pre-Independence Era

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,

1. **The Indian Contract Act 1872**: First step for origin of business is contract law

   enacted way back in 1872 provided norms relating to the very basic aspects of contract formation, which is fundamental to any economy.

2. **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 sanctity to the institution of partnership.
3. **The Sales of Goods Act 1930:** Business in the other name of sale and purchase of goods to regulate the sale and purchase. The Sales of Goods Act 1930 provide provisions for different type of aspects on the sale, purchase of goods.
4. **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.

6.6.2 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 held 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 ofthe Govt. 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 Magna carta ofconsumer 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 Govt. Is a capital issue by companies, corporations etc. 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.

6.7 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 willing to play for them individually, government can provide them and imposes their cost on taxpayers.

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. Markets 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 govt. policy and they affect large part of the population equally and simultaneously. Govt. 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 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 civic amenities.
3. Information: Govt. 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 Govt. to provide the required facilities and encourage the small-scale sector to grow.
5. Transfer of Technology: Govt. owned research establishment transfer their discoveries to the private industry in order to put them to commercial production.
6. Govt. Competition: Govt. often competes with private business firms for the purpose of regulating competition, improving, quality or to supplement private activities with Govt. programmes.
7. Inspection and Licences: Govt. agencies conduct inspection activities on foods and drugs for assuring quality products to consumers Govt. issues licenses to competent business establishment to carry on different activities.
8. Tariffs And Quotas: These are used by govt. to project business from foreign competition. Incentives and subsidies and granted by Govt. to encourage dev. of home industries.

Self-Check Exercise – II

Q3. Mention any type of business responsibility towards government.

Q4. Mention any law related to business that was made pre-independence.

6.8. SUMMARY

The state (i.e. the Govt.) plays a very active role in all economies, including the market economies, albeit, 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 govt. 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 Govt. in India is governed by the principles and provisions of Indian Constitution. The central govt'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.

6.9 KEYWORDS

Legal System, Political Environment, Economic Role, Government intervention

6.10 GLOSSARY

1. Economic Policies = Strategies adopted by government to manage economic activities

2. Political Environment = Impact of political decisions and policies on the business

3. Legal Environment = Framework of laws and regulations that governs business activities

4. Regulatory Role = Government's function to oversee and control economic activities

5. Planning Role = Government's role in formulating and implementing plans for economic development

6.11 ANSWERS TO SELF-CHECK EXERCISE

1. Entrepreneurial role; 2. Legal System; 3. Tax Payment; 4. The Sales of Goods Act, 1930

6.12 EXERCISES

6.12.1 Short Question/Answers

Q1. What are the various elements of political environment of an economy?
Q2. What is the legal environment and its basic elements?
Q3. How does political environment affect the economy of a country?
Q4. How does legal environment affect the economy of a country?

6.12.2 Long Question/Answers

Q1. What is the economic role of the government?
Q2. What are the business responsibilities to the government and government responsibilities to the business?
Q3. Elaborate the business laws made before and after independence.

6.13 SUGGESTED READINGS

1. Business Environment : Francis Cherunilarn
(Text and cases)

2. Business Environment : Rosy Joshi, Sangam Kapoor (2005)

3. Essentials of Business Environment
(Revised addition in 2005-06) :K. Aswathappa

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TECHNOLOGICAL ENVIRONMENT IN INDIA AND TECHNOLOGY TRANSFER

STRUCTURE

7.1 Introduction

7.2 Features of Technology

7.3 Technology S-curve

7.4 Status of Technology in India

'7.5 Historical Background of India's Technology Policy

7.6 Present Technological Policy of India

7.7 incentives provided by the Government for Technology Development

7.8 Technology Transfer

7.8.1 Self-Check Exercise

7.9 Basic Features of Technology Transfer

7.10 Forms of Technology Transfer

7.11 Levels of Technology Transfer

7.12 Issues in Transfer of Technology

7.13 Methods of Technology Transfer

7.14 Summary

7.15 Answer to Self-Check Exercise

7.16 Short Questions

7.17 Long Questions

7.18 Key Words

7.19 Suggested Reading

7.1 INTRODUCTION

Meaning and Definition of Technology

Technology is one of the important determinants of economic and social development of a nation. Technology includes the tools both machines and ways thinking available to solve problem and promote progress among societies. According to the draft 'technology is systematic knowledge for the manufacture of a product for the application of a process or for the rendering of a service and does not extend transactions involving mere sale or lease of goods." Technology includes not only knowledge of methods that are necessary to carry on or to improve the existing production and distribution of goods and services but also entrepreneurial expertise and professional know-now.

7.2 FEATURES OF TECHNOLOGY

1. Self-Reinforcing

According to the self-reinforcing feature of technology that technology acts as a multiplier to encourage its own faster development. Invention in one place leads to sequence of invention in other places.

2. Changes and Development

The very important feature of technology is change and development. Businessman must always watch out for changes and development taking place around. New development must be adopted and new ideas explored lest the business units would perish at the earliest.

3. Widespread Effects

The effects of technology are widespread. It affects every community of the society. People who are living in far away and isolated places cannot escape from it.

7.3 TECHNOLOGY S-CURVE

Commonly observed pattern in the development of technologies and the rate of progress in a new technology follows an S shaped curve, with an initial exponential rate, slowing to a linear rate, and returning off toward a natural limit.

All new basic inventions for a new technology show poor 'performance which dangerous to use and are costly to produce. Due to these reasons a rapid Hush of new ideas that provides exponential increase in performance. Thus begins the linear phase of technology progress on the S-curve. Under linear phase the rate of improvement slows down as it approaches its limit, which may be technological, economic or social. At maturity phase there will be considerable economic and competitive benefit in changing to an alternative technology to which the limit does not apply and consequently in due course a new technology, will emerge and be adopted.

7.4 STATUS OF TECHNOLOGY IN INDIA

The government of India from the very beginning adopted a very positive policy regarding the technological, development of the country. In fact, the new leadership of India was very much aware of the national conditions and capacity along with the international conditions and the superiority of the west in the field of technology particularly. It was obvious that the technology must first attended the basic problem of food, clothing, health and housing of people. At the same time repaid industrial development through latest technology was necessary to catch up with advanced countries. With these objectives government of India set up series of research and Development establishments, space research centres, medical research centre, agriculture research establishments and institutes have been set-up to provide higher education in technology, as on today 500 science and technological institutions and 1080 in house research and development laboratories are running in India. Indian country ranks eighth among Asian countries in the technology front.

7.5 HOSTORICAL BACKGROUND OF INDIA'S TECHNOLOGY POLICY

Scientific policy resolution (SPR) is opted by the government of India on March 4, 1958. Objective of SPR was to ensure adequate supply by highly trained and qualified research personnel by recognizing their work as an important component of nation's strength and to ensure the benefit of science and technology to all the people in the country. The Industrial policy resolution of 1948 and 1956 was one of the first policy option of the government of India. Massive import of both capital and technology was considered essentially for the industrial development of the country. The monopolies and restrictive trade practices (MRTP) act, 1959 was established to extended the scope to private sector industries. Main objectives of MRTP were prevention or concentration of wealth, direction of flow of investment and business operations towards select industries needing advanced technologies and promotion of 'regional development. According, the foreign exchange regulation act, 1974 the nigher rate of foreign equity was allowed provided the turns operated in the high technology areas.

7.6 PRESENT TECHNOLOGICAL POLICY OF INDIA

India is known for its diversity. Technology must suit local needs and to make an impact on the lives of ordinary citizen.

1. AIMS

• Develop technologies that are internationally competitive particularly those with export potential.

• Ensure maximum development with minimum capital outlay.

• Ensure a correct mix between mass production, technologies and production by the masses.

• Attain technological competence and self-reliance making the maximum, uses of indigenous resources.

• Identify obsolescence of technology in use and arrange for modernization of both equipment and technologies.

2. Industrial Development

The government of India decided to give full attention to the development of indigenous technology to achieve technological self-reliance and reduce dependence on foreign inputs, particularly in those areas in which, the domestic base is strong. Incentives will be provided to users of indigenous developed technology and for products and processes resulting from such use.

3. Environmental Factor

Under environmental factor the aim of India's technological policy is to facilitate utilization of natural resources for ensuring a sustainable benefit stream for a better quality of life. It is essential that the technology conversion, process must be made as efficient as possible, as this will provide a much higher output of the productive goods and services from the same material inputs.

4. Strengthening the Technology Base

The technological policy of the government of India is directed to achieve a greater spread in the use of technological developments. Ensure accessibility of technological devices to all segments of the society with the special emphasis on remote and rural communities in order to improve their quality of life. India's technological policy also encourage industries for enhancing human skills and upgrade existing technologies to comparable international level as well as to attain such levels for newer and emerging technologies.

7.7 INCENTIVE PROVIDED BY THE GOVERNMENT FOR TECHNOLOGY DEVELOPMENT

1. Government provides income tax exemption up to 100% of the expenditure incurred on research and development and preferential treatment in licensing for utilization of indigenously developed technologies.

2. The IDBI operates a venture capital fund created by government of India in 1986-87 budget by imposing 95% cess on all imported technologies,

3. Depreciation rate higher than 50% is allowed to users of indigenous developed technologies.

4. There is provision of income tax deduction on the amount spent on pilot or semi commercial plant based on CSIR technology.

5. Central and state financial corporation operate several incentives schemes such as interest subsides to encourage industries who venture to commercialize newly developed indigenous technologies.

7.8 TECHNOLOGY TRANSFER

Technology transfer is the process by which commercial technology is disseminated. Technology transfer may or may not be a legally binding contract but it will involve the communication by the transferor of the relevant knowledge to the recipient. Non-commercial technology transfer such as those found in international cooperation agreements between developed and developing states. Such agreements may relate to Infrastructure or agriculture development, cooperation in the field of research and education.

7.8.1 SELF-CHECK EXERCISE – I

1.Technological environment is a part of ____________ environment.

2. _______________ environment is beyond the control of the business.

7.9 BASIC FEATURE OF TECHNOLOGY TRANSFER

There are two basic features of technology transfer through which the developed countries transfer technology to the developing countries.

1. Foreign Exchange Policies of the Developing Countries:

The developing countries cannot place much reliance on exports due to the structural factors. Therefore, to overcome the foreign exchange difficulties they rely much on foreign substitution. This provides to incentive to MNCs to move to developing countries with their technology Know-how.

2. Principal Instrument of Technology Transfer

The principal instruments of transfer arc MNEs who either through their subsidiaries or through the other contractual transacting made with the developing countries provide mechanized process and equipment to the host countries.

7.10 FORMS OF TECHNOLOGY TRANSFER

There are two forms of technology transfer

1. Internalized Technology Transfer

Internalized forms refer to investment associated technology transfer where control resides with the technology transferor. The transferor normally holding the majority or full equity ownership.

2. Externalized Forms

Externalized forms refer to all other forms such as joint venture with local control, licensing strategic alliance and international subcontracting.

7.11 LEVELS OF TECHNOLOGY

1. Operational Level

Operational level involves basic manufacturing skills as well as some more demanding trouble shooting, quality control, maintenance and procurement skills.

2. Duplicative Level

Duplicative level is also called intermediate level, which includes the investment capabilities needed to expand capacity and to purchase and integrate foreign technologies.

3. Adaptive Level

Adaptive level is also called technological self-reliance level. At this level imported technologies are adapted and improved and design skills for more complex engineering learned,

4. Innovative Level

This level is characterized by innovative skills based on formal research and development that are needed to keep pace with technological frontiers or to generate new technologies.

7.12 ISSUES IN TRANSFER OF TOCHNOLOGY

1. Cost

The developing countries obtain foreign technology at unreasonably high prices. In number of cases of foreign direct investment associated with technology transfer or the net outflow has been found to be much higher than the corresponding inflow,

2. Appropriateness

The appropriateness of the foreign technology to the physical, economic and social conditions of the developing countries in an important aspect to be considered in technology Transfer. There are a large number of cases where the foreign technology transferred has been irrelevant or inappropriate to the recipient country's socio-economic priorities and conditions.

3. Dependence

Heavy reliance on foreign technology may lead to technological dependence. It is noted Mat the import of modern technology has tended to displace the traditional indigenous technology, which have been improved under a different set of policies.

4. Obsolescence

It has also been observed that there is a tendency to transfer outdated technology to We developing countries. Thus, they would not enjoy the advantages of the latest technology and would still technologically lag behind.

7.13 METHODS OF TECHNOLOGY TRANSFER

The following are the important methods of technology transfer:

1. Training and Employment of Technical Expert

Through this method unpatented manufacturing techniques can be transferred by imparting the requisite training to suitable personnel. Alternatively, such technology can be acquired by employing foreign technical experts.

2. Licensing Agreements

Under this method the licensor enters into an agreement with a licensee in another country to use the technical expertise of the former. This method is mostly used at that time when foreign direct investment is not possible or desirable,

3. Contracts for Supply of Machinery and Equipment

Contracts for supply for machinery and equipment is that which normally provide for the transfer of operational technology pertaining to equipment.

4. Turnkey Contracts

Transfer of complex technology often take place through turnkey project contracts, which includes the supply of services as design, creating, commissioning or supervision of a system or a facility to the client, apart from the supply of goods.

7.14 SUMMARY

Technology indicates the potential for development of business, economy and region. Government policy sometimes is a very important technological environment. Technology transfer provides a

competitive advantage. It facilitates not only the introduction of new products but also improvement in the operational efficiency of business.

7.15 ANSWER TO SELF-CHECK EXERCISE

1. External

2. External

7.16 SHORT QUESTIONS

1. Define Technology S-curve.

2. What do you mean by technology transfer?

3. Describe Technology policy of India.

4. Explain features of technology.

7.17 LONG QUESTIONS

1. What is Technological Environment & its status in India?

2. What are the various methods of Technology Transfer?

3. How technology transfer leads to innovation creation and diffusion. Explain.

4. Describe the incentives provided by Government for technological development.

7.18 KEY WORDS

IDBI, CSIR, MNCs, MRTP

7.19 SUGGESTED READING

Business Environment by Francis Cherunilam.
Business Environment by R. Jos y & S. Kapoor

ECONOMIC ENVIRONMENT OF BUSINESS: ELEMENTS AND SIGNIFICANCE

STRUCTURE

8.1 Objectives

8.2 Introduction

8.3 Economic Factors

8.4 Economic System

8.4.1 Self-Check Exercise

8.5 Economic Planning

8.6 Structure of Economy

8.7 Nature of the Economy

8.8 Economic Policies

8.9 Human Resources

8.10 National Income and per Capita Income

8.11 Summary

8.12 Answer to Self-Check Exercise

8.13 Short Questions

8.14 Long Questions

8.15 Key Words

8.16 Suggested Readings

8.1. OBJECTIVES

After studying this lesson, students should be able to answer

- Relevance of economic planning in country's development
- Role of Agriculture and Industrial Sector
- To discuss the nature and structure of the economy.

8.2. INTRODUCTION

Economic Environment refers to all those economic factors, which have a bearing on the functioning of a business. Business depends on the economic environment for all the needed inputs. It also depends on the economic environment to sell the finished goods. Naturally, the dependence of business on the economic environment is total and is not surprising because, as it is rightly said, business is one unit of the total economy.

8.3. ECONOMIC FACTORS

It difficult to be precise about the factors, which constitute the economic environment of the country. It is equally difficult to draw lines of distinction between the political environment and the economic

environment and the technological environment. The type of monetary policy, dear money policy or cheap money policy, the govt. wants to pursue may be partially political-and partially economic. Again, importing a particular technology may be political, economic or both. We include major macro-economic factors, which have considerable influence on business. Such factors are:

a. Growth strategy

b. Economic system

c. Economic planning

d. industry

e. Agriculture

f. Infrastructure

g. Financial & fiscal sectors

h. Removal of regional imbalances

i. Price 84 distribution controls

j. Economic reforms

k. Human Resources, and

l. Per capita 84 national income

The economic environment as it now prevails in our country is the result of the economic growth strategy. Relentlessly pursued during the last four decades by the government of India. It is therefore advisably to recollect the strategy.

The second five-year plan 1956 was quite clear that it cannot be emphasized too strongly that unless steps are taken to augment rapidly the output of the means of production and to build up the fuel and energy resources which are so vital to development, he scale and pace of advancement in the coming years will be inhibited."

In some cases, fiscal or price incentives may have to be relied on; other, licensing system may be essential; in still others, fixation of profit margins, allocation of scarce raw material or other regulatory devices may be necessary. If the targets of planned investment are to be achieved, means have to be found to secure that the necessary resources do in fact, become available and are not devoted to consumption.'

The state emerged both as the mobilizer of savings as well as an important investor an owner of capital. Since the state was to be the primary agent of economic change, it followed that private sector activities had to be strictly regulated and controlled to conform to the objectives of state policy.

The growth strategy also meant, in the early years of planning, a relative neglect of public investments in agriculture. This negligence of agriculture was supported by the prevailing view that a growing labour force in the developing countries could only be absorbed in the industry, and that in the early stages of industrialization, it was necessary for agriculture to contribute to the building up of modem industry by providing cheap labour. A faster development of industry was the central objective of planning.

The above is a thumbnail sketch of the growth strategy followed by the planners in the past four decades. The strategy has been subject to severe criticism particularly during the late 80's when the era of liberalization was set in motion. The criticisms are:

• The neglect of exports and trade opportunities.

• Excessive protectionism and import substitution

• Undue reliance on physical controls

• Inefficiency of public sector

• Total neglect of agriculture

The growth strategy did contribute to the overall growth of the economy.

8.4 ECONOMIC SYSTEMS

Just as there are two political philosophies, viz, democracy and totalitarianism, there are three distinct economic philosophies, viz., capitalism, socialism, and communism.

(a) Capitalism The system of capitalism stresses the philosophy of individualism

believing in private ownership of all agents of production, in private sharing of distribution processes that determine the functional rewards of each participant, and individual expression of consumer choice through a free market place. In its political manifestation, capitalism may fall in a range between extreme individualism and anarchism and the acceptance of some state sanctions as mentioned by Adam Smith the later philosopher of modem capitalism.

(b) Socialism: Under socialism, the tools of production are to be organized, managed an owned by the govt., with the benefits accruing to the public. A strong public sector, agrarian reforms, controls over private wealth and investment and national self-reliance are the other planks of socialism. Socialism does not involve an equal division of existing wealth among the people but advocates the egalitarian principle. It believes in providing employment to all and emphasizes rewards to the efforts put in by every worker. Also called Fabian socialism, this philosophy is followed in our country and other social democratic country of the world.

(c) Communism: Communism goes further to abolish all private property and property rights to income. The state would own and direct all instruments of production. Sharing in the distribute process would have no relationship to private property since this right would not exist. Alternatively called Marxism, communism was followed in Russia, China and East European countries.

8.4.1 SELF-CHECK EXERCISE - I

1. The economic environment is a subset of ______________ environment.

2. ______________ helps in study of strategic positioning of the firm and help to assess thebusiness environment also with respect to the competition.

8.5. ECONOMIC PLANNING

A mixed economy is necessarily a planned economy. It -does not mean simply a controlled economy in which, the govt. interferes in economic matters through fiscal and monetary policies, but it is an economy in which the govt. has a clear and definite economic plan. The public sector will have to be operated according to certain, priorities and to realize specific social an economic goal. Naturally, the public sector should have an economic plan. At the same time, the govt. cannot leave the private sector to function in its own unorganized way.

The govt. has to prepare and implement a comprehensive economic plan integrating the private sector with the public sector. It is for these reasons that we have been having economic planning since 1951 when the first 5-year plan was launched. All the 5-year plans were designed to achieve four important long-term objectives, viz.:

1. Increase production to the maximum possible extent so as to achieve a higher level of national and per capita income;

2. Achieve full employment;

3. Reduce inequalities of income and wealth; and

4. Set-up a socialist society based on equality and justice and exploitation.

8.6. STRUCTURE OF THE ECONOMY

The structure of the economy- factors such as contribution of different sectors such as primary(mostly agriculture), secondary(industrial) and tertiary(service) sectors, large, medium, small and tiny sectors to the economy, and their linkages, integrating with the world economy- are important to business because these factors indicate the prospects for different types of business, certain factors which affect the business etc, for example, if an economy is highly integrated with the global economy it will be quickly affected by the developments in the global economy.

Normally, as an economy develops the share of the primary sector in the GDP and employment declines and those of the other sectors increase. After a certain stage the share of the manufacturing sector may also decline.

In most of the countries the service sector is the largest and the fastest growing sector. The service sector now contributes more than 60% of the world GDP. The developed economies are primarily service economies in the sense that the service sector generates bulk of the employment an income. The contribution of service to GDP and employment is substantially high in particularly the developed economies,

(a) Agriculture

Agriculture sector is a major component of our economic environment.

Role of Agriculture

1. About 30 % of our GDP comes from agriculture alone. It was around 57% in the beginning of 1950's.

2. Agriculture is the backbone for any country's economic development, especially agriculture contributes to economic development in at least four ways:

I. Product contribution, that is, making food and raw material available;

II. Market contribution, i.e., providing the market for goods produced by other sectors;

III. Factor contribution, i.e., making available labour and capital to the non-agricultural sector; and

IV. Foreign exchange contribution

3. Agriculture has been a major source of livelihood for our people. A large percentage of working population (more than 70%) of our population is engaged in agriculture.

4. Agriculture plays an important role in our international trade too. The main

agricultural commodities which are exported, are tea, oil cakes, fruits & vegetables, spices, tobacco, cotton, coffee, cocoa, sugar and other varieties of animal hair and vegetable oils.

5. Fluctuations in agriculture output play a key role in the state of that national economy.

Similarly, performance in agriculture also influences total demand via Government savings and public investments. Since agriculture is the main contributor to national income, this sector is also the primary source of savings, enhance capital formation. Rate of capital formation has a great impact on economic growth.

(b) Infrastructure

Adequate quantity, quality and reliability of infrastructure is the key to the growth of any economy. Economic growth is not possible if any of these growth facilities is lacking. This is precisely what has happened in our country. Due to lack of infrastructure, India is losing a battle that could have placed it firmly in the midst of the most advanced nations in the world. Infrastructure is a tiny word which encompasses the entirety of a nation. It includes:

(a) Energy electricity, coal, oil and non-conventional sources

(b) Transport railways, roads, shipping .86 civil aviation

(c) Communications posts and telegraphs telephones & telecommunications.

Infrastructure facilities are also called the social over heads and belong to the core sector of the economy.

Most infrastructure services in India have until recently been provide by public monopolies and quasi -monopolies and have been beset by severe problems like lack of accountability, low productivity, poor financial performance 81 over employment. In order to meet the challenges of rapid economic growth and international competitiveness, there is an urgent need to achieve greater efficiency and accountability in these sectors, much greater prevalence of commercial principles and much more competition in the provision and operation of infrastructure services. As the government's ability to undertake investment in infrastructure is severely constrained, it is necessary to induce much more private sector investment and participation in the provision of social overheads. The entry of private suppliers can also encourage better risk sharing, accountability, monetary and management in infrastructure sectors.

8.7 NATURE OF THE ECONOMY

The general level of development of the economy has lot of implications for business-it has significant bearing on the nature and size demand, govt. policies affecting business etc. Countries and different regions within a country, show great differences in the level and pattern of economic development.

A widely used method of classification of the economies is on the basis of per capita income i.e., the average annual income per person. Accordingly, countries are broadly classified as: Low income, middle income and high-income economies.

(a) Low-income economies; Low-income economies are economies with very low level of per capita income.

(b) High-income economies: High-income economies are economies with very rich income per capita. There are mainly two categories of high-income economies, industrial economies and oil exporters.

(c) Middle income economies; Middle income economies are subdivided into: lower, middle income and upper middle income.

8.8 ECONOMIC POLICIES

There are several economic policies, which can have a very great impact on business. Important economic policies are industrial policy, trade policy, foreign exchange policy, monetary policy, fiscal policy and foreign investment and technology

Some types of categories of business are favourably affected by govt. policies; some are adversely affected while it is neutral in respect of others. Similarly, an industry that falls within the priority sector in terms of the govt. policy may get a number of incentives and other positive support from the govt. whereas those industries which are regarded as inessential may have the odds against them.

(a) Industrial Policy: Industrial policy can even define the scope and role of different sectors like private, public, joint and cooperative or large, medium, small and tiny. It may influence the location of industrial undertakings, choice of technology, scale of operation, product mix and so on.

lb) Trade Policy: The trade policy can significantly affect the fortune of firms. For example, a restrictive import policy or a policy of protecting the' home industries may. greatly help the import competing industries, while the liberalization of the import policy may create difficulty for such industries.

(c) Foreign Exchange Policy: Exchange rate policy and the policy in respect of cross- border movement of capital are important for business. The abolition/liberalization of exchange controls all around the world since the late 1970's has encouraged cross-border movement of capital.

(d) Foreign Investment and Technology Policy: Until the late 1980's where the worldwide trend towards liberalization set in, foreign capital and technology were under severe restrictions in many developing a socialist/communist country. Restriction on foreign capital and technology constrain not only the foreign firms but also, the domestic firms because it may come in their way of acquiring the technology of their choice from the best source, Restrictions on foreign capital may affect the growth plans of firms, including establishment of joint ventures.

(e) Fiscal Policy: Government's strategy in respect of public expenditure and revenue can have significant impact on the business. The pattern of public expenditure may affect the development of various regions, sectors and industries differently. Such is the case with taxation policy. Govt. often uses tax incentives or disincentives to encourage or discourage certain activities, for example, when an industry suffers from recession, a reduction of taxes like excise duty or sales tax may help improve the demand. A reduction of rates of different taxes like personal income tax and corporate tax may help increase, because of the resultant increase in the disposable income the spending in the economy leading to an increase in demand. Central as well as State Governments of many countries offer different fiscal incentives to woo industries.

(f) Monetary Policy: The Central Bank, by its policy towards the cost and availability of credit, can significantly influence the savings, investments and consumer spending in the economy. Depending on the conditions of the economy and the general economic policy of the govt., the central bank may adopt an expansionary or contractionary or neutral monetary policy.

8.9 HUMAN RESOURCES

Human resources constitute an important part of the total economic environment. There are several reasons which bring out the crucial role of people in an economy. People provide ready market for good produced and services. People together constitute one of the factors of production. Nation depends on the quality of its people. Japan's prosperity owes it to its people.

8.10 NATIONAL INCOME AND PER CAPITA INCOME

Every sector of the economy employs natural, human and material resources and contributes to the aggregate flow of goods and services during a time period. This aggregate flow of goods and services represents the total income earned by factors of production employed during the year and is popularly called national income. A high national income indicates that economy is developed and overall environment is favourable for business growth.

8.11 SUMMARY

General economic conditions affect business. Economy faces periods of boom and recession. Boom is characterized by high levels of output, employment and rising demand and prices. Recession has the opposite of these characteristics.

If a region depends to a significant extent on any particular industry or sector, business in that region would be significantly affected by the fortunes of that industry.

8.12 ANSWER TO SELF-CHECK EXERCISE

1. Business

2. Porter Five Forces Model

8.13 SHORT QUESTIONS

1. Environment is dynamic and multi-faceted". Discuss.

2. Do a SWOT analysis of the Indian Tourism industry?

3. Define Economic System.

4. "The relation between a business and an environment is not a one-way affair". Comment.

8.14 LONG QUESTIONS

1. Define Economic Environment. Critically discuss the role of Economic Policies to provide a healthy economic environment.

2. Describe the Significance of infrastructural Development in economic development of a country.

3. Critically evaluate the economic environment of India in the global context.

4. India's industrial outlook changed significantly after 1991. Why and how?

8.15 KEY WORDS

Economic Systems, Economic Planning, Economic Environment, Economic Factors.

8.16 SUGGESTED READINGS

1. KPMSundharam and Ruddar Dutt (2003), Indian Economy, S. Chand and Company, New Delhi.

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INDIAN INDUSTRIAL POLICY

STRUCTURE

9.0 Objectives

9,1 Introduction

9.2 Industrial Policy Resolution (1956)

9,3 Industrial Policy Statement (1973)

9,4 The Industrial Policy (1977)

9.5 The Industrial Policy (1980)

9.5.1 Self-Check Exercise-I

9.5.2 Self-Check Exercise-II

9.6 New Industrial Policy (1991) or Recent Changes in Industrial Policy

9.6.1 Policy changes in large sector

9.6.2 Policy changes in small sector

9.6.3 Critical Evaluation of New Industrial Policy

9.7 Summary

9.8 Answer to Self-Check Exercise

9.9 Fill on the blanks

9.10 Short Questions

9.11 Long Questions

9.12 Key Words

9.13 Suggested Readings

9.0 OBJECTIVES

The objective of this lesson is to introduce the students with the:

(i) Industrial Policy in India in general;

(ii) New Industrial Policy, 1991, its features and assessment;

(iii) Effectiveness of the New Industrial Policy.

9.1 INTRODUCTION

Industrialisation is a necessary condition for a developing economy like India. Independence of India was followed by not only partition of the territorial area but wide spread industrial unrest also. There was lack of confidence between government and the entrepreneur class. Thus, the active role by the State was needed at that point of crisis not only in industry but in the economy as a whole.

State participated in regulating and streamlining the overall development with the help of a concrete policy of industrial growth, the main objective being to have a solid infrastructure base on which future growth may depend. Thus, the first industrial policy resolution was formulated by the government in 1948. The main purpose of the resolution was to speed up the national and per capita income through rapid industrialization. More just and equitable distribution of wealth, to promote general standard of living of the masses to accelerate production, to meet the requirement of major objectives of the Industrial Resolution of 1948

The large industrial sector of the economy was divided into four categories, on the basis of ownership and control. Thus, classifying various industries, role of the State and the private sector and their inter-relationship was specified. Besides this, the resolution emphasized the importance of cottage and small-scale industries for employment generation. To some extent, and in specified areas, foreign capital was allowed to come just to initiate the process of industrialisation and to meet the internal requirements of finance.

9.2 INDUSTRIAL POLICY RESOLUTION-1956

During 1950-51, Indian Government decided to have a planned economic development with building a strong industrial base. The main idea behind this was to have a socialistic pattern of development emphasising the role of public sector. Under this consideration, the new WR (1956) was announced.

OBJECTIVES

- to accelerate the rate of economic growth and to speed up industrialization to reduce disparities in income and wealth.
- to prevent the growth of monopolies and concentration of economic power in few hands.
- to develop heavy and machine building industries in the country; and
- to enlarge the scope of public sector enterprise as well as cooperative sector.

The main Features of the policy are as follows:

1. New Classification of Industries

IPR of 1956 classified industries into the following three categories in order to specify the role of the State and the private sector:

(1) Schedule A: It consisted of 17 industries which may be described as defence industries (like Arms and ammunitions, atomic energy, iron and steel, heavy machinery and electrical, coal mineral, mining or iron-ore, Chrome ore, manganese ore, gypsum, sulphur, diamond and gold, mining and processing of copper, lead, zinc etc., minerals connected with production and use of atomic energy, air craft, air and railway transport, ship building, electricity generation and distribution, telephone, telegraph, wireless equipment). Industries in this group were to be the exclusive responsibility of the State, but it can take the help of the private sector if and when the interest of the country requires it.

(2) Schedule B: The second category consisted of 12 industries. In these industries, the State would progressively take initiative to set up new units. Though private enterprises would co-exist side by side the state and may even supplement state enterprises. Thus, it was a sort of mixed sector industries included in this group were Aluminium and other non-ferrous metals not included in first category, e.g., Ferro alloy, Basic and intermediate chemicals and products required by chemical industries, Antibiotics and essential drugs, fertilizers, Roads and Sea transport, Synthetic rubber, Corporations of coal, chemical pulp. These 12 industries were those industries which were to be nationalised with passage of time, new investments were to be done only by State. But those units which were running efficiently were to continue,

(ill) Schedule C: The rest of the large industrial sector was left to the initiative of private sector, subject to the social control by the State to ensure objectives of the planned economy.

2. Encouragement of Private Sector

The resolution did not seek to divide the industries into watertight compartments and the government was given the freedom to undertake any. type of industrial production. The private enterprise could also produce some of the items included in category falling in the domain of this State.

3. Emphasis on Cottage and Small-Scale Industries

The small scale and cottage industries were to be favoured for their large employment potential ensuring more equitable distribution of income and for mobilising capital and labour resources still lying unused. Subsidies and tax concessions were to be allowed to them. They were to be provided all facilities for growth.

4. Balanced Regional Development

The resolution also stressed the need for balanced regional development. The areas lagging behind in industrial development were to be extended special facilities. It recognized the importance of cordial relations between labour and management. It called upon the public sector undertakings to become model employers by improving working conditions. It also emphasized the need for maintaining facilities at the University and factory levels for the training of managerial and technical personnel for the fast-expanding public sector undertakings. The undertakings were to be run more efficiently so that they could earn profits to augment state resources.

Industrial Policy of 1956 was looked upon as a programme of action in which both the public and private sector were to co-operate for achieving complete industrialisation. It was a realistic approach unshadowed by ideological consideration.

The 1948 Industrial Policy gave coherence to lose and scattered industrial picture. The 1956 policy enlarged and improving upon it. It reflected the objectives of planning, laid down do's and don'ts and helpful in its implementation. It gave so much weightage to the role of the State that the categories may be described to lead where the government owns, where the government will own and where the government regulates without the active interest taken by the State nothing much could have been achieved in India's bid to develop industrially.

EVALUATION

The shortcoming of Industrial Policy of 195.6 was that by placing over emphasis on heavy industry, importance of agriculture was not properly seen. The small industry was given its due role but these were not integrated with programme of development of large-scale industry.

The implementation of the sixth pillar industrial policy only saw a qualified success by choosing capital intensive techniques, it lost the opportunity to make use of layout intensive methods where they could be profitably employed: Many inefficient and high-cost industries came to be created. There also arose the problem of surplus in most of the public sector industries. Weakness on the implementation front led to inflationary pressure in the economy and the demand of rising prices led to dismay and frustration much more than before. It was felt that the foreign investment policy should be a part of the industrial policy.

The expansion of industry in Third and Fourth Plans was governed by the 1956 Industrial Policy. The role of the public and private sectors was thought of supplementary and complementary to one another. Both were to be encouraged to follow their own laws of growth and receive equal treatment in the matter of access to capital, raw materials, foreign exchange etc.

9.3 INDUSTRIAL POLICY STATEMENT 1973

The Government reiterated the Industrial Policy Resolution, 1956 but added that the State will take direct responsibility for the future development of industries over a wide field in order to promote the objectives of growth, social justice, self-reliance and satisfaction of basic needs. The features of the new industrial policy were as given below:

(i) Updational of Existing Industrial Policy (1956): The Industrial Policy of 1956 updated in the light of Industrial Licensing Policy of 1956 and the Monopolies and Restrictive Trade Practices Act, 1969.

(ii) Definition of Large House: It accepted the definition of large house as laid down in the Monopolies and Restrictive Travel Practices Act, 1969, for licensing restrictions.

(iii) Concept of Core Industries: It enumerated 19 industries as core industries to the national economy in the future. Large houses to be eligible to participate and contribute to the establishment of industries in the list provided the item of manufacture was not reserved for production in the public sector or in the small-scale sector. Large houses were to be excluded from the industries not included in the list except where production was mainly for export.

(iv) Encouragement to Foreign Investment: Foreign subsidiaries and branches of foreign companies were to be treated for the purpose of establishment and participation in industries on the same footing as the large houses. But their investments were to be subjected to the guidelines on the dilution of foreign equity. They were also to be examined as to technological aspects, export possibilities and overall effect on the balance of payments.

Iv) Encourage Small and Medium Entrepreneurs: The government was to continue to encourage small and medium entrepreneurs in all industries including the listed 19 industries. The small enterprise would be preferred over large houses and foreign companies in the establishment of new capacity. The production of ancillaries, where possible, would be in the medium and small-scale sectors. These sectors would be encouraged to participate in the production of mass consumption goods. The public would be assuming an increasing role in the manufacture of consumption goods.

(vi) Participation of co-operative Sector: Co-operative sector would be encouraged to participate in the production of goods of mass consumption.

(vii) Management and Operation of Joint Sector: The joint sector device might be restored in specific cases, keeping in mind the production targets to the plan. Each case was to be examined in the light of social and economic objectives. New and medium entrepreneurs would be preferred in developing priority industries. In the guiding policy management and operation of the joint sector units the government would have an effective role.

Evaluation

The new Policy was heavily weighted in favour of small and medium entrepreneurs and co-operative, particularly in the production of the joint sector. A big departure from the previous policy was that a much wider field was thrown open to foreign concerns. Certain industries were to be opened to them at par with the Indian entrepreneurs. This area open to large houses which had been restricted to 9 core industries in the licensing policy statement of February, 1970, came to the 12 listed industries.

9.4 THE INDUSTRIAL POLICY 1977

The Policy remained in force for a period of two years and had little impact on the industrial policy scene. A critical look at it is useful to assess if it provided any solution for the country's maladies.

(1) Emphasis on Small Industrial Units: The emphasis of the new policy was on the small industrial units. It said, whatever can be produced by small and cottage industries must be produced by them. This emphasis was meant to bring more employment and dispersal of industries in rural areas and small towns. It believed that small was beautiful. Several measures for production of small units were taken, Industrial centres were to be set up in districts to provide all the requirements of those industries. Special arrangements were to be made for marketing the products of small units.

(11) Restricted Areas for Large Scale Industries: The areas specified for the large-scale industries came to be restricted on the basis of the development of small scale and cottage industries. The capital goods industries were to be meant for providing machinery to basic industries and to the small scale and the cottage industries. The high' technology industries producing on large scale were

to be those related to the development of agriculture and small-scale industries, such as fertilizers, pesticides, petrochemicals, etc. All these industries which were not connected with the agriculture and small-scale industries, constituted a separate category. This was a ceiling on the large-scale industries producing items reserved for the small-scale sector.

(iii) Change in Licensing Policy: To secure industrial dispersal over area it was envisaged that no more license was to be issued for new units within certain limits to large metropolitan cities having a population of more than one million and urban areas with a population of more than 5 lakhs as per the 1971 census. Support was to be defied to industries not requiring license for their establishment. Assistance was to be provided to small scale industries wishing to invest in backward areas.

(iv) Implementation of MRTP Act: To reduce economic inequalities the Monopolies and Restrictive Trade Practices Act, 1969 was to be effectively implemented. The expansion of existing undertakings into new lines was not to be usually permitted. The public financial institutions were not to provide funds for the expansion of old and the establishment of new ones wherever the financial institutions were to ensure that management was increasingly professionalised and confirmed to national priorities.

(v) Expansion rate of Public Sector: An expanding role was assigned to the public sector. In addition to producing important and strategic goods it was to be used as an establishing force for maintaining essential supplies for the consumers. It was also given the responsibilities of encouraging wide range of ancillary industries and small scale and cottage industries by making available to them to its expert knowledge of technology and management. A professional cadre of dynamic and efficient managers was to be built up to run these enterprises. Public sector undertakings were to work on lines in order to earn adequate returns on their investments,

(vi) Implementation of FERA: In case of private enterprises, a reasonable dividend was to be made available to share-holders by regulating product prices. They were also to be used for further development of industries. Sophisticated foreign technology, based industries, and promoting, optimum inter-sectional relationship.

(vi) Faster promotion of export-oriented and import substitution industries;however, was not particular where Indian technology was not adequately developed. Leaving those foreign concerns which were hundred percent export oriented, the foreign shareholding was to be restricted to 40 percent as laid down in the Foreign Regulation Act. Approved foreign investment, i.e., those allowed in national interest, were to be free in respect of remittance of profits, royalties and also repatriation of capital.

(vi) EXIM Policy: The policy viewed foreign trade as part of its objectives of self-reliance. Export was to be expanded through export-oriented manufacturing capacity. Exemption from such activities led to addition of substantial net-value and large employment. In view of large foreign exchange holdings, there was to be considerable relaxation and even removal of such restrictions as import quotas.

Evaluation

For a few significant departures, the policy was more or less a continuation of the old Industrial policy, The objective of the new policy was practically the same as enumerated in the earlier policies. When the large industrial capacities created as the result of earlier policies, it emphasized much more the objectives of creating more employment and eradication of poverty. Major aims such as the curbing the monopoly and restriction on economic concentration self-reliance, etc., were similar in both.

The new policy approved the continuation of means already conceived and put into operation by the earlier policies. There were, of course, certain reservations arising from the reservation of items for small sector, extended role of public sector, extension of foreign holding in the foreign companies, liberalisation of imports etc.

There was a big departure in respect of small sector. It was to peruse something general to expect that the large scale and the public sector would exist for the promotion and service of the small sector.

Nothing much could be said in favour of the tools provided for the implementation of the policy objectives. It laid down in the text book style that the restrictions and "irritants* in the industrial procedures should be removed. It talked in terms of automatic platitudes about controlled prices adequate returns to investors, dividend to share-holders, plough back, dispensing with quantitative the restriction and retaining of tariff rehabilitation of sick units on the basis of cost benefit accounting etc. It ignored the fact that the competition between large and small-scale industries generated in the atmosphere of free economy and the disparities in the income pattern might not let the desired industrial structure to come in the existence. The pronouncements in favour of small sector were likely to remind as much unfulfilled in the past. The innovation of the district industrial centre might have proved that the existing official wearing different hats and the old offices refurnished with repainted signboards.

There was no appreciation by the policy makers that the existing administration, management and organization was too inefficient to implement the programme of development. All the defects which plagued the success of programmes of industrialisation in the past were being washed away without any correction being applied.

9.5 THE INDUSTRIAL POLICY OF 1980

The statement on industrial policy made in Lok Sabha on July 23, 1980 recognised that 1956 resolution formed its basis. It sought to pressure the following socio-economic objectives:

(i) Optimum utilisation of the installed capacity;

(ii) Maximising production and achieving higher productivity;

(iii) Higher employment generation;

(iv) Correction of regional imbalances through preferential development of industrially backward areas;

(v) Strengthening the agriculture base by according a professional treatment to agro-based industries, and promoting, optimum inter-sectional relationship.

(vi) Faster promotion of export-oriented and import substitution industries;

(vii) Promoting economic federalism with an equal spread of investments and dispersal of returns amongst widely spread small and growing units, in rural as well as in urban areas;

(viii) Consumer protection against high prices and bad quality; and

(ix) Rehabilitation of faith in the public sector and evolving effective system of management.

The statement recognised that private sector undertakings would be allowed to develop in consonance with targets and objectives of national plans and policies. But monopolistic tendencies and concentration of economic power in a few hands would not be permitted.

The statement proposed to promote economic federalism by setting up a few nucleus plants in each industrially backward district or generate as many ancillaries and small and cottage units as possible. The nucleus would assemble the produce of ancillary units. The nucleus would assemble the produce of ancillary units and also make marketing arrangements for the output. It would also help to upgrade technology of small units.

To ensure the rapid growth of small-scale industries, the limit of investment in case of tiny units was raised from Rs. 1 lakh to Rs. 2 lakhs, small units from Rs, 10 lakhs to 20 lakhs. The Government proposed to strengthen the existing arrangement and make necessary changes to facilitate the availability of credit to the growing small-scale units to help them, it was also intended to build up

better stock of essential materials which were not easy to obtain. In the interest on their growth, reservation of items for this sector would continue.

The generation of higher employment and higher per capita income, village industries like khadi and handloom, weaving received greater attention. The regional imbalances would be corrected by encouraging dispersal of industries and setting up units in the industrially backward areas. Special concessions assessment to the incentives provided in order to find out the extent to which they were effective.

The statement was of the opinion that as a result of increased labour productivity on technological improvements, productive capacities in certain industrial units might have increased. The Government had come to the conclusion that it would not be fair to stand in the way of the maximisation of production, it would, therefore, recognise such capacities on a 'selective basis".

The facility of automatic expansion up to 25 percent in five years had been permitted to 15 industries 411975. This was in addition to the normal permissible addition to production by 25 percent of the approved capacity. The facility would not be extended to other industries in Appendix I to the Development and Regulation Act, 1951.

Government would also consider requests for setting up to 100 percent oriented units, expansion of existing units, exclusively for the purpose of export and export for allowing higher production to exploiting fully the emerging export opportunities. Government could also consider favourably the introduction of advanced technology and would permit creation of capacity large enough to make competitive in the world markets. This would not only encourage exports but also enable industries to produce better quality product for the benefits of the consumers in terms of price and quality.

The industry and energy policies would be dove-tailed. Soft loans would be given for special assistance to enable units to control pollution. Government was also committed to preserve ecological balance and for improving condition in the urban centres.

The licensing producers would be streamlined. A comprehensive system of monitoring the implementation of schemes would be evolved. A data-bank in all major investment proposals, etc., would be introduced to serve an early warning system for identifying symptoms of industrial sickness. Sick units would be encouraged to merge with efficient ones.

As regards industrial relation the tripartite labour conference could be revived. It would be possible through constructive cooperation to establish higher standards of productivity and industrial harmony. The Government would also start a dialogue with the industry to ensure a rationalisation of price for the benefit of the consumers.

The district Industries Centres which had figured prominently in the policy of 1977 were to be scrapped as they had not produced benefits commensurate with the expenditure incurred.

The policy was hailed by business and industry for removing constraints on industrial undertaking. But it is rather said that it is silent about the level of living standards of the people. It does not say that the first change on industrial output would be the need of the citizens of the country. Basic industries are bound to remain in short supply.

9.5.1 SELF-CHECK EXERCISE-I

Q.1. What are the socio-economic objectives of the Industrial Policy 1980?

Q.2. Describe the impact of the Industrial Policy 1977 on the Industrial Policy scene.

9.5.2 SELF-CHECK EXERCISE-H

Q. 3. What is New Industrial Policy? What were its objectives?

Q. 4. What are the main provisions of the Industrial Policy 1991?

9.6 NEW INDUSTRIAL POLICY (1991) OR RECENT CHANGES IN INDUSTRIAL POLICY

Recent changes in industrial policy are in continuation of the changes introduced in 1980 and 1985-86. But quantum of changes makes them qualitatively different in nature. The changes announced on 24th July, 1991 are titled as New Industrial Policy. Objectives of this policy have been to correct the distortion on weakness in the industrial structure and maintain a sustained growth in productivity, gainful employment and attain international competitiveness.

The main objectives of the policy are as given below:

OBJECTIVES

(i) The main objective of the new Industrial Policy is to unshackle the Indian Economy from the Cobwebs of unnecessary bureaucratic controls.

(ii) To build on the gains already experienced and to correct the distortions on weaknesses involved in the system.

(iii) To introduce liberalisation with a view to integrate the Indian Economy with the world economy so that India grows as part of the world economy and not in isolation.

(iv) To abolish restrictions in direct foreign investment.

(v) To free the domestic entrepreneurs from the restrictions of the MRTP Act.

(vi) To maintain a sustained growth in productivity and employment.

(vii) To achieve international competitiveness.

(viii) To make provision for reducing the load of public sector enterprises showing either low rate of return or incurring losses over the year.

(ix) To utilise fully the indigenous capabilities of entrepreneurs.

(x) To foster Research and Development efforts for the development of indigenous technologies,

(xi) To assign the right areas for the public sector undertakings.

(xii) To ensure welfare of the workers and also to provide skills and facilities to the workers to enable them to deal with the inevitabilities of technological changes,

(xiii) As far the external sector while the policy continues to pursue the goal of self -reliance, it places greater emphasis on building up of our ability to pay for our import through our own foreign exchange earnings.

For this the policy of liberalisation both at domestic as well as foreign level has been carried to logical conclusion. The package of changes has been announced in two phases. In the first phase large industrial sector was covered. For small sector changes were introduced in the second phase in August, 1991. Therefore, policy changes are divided into two parts in our discussion:

1. Policy changes in large industrial sector, and
2. Policy changes in small industrial sector.

9.6.1 Policy Changes in Large Sector

Changes in policy in this sector have been announced under the following heads:

A. Industrial Incensing;

B. Foreign Investment;

C. Foreign Technology Agreements;

D. Public Sector Policy; and

E. M.R.T.P. Act.

1. Industrial Licensing Policy: Licensing has been abolished with all the industries except 17 which include coal, sugar, motor cars, cigarettes, hazardous chemicals, drugs, and pharmaceuticals; entertainment, electronics, white goods (refrigerators, domestic washing machines, air conditioners etc., industrial explosive petroleum and products, distillation of alcoholic drinks, animal fats and oils, asbestos, plywood and decorative material, raw hides and skins and paper newsprints except, bagasse based units. The compulsory licensing provisions would not apply in respect of small-scale units taking up the manufacture of any of the above items reserved for exclusive manufacture in the small-scale sector. These specified industries will be subject to compulsory licensing for reasons related to security and strategic concerns, social reasons, problems related to safety and environment issue and manufacture of hazardous nature of products and articles to elitist concern. Government considers that exemption from the licensing will encourage small and medium range entrepreneurs who had been unnecessarily hampered by the licensing system. This is supposed to benefit the entire economy by making it more competitive, efficient and modern.

2. Foreign Investment: The relationship between domestic and foreign industry is being made more dynamic than in the past in terms of both technology and investment. Foreign investment is being welcomed for country's industrial development. In high priority industries, it has been decided to provide approval for direct foreign investment up to 51 percent foreign equity. There shall be no bottlenecks of any kind in this process. 34 industries have been listed in this category. They are metallurgical industries, boilers and steam generating plants, prime movers (other than electrical generators) electrical equipment, electronic equipment. Transportation, Industrial Machinery, Agriculture Machinery, Earth Moving Machinery, Industrial Instruments, Scientific Instruments and Laboratory Equipment, Nitrogenous and phosphatic fertilizers, Chemicals (other than fertilizers) and chemicals for industrial use. Drugs and Pharmaceuticals, Plate Glass, Ceramics, Cement Products, Carbon and carbon products, pretensioned High pressure RCC pipes, Rubber machinery, Printing Machinery, Welding Electricals, Industrial Synthetic Diamonds, photosynthesis, etc. Extraction and upgrading of Minor oils prefabricated Building Material, Soya products, High-yielding and synthetic seeds. Food processing industries and Hotels and Tourism related industry. Clearance will be available if foreign equity covers the foreign exchange requirements for imported capital goods. The payment of dividends is to be monitored through TBI so as to ensure that outflows on account of dividend payments are balanced by export earning over a period of time. Foreign equity proposals including proposals involving 51 percent foreign equity in non-priority areas will continue prior clearance majority. Foreign holding up to 51 percent equity is also permitted for trading companies primarily engaged in export activities and they will be treated at par with domestic trading and export houses in accordance with the import export policy. NRIs were permitted for 100 percent equity,

A special Empower Board is entrusted with the task of negotiations with a number of Large international firms and approve foreign investment in selected areas.

3. Foreign Technology Agreements: For import of foreign technology, following steps have been decided

(i) Automatic permission will be given for foreign agreements in high priority industries up to lump sum payment of Re. 1 crore, 5 percent royalty for domestic sale and 8 percent exports subject to total payments of 8 percent sales over a 10 years period from the date of agreement of 7 years from commencement of production. The prescribed royalty areas are not of taxes and are to be calculated according to standard procedures.

(ii) Non-high priority industries also will be followed above guidelines.

(iii) All other proposals will need specified approval; and

(iv) No permission will be necessary for hiring of foreign testing of indigenously developed techniques. Payment will be made from blanket permits of free foreign exchange according to RBI guidelines.

4. Public Sector Industries reserved earlier for exclusive development by public sector have been restricted to 6. They are arms and ammunition, and allied items of defence, atomic energy, coal and ignite, mineral oils, mining of iron ore technology, manganese, chroms or gypsum, sulphur, gold and diamond, mining of copper, lead, zinc, tin, molybdenum and wolfarm, mineral specified in the schedule to the Atomic Energy, and Railway transport. The reservation has been given to public sector but there would be no bar for areas exclusively to be opened up to private sector selectively. Similarly, public sector will be allowed entry in areas not reserved for it, Chronically, sick units in public sector will be referred to the Board for Industrial and Financial Reconstruction (BIFR) or other similar high-level institutions created for the purpose. A social security mechanism will be created to protect the interest of the worker likely to be affected by such rehabilitation packages including closures.

Board of Public Sector companies would be made more professional. Management will be given greater autonomy and will be held accountable for performances.

5. M.R.T.P. Act: The threshold limits of asset in respect of M.R.T.P. companies and dominant undertakings have been done away with. This eliminates the requirements of period, approval of Central Government for establishment of new undertakings, expansion, merger, amalgamation and takeover, the appointment of Directors under certain circumstances.

M.R.T.P. commissions will concentrate on controlling and regulating monopolistic, restrictive and unfair trade practices and is authorized to initiate investigation on complaints received from individual consumer in these matters. To enable the MRTP Commission to exercise punitive and compensatory powers necessary amendment in the Act has been decided.

9.6.2 POLICY CHANGES FOR SMALL SECTOR

The primary objective of small-scale industrial policy during the decade of nineties would be to impart more vitality and growth impetus to the sector to contribute in terms of growth of output, employment and exports of the country. To remove all letters on its growth potential following policy initiatives are taken

1. Investment Limit

Investment limit in plant and machinery of small-scale industries, ancillary have been kept at Rs. 3 lakhs and 6 lakhs respectively. Such limits in respect of the enterprises have been increased from Rs. 2 lakhs to Rs. 5 lakhs irrespective of location of the units. All industries related to service and business enterprises irrespective of their location as recognised as small scale industries and their investment ceiling would correspond to those of tiny enterprises,

2. Financial Support

While the small sector scale other than tiny enterprises would be entitled to one benefit like preference in allocation, power connection access to facilities for skill technology upgradation, the tiny sector will be eligible for additional support on continuing basis including easier access to institutional finance priority on government purchase programme and relaxation from certain provisions of labour laws.

It has been decided to widen the scope of the National Equity Fund Scheme, to cover projects up to Rs, 20 lakhs with working capital margin up to Rs. 10 lakhs. Facilities available through State Financial Corporation (SPCs) and State Small Industries Development Corporation (SSICs) would also be channelised through commercial banks. A special monitoring agency would be set up to oversee the genuine credit.

Other industrial undertakings have been allowed equity participation in small scale up to 24 percent of the total shareholding. This is supposed to encourage ancilliarisation and sub-contracting. A suitable legislation is also being passed to ensure prompt payment of small industries bills.

3. Infrastructural Facilities

A new scheme of integrated infrastructural development (including Technological Back up Services) for small scale industries is being implemented with active participation of State Government and financial institutions.

This includes setting up of Technology Development Cell (TDC) in small industries Development Organisation, TDC would co-ordinate with tool rooms and process-cum-product Development Centres. These measures will help in technology modernisation and make available the needed raw materials.

4. Marketing and Exports

Marketing products of the small industries will be promoted through National Small Scale Industries Development Organization (SIDO), producers of ancillarisation and sub-contracting of small units while the large enterprises in public sector will be encouraged.

SIDO has been recognised as nodal agency to support the small-scale industries in export promotion. An Export Development Centre is being set up in SIDO to help the sector in this matter through a network of field offices.

5. Other Measures

Several other measures have been announced for promoting small scale industries. This includes measures to promote entrepreneurs, simplification of rules and procedures and special provisions of resources, materials and facilities for village industries, particularly handloom sector, handicrafts sector and other industries.

The policy changes announced for small sector intend to create greater integration of small sector with the large industrial sector. It is entrusted with the task of creation of large employment and help the country in earning of large amount of foreign exchange. The changes announced are also in consonance with the policy measures of large sector in terms of greater liberalisation of the economy and promotion of competition in the country.

9.6.3 CRITICAL EVALUATION OF THE POLICY

The recent policy changes are motivated to productivity improvements through greater privatization, decontrol, liberation and greater competition both at national as well as international level, The greater efficiency in resource use and the technological upgrading is expected to boost the rate of growth of industrial sector of economy. The objective of growth is given preferences over other objectives of the policy in India. The critics of the policy changes point the following difficulties which need serious consideration.

The main plus points of the policy are as follows:

1. The changes which are introduced by the new industrial policy will make our industries competitive both internally as well as in the international markets.

2. By abolishing the industrial licensing, this policy has fulfilled the Icing felt demand of the industry. The abolition of all registration schemes will free the entrepreneurs from making endless trips to New Delhi, for seeking permission from the bureaucracy of the country. The industrialists can now concentrate on their business and move quickly to seize the new business opportunities.

3. The scrapping of the MRTP limits by the Government will enable the MRTP companies to establish new undertakings and effect plans of expansion, mergers, amalgamations and takeovers

without prior government approval. They shall also have the right to the appointment of their directors. These provisions have ben heartily welcomed by the business circles.

4. Reforms relating to public sector like privatisation and transferring chronically sick units to the BIFR will improve the performance of the public sector undertakings. Moreover, the disinvestment of public holdings of the some of the public enterprises would subject these enterprises to the discipline of market forces.

5. The new industrial policy aims at integrating the domestic economy with the world economy. The provisions relating to direct foreign investment, permitting 51% equity participation in a wide range of industries, the easier facilitation of foreign technology agreements and other related measures go a long way in attracting foreign investment and technology. This is in total contrast to the previous controls and to some extent a closed economy.

6. To thrust of the new industrial policy is to step up the growth rate of industrial production through an efficient use of resources. The policy will also enlarge the quantity of resources. The industrial production will be accelerated as the project time and projected cost of production will reduce. Foreign capital, technology and managerial expertise from abroad will improve the efficiency of production.

To summarise, we can say that the new industrial policy is truly historic. It was high time for the Indian Economy to open up and to integrate with the World Economy and to modernise,

Criticism: Some Economist have strongly criticised this policy on some grounds, which need attention.

(a} Social Justice

Removal of MRTP limits for large monopoly houses, open invitation of MNCS, abolition of licensing for large number of industries and move to privatization of public sector enterprises are steps which ensure greater expansion of assets and income of monopoly house in the country. This will add further to meet the needs of the upper sections of the society. The commodities of mass consumption which are consumed by the poor will be ignored. The complete neglect of objectives of social justice will have serious long social implications which a country cannot afford to ignore.

(b) Self-Reliance

The main thrust of the recent policy is to integrate the industrial sector of the country with the global economy. Interestingly this sector will produce for foreign market, and will invite more foreign firms and their capital and technology leading to increased dependence on foreign sources both for market as well as for capital and technology. This will undermine our long-cherished objective of self-reliance on one hand and add to Indian's already deteriorating balance of payment problem,

(c) Employment

India is suffering from a serious unemployment problem. This is contributed by a Strong demographic pressure on one hand and slow expanding employment on the other hand. In the decade of 1980s, the large private sector in the country did not contribute any additional employment. Whatever little additional employment has been created it has been by public sector enterprises and the small-scale sector. Both these sectors will suffer due to recent policy changes and large private (both Indian and Foreign) sector will gain in terms of resources and output. This will badly affect the process of creation of the additional employment. Consequently, the problem of unemployment will become more serious. The first victims of unemployment are women and children from the very poor families,

(d) No Exit Provision

One very serious setback of this policy was that there is no exit policy for the entrepreneurs of old, weak and sick units. These provisions are important because with the entry of large new industries, go into losses will be under great pressure and strain.

(f) Labour Problems

Labour will be the most adversely affected party in case of closure of a business. This requires that provisions should be made to compensate with them, and for to train and help them to get jobs elsewhere, but it was ignored in the policy,

(f) Little Role of Research and Development

This policy has not paid much attention to the role of research and development in making the industry innovative in respect of resource use, processes and products and their marketing. Two key factors in this area which have been left out are:

(1) The size of resources and sources from which these activities are to be financed, and

(2) The question of the intellectual property rights.

These factors are of utmost importance if programs in Science and Technology is to be promoted. Thus, the thrust of the new industrial policy is to promote the rate of industrial development and ignore the objectives of economic policy in the country.

9.7 SUMMARY

The concept of 'Industrial Policy is comprehensive and it covers all those procedures, principles, policies, rules and regulations which control the industrial undertakings of a country and shape the pattern of industrialisation. By concluding this lesson, we can say that while the new industrial policy is good some very important ways, it needs to be modified in several aspect so that it attends to the various problems that have been left out or have not been properly, dealt with. This step will complete the package for a fast and healthy industrial development.

9.8 ANSWER TO SELF-CHECK EXERCISE

Exercise-I

Ans.1 Socio-Economic Objectives of Industrial Policy 1980:

1. Optimum Utilisation of Installed Capacity.
2. Maximum Production.
3. Employment Generation
4. Reduction in Regional Imbalance.
5. Strengthening the Agriculture.
6. Faster Promotion of Export Industries.
7. Faster Promotion of Import Substitution Industries.
8. Promoting Economic Federalism.
9. Consumer Protection.
10. Development of Public Sector.

Ans.2 Impact of Industrial Policy 1977:

The impact of Industrial Policy 1977 can be studied by considering under mentioned steps:

1. Emphasis on Small Industrial Units.
2. Restricted Areas for Large Scale Units,
3. Changes in Licensing Policy.

4. Implementation of MRTP Act.

5. Role of Public Sector.

6. Implementation of FERA.

7. EXIM Policy.

Exercise-II

Ans.3 New Industrial Policy: The new Industrial Policy has been in operation since July 24, 1991. Some amendments have been made in this policy since then. This policy is a big departure from the old policy, as it is in use with the liberalisation move introduced during the eighties. This policy has radically liberalised the industrial policy itself.

Objectives of New Industrial Policy

Please refer information given in point no. 6.6 of the lesson.

Ans. 4 Main Provisions of the Industrial Policy 1991:

(A) Policy Changes in Large Industrial Sector:

1. Industrial Licensing.
2. Foreign Investment.
3. Foreign Technology Agreements.
4. Public Sector Policy.
5. MRTP Act.

(B) Policy Changes for Small Sector:

1. Investment Limit.
2. Financial Support,
3. Infrastructural Facilities.
4. Marketing and Exports etc.

9.9 FILL IN THE BLANKS

1. Under Industrial Policy of ____________________ a separate wing of IDBI was established to feed the credit requirements of small-scale industries.

2. Stocks of all the blue-chip companies are listed and traded in ____________________.

9.10 SHORT QUESTIONS

1. Give important features of Industrial Policy 1973.

2. What do you mean by new classification of industries?

3. Critically analyse the MRTP Act.

4. What do you mean by Industrial Policy Resolution?

9.11 LONG QUESTIONS

1. "Liberalisation has proved to be a big boon for the service sector". Discuss.

2. "The role of industrial policy is more important in a planned economy like India." Discuss.

3. How far the Government has been able to achieve these objectives?

4. Critically analyse the Industrial Policy of 1948. Do you think soon after independence,government did a good job by framing an industrial policy like that?

9.12 KEY WORDS

1. IPR — Industrial Policy Resolution.
2. MRTP Act — Monopolies and Restrictive Trade Practices Act.
3. BIFR — Board of Industrial and Financial Reconstruction.
4. SFL's — State Financial Corporations.
5. SSIL's — State Small Industries Development Corporations.
6. TDC — Technology Development Cell.

9.13 SUGGESTED READINGS

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2. Business Environment By K. Asawthapa.
3. Business Environment (Text and Cases) By Francis Cherumilam, Himalaya Publishing House.

MONETARY POLICY STRUCTURE

10.1 Objectives

10.2 Introduction

10.3 Meaning of Monetary Policy

10.4 Nature of Monetary Policy

10.5 Objectives of Monetary Policy

  10.5.1 Exchange Stability

  10.5.2 Full Employment

  10.5.3 Increase Liquidity

  10.5.4 Controlled Expansion

10.6 Instrument of Monetary

  10.6.1 Self-Check Exercise

10.7 Quantitative Techniques

  10.7.1 Bank Rate

  10.7.2 Open Market Operations

  10.7.3 Variable Reserve Requirements

10.8 Qualitative/Selective Techniques

  10.8.1 Moral Persuasion

  10.8.2 Rationing of Credit

  10.8.3 Regulation of Consumer Credit

10.9 Answer to Self-Check Exercise

10.10 Short Questions

10.11 Long Questions

10.12 Key Words

10.13 Suggested Reading

10.1 OBJECTIVES

The objective of this lesson is to provide the knowledge of Monetary Policy. After studying this lesson student will understand (1) the monetary system of the country, (2) how the central bank (3) how the RBI works and controls the money through this monetary policy.

10.2 INTRODUCTION

There is probably no field of economics in which the writings of economists have so strongly influenced both current thought and current problems of economic policy as the field of monetary

policy. In the post-war periods, economists generally regarded monetary expansion as a measure to stop depression. But whether control of money supply is an effective weapon to control inflation or not was not very clear. Some economists took the extreme view and thought monetary restraint to be completely ineffective. But it was generally thought that the war time Legacy of a large and widely held public debt was a major obstacle to the application of monetary restraint.

The post Korean war inflation forced the termination of bond- support programme and there after monetary policy became the chief instrument of controlling short-run fluctuations. The availability doctrine of monetary policy has left its mark on the field in as much as the majority of monetary economists would probably explain how monetary policy influences the economy by reference to its effect on the availability and cost of credit.

This idea was cherished in the pre-Key7esian period also, when monetary policy was the single established instrument of aggresgative economic policy, and price stability was its established objective. Keynesian economics brought in its wake the idea of fiscal operations and the objective of economic stability and maintaining full employment.

Role of money supply was viewed differently by different schools of thought. The classical economists were of the view that its effect was only to cause an equi-proportional change in prices. Money was thus a passive factor in the basic functioning of economic system. Its effect was felt on prices alone and this was the chief reason why it was regarded important.

Such a belief in the classical dichotomy could not be dispelled even by subsequent development in the classical monetary theory. The credit for bringing money as a factor in economic analysis really belongs to Keynes. As professor H.G. Johnson has observed "the fundamental contention of Keynesian monetary theory is that a monetary economy is essentially different from barter economy- that money is not merely a veil but exercise an influence of its won in the working of the economy." Keynes showed how money supply affected interest rate through liquidity preference and how interest rate in turn affected investment and economic activity.

10.3 MEANING OF MONETARY POLICY

Monetary policy refers to the steps taken by the Reserve Bank of India to regulate the cost and supply of money and credit in order to achieve the socio-economic objectives of the economy. One of the most important function of Reserve Bank is to formulate and administer a monetary policy. Monetary policy is discretionary act undertaken by the authorities designed to influence

(a) supply of money

(b) Cost of money

(c) availability of money

10.4 NATURE OF MONETARY POLICY

Monetary policy is as old as monetary system and money itself. There are evidences which suggest that even in ancient period Monetary management was known in Greece. The prince who minted the first coin was a monetary reformer and the princes who debased their coins to finance deficit were also monetary reformers. Managed currency was not entirely unknown to the ancient Egyptians. Greeks and Chinese who shifted to and from the shrines of their temples in order to counteract movements in the price level. But before 1914 the whole thinking about monetary policy was based upon the idea of automatic gold exchange system.

During the World War (1914-1919) this notion was almost shattered and monetary policy assumed new dimensions. In the modern sense monetary policy aims at systematic regulation of the volume of money (currency as well as credit) with a definite objective in view. Monetary policy should be able to work both ways - forward as well as backward, irrespective of the objectives of monetary policy it has attained a definite dimension in which it works the objectives of monetary policy generally revolve around expansion or contraction of credit. It implies a positive endeavour to regulate the

volume and value of currency and credit in a way that is considered to be in accordance with the interest of the increase of the welfare of the community, independently of the technical international considerations which has been in the past regarded as being of paramount importance.

The genesis of monetary policy took place after the world war I when the gold exchange standard showed a breakdown. Inflation in Germany and two conferences in 1920 in Brussels and in 1922 In Geneva compelled the Statesmen in the world to think about a new monetary system which was bound to affect the monetary policy in every country. Before that has already been stated automatedly of gold exchange system was cherished because of which the idea of central banking was nebulous. In due course, the return of Great Britain to the gold standard was hailed as giving a lead in the great work of monetary reconstruction. But this was only the beginning of a herculean task. At the time scarcely anyone considered that the price level could or ought to be the care and pre occupation, for less a main objective of policy of a central Bank. Increasing unemployment was a reminder of the world that the monetary problem that of providing and working through satisfactory currency and credit mechanism cannot be solved easily and finally before a distant future. The depression of the thirties provided future stimulus to the thinking of reforms in the field of monetary management.

In the recent pa.st, the horizons of monetary policy have further been widened greatly. The central Bank of a country has to decide whether to maintain or to change the term on which it is prepared to grant credit; exchange control authorities have to take action day by day and hour by hour. Banking leaders and treasury officials have to be in constant touch with each other to consider the questions that arise daily.

To define monetary policy in specific terms, it is control of availability, cost and the use of money and credit. The traditional agent of monetary policy is the central bank, which works through the monetary system. More or less, it deals with the monetary system of a country. It may have been defined in different words by different monetary economists, all of them testify its concern with the measures, and decisions of monetary nature.

Monetary policy can be defined from another point of view also. All monetary decisions and measures irrespective of whether their aims are monetary or non-monetary and all nonmonetary decisions and measures that aim at effecting the monetary system, constitute monetary policy. In this category will be included the steps taken for influencing the value and volume of money and the monetary measure which pursue non-monetary economic, social or political aims. Monetary measures like debasements inflation, deflation and devaluation etc. and non-monetary measure like price and wage controls, physical controls budgetary devices, export drives, import cuts, quota system etc. will all come under monetary policy because they aim to influence the monetary situation in a country.

It is imperative to distinguish clearly between various allied policies. Monetary policy is a close ally of fiscal policy and banking policy. The relationship between these is so close that often monetary policy and banking policy are taken as one, whereas fiscal policy is considered as an end of means of monetary policy. They may be complementary and sometimes it may be difficult to draw a lien in between, still they are different.

Fiscal policy mainly refers to measure taken through the mechanism of budget. It deals with the revenue, expenditure, borrowing, debts redemption etc. the operations of these items as well as the relationship among titles, form the core of fiscal policy. But fiscal policy cannot be segregated from the monetary policy altogether. Meeting the expenditure by deficit will increase the prices. Taxation certainly affects the general level of prices. Conversion operations definitely affect the power of the banks to create and credit the amount of bank credit.

The difference between monetary and banking policy lies in the fact that banking policy is a part of monetary policy. Change in banking policy sometimes does not change monetary policy. For instance, the decision of selective credit control would change the banking policy, but there might be no overall change in the monetary policy, as the bank credit through selective credit control policy of the central Bank of a country may not effect' the total volume of credit appreciably but it may affect credit distribution among different categories of borrowers. Similarly, the policy with regard to new public

issues of securities may produce monetary effects if it aims at influencing the total volume of capital investment. This will not fall in the category of monetary policy on the other hand, it merely aims at discouraging types of issues and seeks to prevent unwanted expansion in some industries an encourage expansion in other industries, it will amount to monetary measure.

10.5 OBJECTIVE OF MONETARY POLICY

Monetary policy of a country is an important aspect of its overall economic policy. If it helps a healthy growth of the economy of the country, by adjusting money supply to the needs of growth, by directing the flow of funds in the required channels and by providing institutional facilities for credit in some specific fields of the economy.

The traditional agent of monetary policy is the Central Bank, which works through the monetary system with the help of commercial banks and other credit institutions. Monetary policy is so closely related to fiscal policy that sometimes these are jumped together as national financial policy. In the boarder sense, monetary, fiscal policy and debt management cannot be thought of operating separately, but in conjunction with each other. Monetary policy, fiscal policy and debt management cannot be divided into watertight compartments. To fence out the Treasury would be to frence in the central bank and to stifle the effectiveness of both. However, in the narrow sense, monetary policy is identified with all the credit control measure of the Central Bank.

Monetary policy consists of the measure taken by the Central Bank to regulate credit. It operates through five interrelated factors; the availability of credit, the volume of money, the cost of borrowing the prices of capital assets, and the liquidity of the economy. The primary task of the monetary policy is the mobilisation of resources to the proper channels.

The identification of the objective of monetary policy became our first task if we want to analyse the appropriate monetary policy. The objective of monetary policy differ with the economic conditions of the country, still there is a spectrum of objectives that a country can adopt. Since monetary policy is a means to an end and in itself, it is expected to achieve certain objectives determined by the monetary authority and/or the state. Its objectives, must be regarded as being part of overall economic objectives to the extent that monetary policy is concerned with subsidiary objectives of its own, these latter must assist in attaining the basic objectives of economic policy.

The objectives of monetary policy have been changing from time to time. The instruments available to the central banks also differ from country to country. Even for the same country, the objectives differ at different times. Monetary policy in the narrow sense has signified one thing at one time and another at other time. Its objectives change with the changes in the conditions of the economy. Empirically also this type of generalisation can be tested. Still monetary policy has been directed to achieve a few traditional and set objectives.

10.5.1. Exchange Stability

Under gold standard maintenance of exchange stability was the most important objective of monetary policy. Because the monetary system was an automatic system, the central bank was practically passive. The supply of money was regulated by the automatic inflow and outflow of gold. At that time scarcely anyone, considered that price level would ought to be the care and pre-occupation for less a main objective of policy of a central bank.

After the end of first world war with the decline of gold standard, central bank was expected to exercise a discretionary influence on monetary system. The international monetary instability the growth of nationalistic feeling, the rigidities in economic structure and the appearance of a huge volume of hot money sounded the knell of the gold standard. In the words of sayers, the Inter-war period ca., perhaps be called the heyday of Central Banking. There was a deal of discussion about the objectives of monetary policy in the changed circumstances. Mac Millan Committee (1929-31) spoke of the Central Bank as being called upon to look after the maintenance of the parity of the foreign exchange without unnecessary disturbance to domestic business, the avoidance of the credit cycle and

the stability of price level. In the changed circumstances, the regulatory functions of central banking were emphasised.

10.5.2. Full Employment

With the emergence of Keynesian Revolution, maintenance of full employment became the objective of monetary policy. With the advent of great depression in 1929, resulting in mounting unemployment, the role of monetary policy to stimulate total demand and thereby help maintenance of a high level of income was emphasised.

10.5.3. Increase Liquidity

This was sought to be achieved by making available enough credit at a low cost. Thus, cheap money was adopted. But experience and the lesson of "General Theory" made the people believe that monetary policy was completely ineffective. It is easy to discourage investment by raising interest rate, but we are not sure that lowering the interest rate would increase investment. Moreover, cheap money policy was indispensable to loan financed compensatory spending. The scope of effective anti-depression monetary policy is clear from the fact that even of credit policy is incapable by itself turning the tide of depression it can increase over all liquidity via open market operations and other conventional methods thereby creating the monetary atmosphere necessary for the successful operation of more effective measures of fiscal and other policies.

10.5.4. Controlled Expansion

After the second world war, the inflationary trends in the world again revived the interest in monetary policy, especially in the interest rate mechanism. Dear money policy as a measure of controlling inflation caught the attention of the policy framers. the political feasibility of effective fiscal policy in the form of tax increase and reduction in expenditure was doubtful. Central Bank credit control measures seem to be more effective in controlling credit expansion. An additional reason was the relative freedom of the central Bank to operate unpopular anti-inflationary monetary measures.

The latest of the objectives of the monetary policy attains a different shape as compared to the conditions explained above. Redcliffe Committee, which examined the working of the monetary policy, makes a list of set of objectives to be followed by the monetary authorities. They include the attainment of full employment stability in the internal value of money, steady economic growth, some contribution to the economic development of other countries and strengthening of international reserves.

In this constellation of objectives, there are possibilities of conflict among these five objectives. Stability of internal value of money, remains the major objective. The government independent of the economic situation in the country cannot decide at its own, objective is the foremost. It depends upon the importance of each of these objectives.

To choose anyone of these objectives is not a problem, but it is very difficult to bring out coordination and consistency in amount for different objectives. In addition to traditional objectives, economic growth has become an important objective of monetary policy. In a developing country, economic development with an equitable distribution of income became a central objective of monetary policy. In the administration of development objective, a number of difficulties may arise. Economic development is a moving target, it is indefinite. It is possible to predict the projected rate of growth but to find out the ideal rate of growth is a problem,

10.6 INSTRUMENTS OF MONETARY POLICY

Having set out the general framework for the operation of the monetary policy, we can examine the instruments of monetary policy. In fact, the effectiveness of monetary policy depends upon the instruments of credit control. The technique of monetary control has to be conditioned by the pattern of banking and financial institutions. The extent of success of the policy depends upon the instruments employed.

The techniques available to monetary authorities to maintain internal stability consist of (a) regulating quantity of the money and to some extent of the near money with the purpose of directing and influencing the volume of expenditure (b) manipulating the level of interest rates or the relationship between short-run and long run rates, and (c) regulating quality of credit according to purpose or use of it. The powers of the monetary authorities to regulate creation of money and to near money depends largely upon their power to control, by direct or indirect means, and the credit and instruments policies of the money creating institutions.

The techniques of monetary policy in a contemporary world are undergoing a, rapid transformation. Formerly exclusive instrument which most of the Central Banks in the world were using, was the variation in the rates of interest at which the Central Banks were willing to discount bills. During the depression of the 1930s however, monetary orthodoxy was gradually abandoned.

In recent years, Central Banks have become concerned, not only with the control of the volume of credit, but also with the flow of credit into specific sectors of the economy. In India, this changed role of central banking has been the guidelines since the first five-year plan. The first plan states thus: Central banking in a planned economy can hardly be confined to the regulation of the overall supply of credit or to a somewhat negative regulation of the flow of bank credit. It would have to take on a direct and active role, firstly in creating or helping to create the machinery needed for financial developmental activities all over the country and secondly, in ensuring that the finance available flows in the directions needed" (Page 38)

With this objective in view, and depending upon the time-to-time requirements of the economy the Central Bank of a country applies constantly changing combinations of various instruments. These instruments can be quantitative or interest rate (Bank Rate). Reserve requirements and open market operations.

Qualitative techniques are of recent origin. These measures consist of credit regulation for a specific sector (selective credit control) and moral suasion. Of these the most important and widely used instruments are Bank-Rate, Open Market Operation and Selective Credit Controls. The policy implication of these instruments of Monetary Policy have been analysed below.

10.6.1 SELF-CHECK EXERCISE

1. _________________ of the RBI and other banks are deducted before we calculate the stock of money.
2. ______________________ of money is a sensitive issue as even a slight imbalance can create havoc in the form of deflation or hyperinflation in the country.

10.7 QUANTITATIVE TECHNIQUES

10.7.1. Bank Rate

The bank rate, or the discount rate as it is called in the United States, is the officially announced rate charged by the Central Bank for discounting of advances to member banks. In other words, it can be called as the cost of borrowing by the banking institutions from the central bank. By changing bank rate, the central bank affects the cost of borrowing and thereby influences the volume of credit.

In the monetary market, if it is organised one, there is a close relationship between the bank rates and the short-term money. The presence of an organised money market is very essential for the effective use of this technique because it is only in an organised money market, that the central bank can come to know that the current flow to bank credit and money is or is not in commensurate with the needs of the economy. Consequently, a change in the bank rate is commonly viewed as an amber light - an important index of the direction of the official policy.

Ostensibly by official policy is successfully implemented through a responsive banking system, but technically the effectiveness of change in the bank rate should take into account its influence of the following.

1. Effect on enterprises expectations as to the profitability of new investments and the resulting effect on their demands schedule for credit.

2. Effect on credit rationing policies by financial institutions.

3. Effect on the increasing government bond rates on the willingness of investors to take the capital loss resulting from the sale of securities to make private loans.

4. Effect or rising yields on government securities on the eagerness of lending institutions to earn higher incomes on private obligation.

5. Effect of declining capital value on the propensity to consume.

6. Multiplier effect of any initial decline of spending resulting from the above

changes. The above-mentioned factors go to prove that the banking system must view change in the official rates as a "caution light". The demand for credit must also be sensitive to cost. While as Howtrey suggest "there is nothing to prevent the Central Bank from pushing the rate up to required level, it is only to small increases, the bank rate owes its real effectiveness.

In recent years, a great deal of controversy has entered around the question of the efficacy of the bank rate. Even monetary commissions of international repute, like the Redcliffe Committee, have expressed their mixed feelings regarding the potentiality of this instrument. The final word has not been said, but it is definite that most economists regard it as some importance.

But another aspect of bank rate, relatively unknown, assumes special importance. In developing nations, like that of ours with planned economy where the public sector accounts for the larger part the nation's investment 86 where the government are equipped with a set of more direct and Powerful instruments, the bank rate losses much of its significance because bank rate will affect only a small number of enterprises. Furthermore, a well organised and responsive money market, which is essential for the effective functioning of the bank rate, is also absent in most instance. The number of negotiable and credit instruments to be rediscounted is very small. These factors help to suggest the limited efficacy of the bank rate in developing countries. This is the reason why this instrument is not used in such economics are frequently, as is used in some advanced countries, like the U.K. and U.S.A. etc.

10.7.2. Open Market Operations

In the broad sense, open market operations refer to the purchase or sale of securities in the market by the Central Bank. The objective is to influence the reverse position of banks which indirectly would bring about relative changes in money rates and credit conditions. The end result is to effect desired adjustment in domestic prices, cost of credit conditions and production. A notable feature of open market operations is that regardless of the parties involved. These operations have a direct and positive impact on the volume of bank reserves. It can be applied in desired magnitude, and the quickly reserved. These operations are, therefore an active reflection of the prevailing monetary philosophy of a country.

The efficacy of open market operations depends upon a variety of factors, chief among them being the existence of an active and broad money market. This is imperative if the Central Bank wishes to buy or sell securities in appropriate amounts in order to exert the desired effect of bank's reserves. Of course, it hardly needs to be mentioned that the Central Banks should have in its portfolio sufficient volumes of securities of various maturity periods for an effective use of this instrument.

In developing countries money markets are not fully development consequently, open market operations are often used to broaden the Securities markets so as to create an institutional setup for a more effective use of this instrument Many of these nations also make the traditional use of this, depending upon the character of the financial. institutions.

10.7.3. Variable Reserve Requirements

A change in the variable reserves ratio does not change the total reserve position of the commercial banks. It only affects the amount of excess of secondary reserves. The logical reason for this is the power of the banks to create credit, mainly depends upon the excess reserves. Hence, a change in the reserve requirement affects the credit creating capacity of the banks, and, in turn, their power to effect money supply.

A change in the reserve requirements has too-fold effects.

1. Assuming that there is an increase in the reserve requirement, there is an immediate decline in the excess reserve of commercial banks. They find additional funds to meet the larger reserve requirements; which can only be had by reducing the excess reserve on the basis of which credit is created.

2. An increase in requirement would reduce the rate of multiple expansion of deposits for the entire banking system.

The instrument of variable reserve requirement is generally considered to be Blunt and clumsy, the reason being that it has technical and psychological limitations. For one thing, it is difficult to use this instrument in moderate doses even every small change in the rate results in a substantial change in the liquidity position of commercial bank. For another, this instrument does not take into account the relative strength of the Banks and therefore affects the smaller banks more severely. Furthermore, there is a difficulty in managing it too.

Since the change becomes effective on a specific date, a sudden and quick adjustment in the liquidity positions of the banks become essential. This process of adjustment is likely to have undesirable disturbance in the market. For these and other reasons Central Banks generally use this weapon with moderation and discretion, and that too under some special and pressing circumstances.

10.8 SELECTIVE AND DIRECT REGULATIONS

Over all quantitative controls operated by an affecting overall bank reserve and overall credit. Selective controls, by contrast are applied to influence specific sectors of the economy which are most vulnerable. Under this type of regulations, no attempt is made to restrict the general flow of credit, rather restrictions are imposed upon the use of credit in specific sectors regardless of the quantum of credit available for such purposes.

The rationale of selective controls is that, consistent with a general credit situation appropriate to a healthy economic system, credit may be so easy to obtain for some purpose that demand expands unduly in particular directions, or speculative activities are over activated, endangering the stability of the whole economy.

A further need of selective credit control relates to its use as a supplement to general control. When the latter cannot be expected to act in a specific sector either quick or effectively to deal with the partial or sectorial inflationary situation. While there is nothing to prevent a Central Bank from using selective controls independently. The experience of various countries show that their effectiveness is considerably enhanced, used along with general credit controls.

In one form or another, many Central Banks also make use to direct regulations either as an alternative to the quantitative and qualitative controls or in conjunction with them. Direct action can be very important in countries which have considerable Central planning and supervision by government business.

These controls also assume special importance situations where the banking system is either non-respective to Central Bank's appeals or consists of a few large banks which could be easily directed to follow the Central Bank's general policy.

Direct action may take several forms. The Central bank may refuse rediscounting facilities to those banks whose credit policy is inconsistent with the banks policy. The bank may issue directives to banks generally concerning their lending or investment operations. Direct action can also be taken as

a coercive measure against an offending bank. Whatever the form, direct actions always carry punitive threats for non-compliance and are used primarily to butters general and selective credit policies.

10.8.1. Moral Persuasion

In the wider sense of the term, moral persuasion may be treated as one of the milder forms of selective credit control with the important difference that this instrument is not accompanied by statutory compulsion or threats of punitive action.

Moral persuasion carries with it the advantage of creating a less unfavourable psychological reaction and a greater response to the appeal of the Central Bank. It is, therefore, easier for the Central Bank to secure the willing and active co-operation of the commercial banks in the spirit as well as in the letter.

Another advantage of moral persuasion is that this informal method of control can be adopted by the Central Bank for exerting an appropriate influence on non-scheduled banks and also on the other kinds of credit and financial institutions generally considered to be outside the scope of the Central Bank regulation.

Moral persuasion can be affected in many forms. The Central Bank may call in the leading bankers for heart-to-heart talks. An appeal to their nationalistic spirit may be made. A displeasure may be expressed over their non-compliance with law. Vague threats concerning future availability of credit may be made, or banks may be warned of direct and punitive actions.

10.8.2. Rationing of Credit

Rationing of credit is another technique of selective credit control. In this method RBI fixes the quota for member banks as well as their limits for the payment of bills,

10.8.3. Regulation of Consumer Credit:

The consumer credit schemes which are adopted by the consumer durables is paid by the consumer in cash. The balance amount is bank require that a certain percentage of the financed by bank. The central bank can control credit by the changing the total amount which can be borrowed by the consumer for durable goods.

10.9 ANSWER TO SELF-CHECK EXERCISE

1. Non-monetary liabilities

2. Supply

10.10 SHORT QUESTIONS

1. Discuss how Monetary Policy influences inflation.

2. Discuss the relation between inflation and interest rates.

3. Explain open market operations.

4. Describe, in brief, the function of Reserve Bank of India.

10.11 LONG QUESTIONS

1. Define Monetary Policy and differentiate it from other economic policies.

2. Explain in detail objectives of monetary policy in a developing country like India.

3. "Effectiveness of service depends upon the kit of tools." In the light of this statement, do you think monetary policy has a perfect kit?

4. "Monetary Policy and Fiscal Policy are complementary." Discuss the statement.

10.12 KEY WORDS

Monetary Policy, Fiscal Policy, Hyperinflation, Economic Policies

10.13 SUGGESTED READING:

1, Business Environment Joshi and Kapoor

2. Indian Economy S. Chand, Delhi

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FISCAL POLICY STRUCTURE

11.0 Objectives

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11,2 Fiscal Policy and Stability

11.3 Pump Primning

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11.0 OBJECTIVES

The objectives of the lesson are to give the knowledge about the fiscal policy. To make them understand government expenditure and revenue. This lesson tells that how government earn income and spend those expenditures,

11.1 INTRODUCTION

The word fiscal is derived from the old French Word Fisc, which means the money basket or the treasury. Thus, fiscal means pertaining to treasury or government finance. Fiscal policy means the government policy of taxation, expenditure and public debt etc. Fiscal policy may be defined as "a policy under which the government uses its expenditure and revenue programmes to produce desirable effect 8E. avoid undesirable effect on national income, production and unemployment. It emphasizes the effect of government expenditure and revenue upon total economy and argues that they should be used deliberately and consciously as a balancing factor to secure economic stabilisation." Gerhard Colna defines fiscal policy as the "the conduct of government expenditures, revenues and debt management in such a way as to take fully into account the effect of these operations in the allocation of resources and the flow of funds and thereby their influence on the level of income prices employment and production."

In the modern government organisation, the amounts of public expenditures, revenues and public debt are so huge, that they have begun to assume a major importance in the national economy. The desired fiscal policy can be pursued by budgetary measures like taxation, expenditure, public debt etc.

The role of fiscal policy in regulating the economy and protecting it from the ills of the market mechanism were recognised very slowly. As discussed in an earlier lesson, governments were wedded to the traditional ideals of sound budgetary policy of avoiding deficits. Such a policy, amongst other things, was causing to problems. One was as Keynes pointed, the fact that an attempt to balance the budget would put it to an unbalance and vice-versa. The second was that through the process of balanced budget multiplier, the budget was adding to the severity of cyclical fluctuations. It was with great difficulty that the appropriateness and usefulness of the fiscal policy in combating the ills of the economy were recognised, especially during the great Depression of 1930s. It was conceded that the government had a primary responsibility of helping the economy towards stabilisation,

11.2 FISCAL POLICY AND STABILITY

As mentioned earlier, the role of fiscal policy in promoting economic stability was recognised slowly, and not sufficiently till the Great Depression of 1930s. Actually, as Keynes pointed out, the orthodox sound budgetary policy of avoiding deficits itself contributed towards greater instability and made the task of keeping the budget balanced, all the more difficult. This is fact, generated a "perverse" policy on the part of the authorities, pushing the expenditure and demand in the economy down during a period of depression and pushing them up during a boom.

The development of the concepts of "multiplier", and accelerator" and the relationship between the macro-variables like investment, income consumption and savings enabled the economics to visualize more clearly the machines of trade cycles and the role which fiscal policy could play. This gave rise to the principle of compensatory finance and functional finance. It was realized that through fiscal policy, the government could to a great extent, neutralize the establishing movements in the economy. The general theoretical farm work, was that a depression is caused by a deficiency of effective demand. Fiscal policy should remedy it by increasing public expenditure and by encouraging private expenditure. Similarly, during a boom period, the need is to control the demand which again can be partly done through curtailing public expenditure and partly through curbing the private expenditure.

To encourage demand during depression, the authorities should reduce the tax rates or abolish taxes on various items 86 activities. This would push up profits and reduce the price through a reduction in the cost of supply. Lower prices are expected to increase demand, production and employment, which in turn would bring further increase in demand a.na so on. A similar action can be taken in the field of custom duties also. Raising import duties would divert domestic demand from imports to home produced goods or abolishing export duties or giving export subsidies would increase the demand for exports and would contribute towards recovery from depression.

11.3 PUMP PRIMNING

The stimulating effect of tax reduction on private business outlay may not raise the level of aggregate spending adequately, if public expenditure remains unchanged or does not increase as well. The kind of public spending which is associated with a recovery program is known as "Pump Primning" which presuppose that private investment is periodically deficient and therefore, needs to be stimulated by public investment. This type of public spending stimulates private investment in two respects i.e., both a method of financing and a method of spending.

During a period of depression, the banks 86 the general public tend to accumulate idle cash balance rather assume the risk of investment. If the government borrows from banks and individuals with an excess of cash, which they would not otherwise spend themselves, such borrowing provides an outer for idle cash balances. By borrowing from the banking system, the government enables bank assets 8a deposits to expand and so create new money to be spent by the economic system. Thus, the very method of financing pump Primning is conductive to recovery, "Pump Primning" as a method of financing, not only facilities in investment by institutional savers but also supplements monetary policy by stimulating credit expansion and general business recovery.

"Pump Primning" stimulates private investment mainly through its magnifying effect on income via the multiplier principle. Once consumption expenditure is enlarged by the initial public outlays, the rest are taken care by the operation of the acceleration principle provided that excess capacity and

other offsetting conditions do not exist. The sequence of events leading to recovery is "Pump Primning", increased consumption, increased induced investment and increased total spending.

11.3.1 SELF-CHECK EXERCISE

1. Savings with the post office is a part of ______________ aggregate of money supply.

2. People trust the stocks of the public sector units. This facilitates the ______________ forcontrolling monetary supply in the economy.

11.4 COMPENSATORY FISCAL POLICY

Along with secular structural changes in advanced economics, there has occurred shifts of emphasis from the traditional business cycle analysis to the levels of income and employment and a parallel change in policy from monetary policy and "pump Primning" to "compensatory" fiscal policy. Business cycle policy no longer consists of "eliminating" the causes of cyclical disturbances so as to render government intervention unnecessary but rather of letting public investment fill the inevitable cyclical and secular gaps created by a deficiency of private spending. Thus "compensatory" spending is based on the assumption that private capitalism left to itself, is no longer capable of maintaining aggregate spending at a level compatible with full employment either in the short run or in the long run. On the basis of his analysis of persistent tendencies towards under employment equilibrium, Keynes stressed the need for public investment as a balancing factor. This he believed to be a sin-que-non of the continuation of the capitalist system in a new dynamic and stable form. Hansen and others have also emphasized the need for bold long-range programme of public investment for stabilization as well as for welfare reasons. As a matter of fact, "Compensatory spending" is an integral part of a general policy of guaranteeing full employment (Britain) etc. or of guiding the national economy along the lines of maximum output, employment, and purchasing power," (USA).

However, there are some implications of compensatory spreading which cast some doubt on the feasibility of large scale, continuous public investment even as a balancing factor. The compensatory spending, tends to supplement monetary policy. It is feared that a large and growing public debt incident to compensatory spending, will render the traditional monetary controls ineffective as "instruments of control of economics fluctuations". A large and growing public debt has the effect of increasing excess reserve of banks for potential excessive credit expansion the one hand and of reducing interest rates on the other.

As for lower interest rates, although public investments are undoubtedly facilitated by low interest cost, some types of private investment will be discouraged by the low interest return from investment. It is feared that compensatory spending will eventually require borrowing at a zero rate of interest and wipe out the incentives of a wide range of institutions of individual's depending on fixed-income-yielding investments. However, it is concluded that these short-run effects of a long-range programme of compensatory spending could perhaps be "dismissed as a part of the necessary costs of a successful monetary policy". Provided that the low rate of interest did actually achieve an adequate recovery of investment, output and employment.

11.5 INFLATIONARY FISCAL POLICY

Inflation is a result of the aggregate demand for goods and service being in excess of the aggregate supply. Therefore, the obvious fiscal remedy for it is to reduce total demand. As you are aware, inflation is caused either due to an increase in demand or as a result of change in cost, or by both. The changes in costs often stem from rise in wages.

11.5.1. Government Expenditure

A reduction in the aggregate demand should be the most essential part of an anti-inflationary policy. Since inflation is caused by increasing expenditure, a check on this is the most logical step to be taken. Government expenditure should, therefore, be reduced and its revenue increased to counteract the increase in private spending. There is often a part of the government expenditure which is comparatively non-essential and such expenditure must be reduced. But as substantial part of

government is regarded as very essential and cannot be reduced as for example, even during the peace time, the expenditure on defence is unavoidable and it may be difficult for the government, to prevent the general tendency of defence expenditure from rising. In developing countries, the planned economic development claims a substantial part of public expenditure and any reduction in the same will bring down the tempo of economic growth. Large amounts expenditure is incurred by public authorities on essential long-period social programmes and such expenditure cannot be curtailed. Thus, there is a certain irreducible minimum of expenditure that must be incurred by the government.

No, reduction of government expenditure as part of anti-inflationary programme, therefore, appears possible, inflation cannot be attacked from this side with success.

11.5.2. Taxation

Thus, the major attack on an inflation situation comes from the side of taxation, increase in the amount of tax revenue decreases the disposed of income with the general public and therefore, have anti-inflationary effects, The large volume of surplus purchasing power that gets into the hands of the people and exerts a pressure on demand, is mopped up by increased taxation. The increased government expenditure is sought to be covered by revenue and is not allowed to create a large budget deficit. Now taxes are imposed and the rates of old taxes are raised. Demands for tax relief and abolition of taxes have to resisted to make an anti-institution policy successful.

The taxes to be used for this purpose have, however, to be carefully chosen. Some taxes are more suitable than others and operate more directly on the points which are important in the inflationary economy. Direct taxes have a more direct influence in such a situation. The income tax, especially takes away from the public in a very progressive manner a part of the purchasing power, and therefore, is a useful tax. An expenditure tax not only takes away surplus purchasing power from the economy but also has a discouraging effect on consumption". The Excess Profit Tax is another suitable tax which was tried in many countries during World War-II.

Indirect taxation is a good instrument for mopping up surplus purchasing power with the general public, for it effect a larger part of the population than direct taxation. In a country like India, where only a few are under the purview of direct taxation large majority of people can be reached only through indirect taxes.

11.5.3. Public Debt

The effect of large budget deficit which are mainly responsible for inflation can be partly counteracted by covering the deficit by public borrowing. Government borrowing also helps in taking a part of the large amount of purchasing power available to the people and reduces the inflationary pressures. The part of the government debt help by non-banking investor indicates that so much less purchasing power is used by people for buying commodities. However, it must be clearly understood that it is only government borrowing from non-banking investors that has a disinflationary effect. Public borrowing reduces total demand only when it has restrictive influence on private consumption and investment.

11.6 AN APPRAISAL

Fiscal measures are not wholly successful in preventing inflation in times of war or in period of rapid economic development, as has been observed large government spending is inevitable in such conditions and certain amount of deficit financing has to be done. In times of war the production of commodities for consumption has to be drastically cut and in a developing economy, the investment takes time to mature. Therefore, the creation of money income is always ahead of the available of goods and services. Thus, the reduction of demand through control of public expenditure has very limited scope.

Increasing taxation and borrowing have also their limitations. The effects of high taxation on production have to be guarded against and loans from the general public cannot give all the funds required for the government spending. A carefully devised tax structure and cautiously regulated rates

are helpful in restraining inflationary pressure. But the total effort of all these measures is to moderate the pressure, not eliminate them completely.

It may therefore, be concluded that fiscal policy by itself cannot do all that is required in controlling an inflationary situation. Other kinds of measures such as monetary control, price control and rationing are more effective. Fiscal devices are more efficient as support to other policies than as independent devices, during inflation.

11.7 ANSWER TO SELF-CHECK EXERCISE

1. Old/Broad

2. Open Market Operations

11.8 SHORT QUESTIONS

1. Define Fiscal Policy.

2. "Supply of money is a sensitive issue as even a slight imbalance can create havoc". Discuss.

3. Analyse open market operations and selective credit control as measures to control money supply in the economy.

4. How does the budget of Central Governments differ from the budgets of the StateGovernments?

11.9 LONG QUESTIONS

1. Describe briefly how fiscal policy can be used to achieve full employment. Bring out its limitations.

2. Describe how fiscal policy can be used to influence the level of business activity in a country.

3. "Fiscal devices are more efficient as support to other policies than as independent devices". Discuss.

4. "It is through fiscal policy that the government tries to correct inequalities of income andwealth". Elaborate.

11.10 KEY WORDS

fiscal policy, Public Debt, Government Expenditure, Inflation

11.11 SUGGESTED READINGS

1. A.C. Pigou — Public Finance Part-HI, Chapters 1 to VI.

2. U.K. Hicks — Public Finance, Chapter XVII.

3. Raja J. Challiah — Fiscal Policy in Underdeveloped Countries, Chapter I

Lesson No. 11

ECONOMIC REFORMS, STRUCTURAL ADJUSTMENT PROGRAMME AND LIBERALIZATION STRUCTURE

12.0 Objectives

12.1 Economic Reforms

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12.0 OBJECTIVES

After reading this chapter, the student should be able to!

(i) Understand various phases of economic reforms

(ii) Understand liberalization policy and its impact.

(Hi) Understand globalization of Indian business. {iv) Understand privatization process in India.

12.1 ECONOMIC REFORMS

The economy of entire world has been experiencing dramatic and momentous changes during the last two decades. But the economic reforms have never been as widespread as today. These reforms are being undertaken by almost all the countries of world-developed countries, underdeveloped countries and developing countries.

12.1.1 The First Phase of Economic Reforms

The first phase of economic reforms has its origin in 1985 when Mr. Rajiv Gandhi took over as Prime Minister of the country. He puts emphasis on improvement in productivity, absorption of modern technology, full utilization of capacity and finally on greater role of private sector.

In order to provide more scope to private sector this new economic policy introduced various policy changes regarding of undermentioned policies:

1. Industrial Licensing
2. Technology
3. Elimination of controls and restrictions
4. Foreign equity capital
5. Fiscal policy, and
6. Export Import policy

These all-policies changes were introduced with the sole intention of creating a favourable climate to give boost to private sector investment, which would in turn help in rapid growth of economy and also pave the way for modernisation of the economy. Also, the New Economic Policy stressed on removing unnecessary restrictions in issuing licenses, in denying Industrial licensing to MRTP companies and making adjustment of output to administered prices.

12.1.2 The Second Phase of Reforms

The first phase of Economic reforms failed to yield the expected results on most of fronts. The deficit in BOP (Balance of Payments 1 gradually increased during sixth and seventh plan. The country experienced continuous BOP crises and depleted foreign exchange servers, international confidence collapsed, industrial production was falling down and the rate of inflation reached an all-time high level above 17%. In order to restore both internal and external confidence, Narsimha Rao government initiated good number of stabilisation measures in 1991-92. These measures include

1. Stringent monetary policy by raising interest rates.
2. Adjustment of exchange rate of rupee by 22%.
3, Liberalisation and simplification of foreign trade policy.
4. Reduction in fiscal deficit.
5. Introduction of other new reforms in economic policy which are as given below

(a) The industrial policy reforms for providing greater competitive structure to in

(b) Trade policy reforms for providing a stimulus to export and to contain BOP crisis.

(c) The public sector reforms to attain viability and improvements in its performance.

(d) Macroeconomic stabilisation through fiscal corrections.

12.1.3 Extension of the Scope of Reforms

To extent the scope of economic reforms to a wider level, the most important policy measures were introduced in 1992-93, 1993-94, 1994-95, 1998-99, 2000-01, 2001-02 budgets, which were as given below:

(1) Introduction of Export Import Policy in 1992-97 and 1997-2002 and its modifications

(2) Policy of Tax Reforms

(3) Fiscal stabilisation

(4) Public sector disinvestment

(5) Full convertibility of rupee

(6) Current account convertibility

(7) Partial capital account convertibility

Thus, economic strategy followed by the present government depends solely on two pillars of fiscal discipline and structural reforms.

12.1.4 Second Generation Reforms

In 2000-2001 Mr. Yashwant Sinha, the finance minister presented budget in which he stated that government wanted to attain second generation reforms. According to him, "Growth is not the only objective itself. It is a source of expansion of employment and to raise the standard of living especially of down trodden class." Increase in rural development, road development, increase in knowledge-based industries to improve human resource will lead to increase in employment opportunities.

Following were the reforms undertaken:

(i) To provide proper base for agricultural and rural development.

(ii) To enhance the revolutionary capacity of information technology, biotechnology and knowledge-based industries.

(iii) To modernise leather, Agro processing and small industries.

(iv) To remove hardships of power, road telecommunication, railway and air services.

(v) To give prominence to the poor class and other social services.

(vi) To increase exports aa foreign investment.

(vii) To provide fiscal discipline.

12.2 STRUCTURAL ADJUSTMENT PROGRAMME

Structural Reforms during 2002 Budget

The following structural reforms are undertaken in 2002 budget:

1. Administered Price Mechanism (APM) for Petroleum: The following measures are provided in APM

(a) The pricing of petroleum products will become market determined.

(b) Private companies will be permitted in distribution subject to specified guidelines.

(c) The subsidies on LPG and kerosene will be on a specified flat rate basis from April I, 2002. The retail prices will vary with the changes in price of crude oil in international market.

2. Industrial Restructing: To deal with forces of competition, industrial and other companies require restructuring on a continuous basis. For this purpose, it is essential to promote out of court mechanism for timely and transparent corporate debt restructuring of viable units.

3. Small Seale Industries: These industries are now subject to increasing competition with the completion of trade liberalisation. A new approach to the promotion of these industries therefore, has already been adopted:

(i) The net bank credit outstanding increased from 45789 cr. in 2001 to Rs. 48445 cr. in 2002.

(ii) The limit of loan has been increased from 2 lakhs to 5 lakhs.

(iii) The extension of credit to SSI has already been facilitated through credit linked capital subsidy scheme for technology upgradation.

(iv) Public sector banks have now decided to introduce a scheme called 'Laghu Udyami Credit Card (LUCC)'.

4. Exports: The Government is committed to provide all assistance to accelerate export growth A new initiative is the establishment of Special Economic Zones (SEZs). The outlay has been increased for the scheme from Rs. 97 crore this year (2001-2002) to Rs. 330 Cr. for 2002-2003, Overall outlay for the year 2002-2003 has been increased by 55 percent to Rs. 775 crores.

5. Human development: The 93rd amendment of the constitution has made free and compulsory education for all children in the age group of 6 to 14 yrs., a fundamental right. Accordingly, the plan allocation to the Department of Elementary Education and literacy has been enhanced from Rs, 4000 Cr. this year to Rs, 4900 Cr. for 2002-2003.

6. Social Security: Last year it was mentioned that the Insurance Regulatory and Development Authority (IRDA) would be asked to provide a map for new pension scheme so that the unorganised sector is provided adequate security coverage. Action on these recommendations will be taken now by June 30, 2002. Access to good and responsive health care is still a distant dream for the majority of the rural population. An insurance scheme called "Janraksha" is being designed by the public sector Insurance Companies to provide protection to the needy population with a payment of Re. 1 per day as insurance premium, a person will be entitled to indoor treatment up to Rs. 30,000 per year at selected and designated hospitals.

7. Women and Children: The year 2001 was celebrated as the women's Empowerment year and several policies, legislative and programme initiatives have been launched to help in the empowerment of women. Plan allocation for the Department of 'Women and child Development' has increased by 33 percent i.e., to Rs, 2200 crores, to solve the problem of malnutrition, The Prime Minister announced a 'National Nutrition Mission' in his Independence Day speech. As per this mission food grains at subsidised rate would be made available to adolescent girls and expectant and nursing mothers belonging to below poverty line families.

8. India's System of Medicine (ISM): The National Institute of Siddha at Chennai has been provided Rs. 4 cr. for commencing its services. A national Ayurvedic Hospital will be set up at Delhi with private sector participation. The Budgetary support for ISM has been increased by 25 percent to Rs. 150 cr.

9. Scheduled Castes and Tribes: The allocation for the welfare and upliftment of S.C. is the Ministry of Social Justice and Empowerment has been increased from Rs. 792 cr. this year 2001-2002 to Rs. 879 cr. in the coming year 2002-2003.

10. Development of North Eastern Regions: During the current year an additional sum of Rs. 500 cr. was provided to the North Eastern States from the central pool Share of Eastern States out of the central plan of various Ministries has also been increased from Rs. 3,457 Cr. in the current year to about Rs. 5,016 Cr, next year,

11. Science and Technology: The plan allocation for the Department of science and technology has been raised to Rs. 625 Cr. in 2002-2003, an increase of more than 52 percent. A fund for the improvement of science and technology (FIST) has also been established.

12. Entertainment: India's Global leadership in computer software must now be complemented by another area of one core competence. Today we are the world's largest producer of films. Accordingly, the budgetary support for the Ministry of Information and Broadcasting has been increased by 22 percent of Rs. 415 cr. for 2002-2003. It is time we brought about a fiscal regime to usher in more "Khushi" and take away the remaining "Gham" from the entertainment industry.

13. Fiscal Consolidation: The fiscal deficit has been reduced from 5.1 percent in 2000-2001 to 4.7 percent in 2002.

14. Expenditure Management: The success can be achieved by containing non-plan expenditure. The recommendation of the "Expenditure Reforms Commission" (ERC) provide a very useful framework for immediate moderation is expenditure growth.

15. Pension Reforms: The present pension scheme for Government employees casts an open-ended financial burden on the Government. The new pension scheme for new recruits will be announced and implemented by June 1, 2002.

16. Privatization: The Government has now completed strategic sales in seven public sector companies and some Hotel properties of the Hotel Corporation of India (HCI) and India Tourism Development Corporation (1TDC). The change in approach from the disinvestment of small lots of shares to strategic sales of blocks of shares to investors has improved the price earnings ratios obtained. Disinvestment receipts for the present year are estimated at Rs. 5000 cr. which is excluding the special dividend from Vidyut Sanchar Nigam Limited of Rs. 1887 Cr. Encouraged by these results the finance minister is again taking credit for a receipt of Rs. 12,000 cr. from disinvestment next year.

17. Defence: Modernisation and upgradation of our defence preparedness is an area of highest national priority. A provision of Rs. 155,000 Cr. for defence is made. As a measure of welfare of the defence forces and their families and as announced by Prime Minister, a major programme of housing construction for defence personnel has also been taken up.

12.2.1 SELF-CHECK EXERCISE

1. Indian stock market is called the _____________.

2. When government leases its assets to a private company, it transfers it the _____________ ownership.

II. LIBERALIZATION, GLOBALIZATION AND PRIVATIZATION

12.3 LIBERALIZATION POLICY AND ITS IMPACT

The central govt. announced the new industrial policy in July 1991, with a view to maintain a sustained growth in productivity and gainful employment, ensure optimal utilization of human resources and attain international competitiveness. Consequent upon announcement of liberalized industrial policy and other reforms by the central govt., it was felt that the state govts. should also take necessary steps towards simplification of procedures and liberalization of their policies so that delays in the implementation of industrial projects are reduced to the minimum and the pace of industrialization picks up at the state level. While all the state govts. appreciate the rationale behind

the reforms and recognize the need for suitable initiatives at their level, the ground level situation varies from state to state.

The most important initiatives of the central govt. are with respect to the virtual scrapping of industrial licensing and registration policies, an end to the monopoly regime and more liberal approach to foreign investments, apart from redefining the role of the public sector during the last decade. These measures were aimed at freeing the industry from regulations. The most important aspects of the liberalization relate to the following:

• Industrial Licensing

• Foreign investment

• Foreign technology agreements

• Public sector policy

• MRTP Act.

During the last decade a lot of decisions pertaining to the above were taken thereby liberalizing the economy particularly related to the procedures, which used to be bottlenecks for the healthy growth of industry. Major policy initiatives and procedural reforms are called for in order to encourage and assist entrepreneurs to exploit the emerging domestic and global opportunities and challenges in the face of competition.

The main purpose behind all such package of measures of is that the entrepreneurs make investment decisions on the basis of own commercial judgement. The attainment of technological dynamism and international competitiveness requires that enterprises must be enabled to swiftly to respond to changing conditions that has become of today's industrial world. Government policy and procedures must be geared to assisting entrepreneurs in their efforts. This can be possible only if the role played by the government was to be changed from that of exercising control to one providing help and guidance by making essential procedures fully transparent and by eliminating delays.

So, the liberalization can be defended as the policy by which the controls by the government are minimized and extending the fullest co-operation for the systematic and healthy growth of the industry.

This calls for bold and integrative decision designed to remove restraints on capacity creation, while at the same time ensuring that overriding national interests are not Jeopardized. In the above context, the industrial licensing will be hence forth abolished for all the industries, except for some specified irrespective of the levels of investment. These specified industries will continue to be subject to compulsory licensing for reasons related to security and strategic concerns, social concerns, problems related to safety and environmental issues, manufacture of products of hazardous nature and articles of elitist consumption.

While freeing the economy from official controls it is also important to open the avenues for promoting the foreign investment with a view to make the industry more dynamic market driven, technologically sophisticated in addition to bring the marketing expertise. Modern management practices and opening up of new possibilities of export promotion, with the help of foreign investment, new large-scale industry and technology of national Interest can be given top priority. The entry of customable giants in the Indian market has only been possible through the initiatives of liberalization by the government. The competition being witnessed in the white goods market with the entry of Sony, Samsung, LO, ken star, etc. and for that matter any industry can also be attributed to the policy of liberalization.

The govt. is also limiting its own role as entrepreneur with only priority areas of national interest remaining in its hands, namely Essential infrastructure goods and resources. In fact, the govt. has already initiated the process of disinvestment in a number of public sector enterprises. More recently, the telecom sector has been opened to the private operators through WLL and mobile phones. The govt. is also a service provider and facing the competition. Rather the oil exploration is being done by the reliance where the govt. has been the service provider. In view of these considerations govt. is reviewing its existing portfolio with greater realism. In fact, the report by the disinvestment commission, Punjab has recommended that all the State-owned companies be sold or wound up, albeit in a systematic manner.

With the growing complexity of the industrial infrastructure and the need for achieving economies of scale, the interference of the govt. through the MRTP Act has become redundant and is no more required now. The provisions of the MRTP Act have also been restructured by eliminating the legal requirement, for prior governmental approval for expansion of present undertakings and establishment of new undertakings. The provisions relating to merger, amalgamation and takeover have also been repealed. Similarly, the clauses regarding restriction on tile acquisition and transfer of shares have been appropriately incorporated in the companies Act.

12.4 GLOBALIZATION

Globalization is not a new feature of the world economy. The era before the first world war was one in which strong globalization tendencies produced a very uneven pattern of global economic development, exposing the limits of global economic integration. For example, the integration of the economy in to the capitalist economy is part of the globalising tendencies of capitalism. Thus, it provided a legal framework for the dependence of the Indian economy on the economy of western countries. Thus, our economy became producers of raw materials for Industries in advanced capitalist societies. Historically, the process of globalization had started in small way in the nineteenth century. This was when capital moved from Europe to open up new areas in America and Australia, mostly in the building of rail road systems and agriculture that would be central to the expansion of capitalism.

The subsequent maturation of joint - stock companies and developments in the areas of banking, industrial, capital and technology, aided among other things, the scramble for and partitioning of Africa and, its then attendant rapacious exploitation of these parts of the world. Even though, the pre-eminence of globalization as championed by America was interrupted by the cold war era, with the effective end of latter in 1990, the west no longer needs to compromise as before, ideology of globalized culture on the account of communism. During the eighties, the disillusionment witnessed in the socialist economies accelerated the process of disenchantment with the public sector in the mixed capitalist enterprise systems in the world. The wave of economic reforms under perestroika started in the USSR swept,

The economies of Eastern Europe consequent on this, the global economy continued to experience some fundamental changes in nearly all ramifications including "even the language of global discourse." This trend is currently being pursued with vigour by the now acclaimed instrument, of globalization. These Instrument - (a) the reformed old Bretton woods institution (IMF and world Bank), (b) world trade organisation and (c) The GB) - according to Banjo are the "wicked machines of the imperialists," Which completely have their pedigrees in the ideological frameworks of the west and its monopolistic view of what the world should look like.

The roles of the International monetary fund and the world bank are significant in the process of globalizations since the primary goal of globalization is the issue of global capital. In this direction, the IMF and the world Bank have played crucial roles in the entrenchment of global capital. This has been done through policies such as liberalization, privatization and deregulation. In respect of liberalization which is a process of removing artificial registration on production exchange or use of goods services and Factors Production, there has been a liberalization of international trade and factor movement which are necessary conditions for firms to globalize. Indeed, firms, National companies play crucial roles since the logic of private enterprise is the drive for profits, the movement of firms and capital across borders in pursuit of profits is inherent in the expansion of firms. Thus, economic activity could not be global without the capacity of business to operate simultaneously in more than one country, but the unique capacity for organizational flexibility and integration that characterizes many transactional corporations today, serves as a driving force for globalization.

The protagonists of globalization in various developing countries have continued to consistently lure developing countries into the "Villagized world" without much guarantee of equality and fairness in the asymmetrical game - play involved. They have been doing this by laying irresistible emphasis on the advantages of science and technology particularly in the areas of 'Internet connectivity", new Information communication technologies", customization," Internet-based cybermail, and modernised agriculture." The wholesale acceptance of globalization as a saviour of the developing countries particularly those in Asia, has been likened to that of a moving train which Asia and Asians must keep pace with, regardless of whether the latter has similar destination in mind, indeed, the globalization of technology promotes the globalization of production and Finance by spurring the dissemination of information and lowering the cost of linking markets Internationally. The globalization of technology has created rapidly rising numbers of global consumers. It must be clear at this point, that the current utilization of the world, as globalization, has greatly the developing countries in nearly all facets of life.

12.4.1 CONCEPT AND MEANING OF GLOBALIZATION

Globalization means several things to several people. For some it is a new paradigm - a set of new beliefs, working methods and economic, political and socio-cultural realities in which the previous assumptions are no longer valid. For developing countries, it means integration with economy. In simple economic terms, globalization refers to the process of intration of the world in to one market. Such unification calls for the removal of all trade barriers among the countries. Even political and geographical barriers become irrelevant. Basically, meaning Business without boundaries. At the company level it means two things.

- The company commits itself heavily with several manufacturing locations around the world and offers products in several diversified industries.
- It also means the ability to complete in domestic markets with foreign competitors.
- In the popular sense globalization means multi - plant operations. A company which has gone global is called a multinational or a translational.

To be specific, a global company has three characteristics:

1. It is a conglomerate of multiple units (located in different parts of the globe) but all linked by common ownership.

2. Multiple units draw on a common pool of resources such as money credit, Information patents, trade name and control systems.

3. The units respond to some common strategy.

Pepsi, Coca - Cola, Nestle, IBM, GE, Ford, shell. Philips, Sony and unilever are some of the multinationals having operation in a number of countries. Globalization refers to the process of the intensification of economic, political, social and cultural relations across international boundaries. It is principally aimed at the transcendental homogenization of political and socio - economic theory across the globe. It is equally aimed at "marking global being present worldwide at the world stage or global arena.' It deals with the "increasing breakdown of trade barriers and the increasing integration of world market. In other words, Globalization can be seen as an evolution which is systematically restructuring Interactive phases among national by breaking down barriers in the areas of culture, commerce, communication and several other fields of endeavour.

This is evident form its push of free market economics, liberal democracy, good governance, gender equality and environmental sustainability among other holistic values for the people of the member states. The process of globalization is impelled by the series of cumulative and conjunctural crises in the international division of labour and the global distribution of economic and political power. In global finance, in the functioning of national states and in the decline of the Keynesian welfare state and the established social contact between labour and government. In fact, its hallmark of free - market capitalism has been aided among other factors by the sudden though expected changes within the physiology of global political community in recent times.

Within the parameters of the foregoing, globalization could be correctly defined form the institutional perspective as spread of capitalism. However, it is germane to adumbrate that the collapse of the eastern bloc in the late 80s and early 90s led to the emergence and ascendancy of a global economy that is primarily structured and governed by the interests of western countries, thus, facilitating the integration of most economies into the global capitalist economy. With the demise of the Eastern Europe in the early 90s, capita/ism as an economic system now dominates the globe more than it had been at any time in the history. Even China, by far the largest non-capitalist economy, has undergone dramatic changes in its international economic policy orientation, and is today the recipient of almost one - half of all foreign direct investments that go into developing nations - this is a country that essentially blocked all foreign investments till the 1980 (United Nations, 1995b). Beyond this simplistic analysis of globalization in terms of capital inflows and trade investment, it is important to state that it has been of disastrous consequences to the governments and people of the Asian continent.

Globalization, is the broadening and deepening linkages of national economies into a worldwide market for goods and services, especially capital. It seeks to remove all national barriers to the free movement of international capital and this process is accelerated and facilitated by the supersonic transformation in information technology. It is principally aimed at the universal homogenisation of ideas, cultures, values and even life styles as well as, at the deterritorialization and villagization of the world. It is principally concerned with the expansion of over the oceans and airspace, beyond traditional alliance which were restricted by old political spheres of influence. Thus, it presupposes the "making or remaking" of the world by carting 'a basic change in the way in which major actors think and Property across the globe". In other words, it connotes "the rapid expansion through giant multinational companies of capitalism and their "blood sapping principles" of liberalization". Commercialisation", privatisation" and "undemocratic and property - based democratization "to several areas of the world including where it had hitherto been resisted or put in check."

Very critical to our understanding of globalization is the dire need to use it as a synonym for liberalization and greater openness. The implication of this is that both domestic and foreign liberalization are said to imply globalization, since the former brings domestic markets more in conformity with forces operating in markets abroad, and the removal of administrative barriers to international movement of goods, services, labour and capital increases economic interaction among nations. It is within this purview that we can argue that globalization is a phenomenon of capital mobility. Its two prongs are (1) foreign direct investment, and (2) international portfolio flows. Thus, a global economy is one which is dominated by transitional firms and financial institutions, operating independently of national boundaries and domestic economic considerations.

Another important feature of globalization is that, it enhances the volume of international trade and investment, which is a reflection of global pattern of specialization in production (Le. international division of labour). Though, there is an increase in the volume of goods among nations, international trade continues to largely concentrated in developed countries i.e., trade continues to exist between economies at the same level of economic development). For example, in 1992 56% of world trade was among developed countries, virtually unchanged from its 1970 level.

In the same year, 77% of developed countries imports originated from other developed countries, compared to 78% in 1970.

12.4.2 REASONS FOR GLOBALIZATION

There are several reasons why companies go global. The primary motive for going global is that there is money in the overseas markets. The world investment Report (1999) has ranked the world's top 100 multi-National companies (MNCs) and the 50 biggest MNCs in the developing countries for 1997. The MNCs from the US., Europe and Japan have assets and more than quarter of assets are found in foreign markets. GE of the US in the top MNC with assets of over $ 300 billion in 1997 and nearly a third of its assets lie in overseas countries. The Dutch /UK firm shell has the fourth largest assets among the MNEs and three fifths of these are located overseas. Among the developing countries, the Venezuelan oil firm petroleos leads the first with a fifth of its assets in overseas countries. Some of the other reasons are mentioned hereunder:

1. One reason could be the rapid shrinking of time and distance across the globe thanks to faster communication, speedier transportation, growing financial flows and rapid technological changes.

2. It is being realized that the domestic markets are no longer adequate and rich. Japanese have flooded the US market with automobiles and electronics because the home market was not large enough to absorb whatever was produced. Some European companies have gone global for similar reason. Ciba Geigy, for example, could not survive only in Switzerland where the population at that time was just six million. It was forced to go in search of international markets and has consequently set up overseas production facilities.

3. Raymond Vernon has propounded a theory explaining why companies go international. Though propounded in the late 1960s, Vernon's theory is relevant even today, this theory is called product-cycle theory.

4. H. levy and M. sarrat proposed yet another theory for most foreign investments. They compare companies that acquire foreign production facilities to investors who diversely portfolio of investments. Much as such an investment portfolio is usually designed to protect its owner from fluctuations in the value or return of any single asset so direct foreign investment lets a company construct a portfolio which has more optimal risk/return characteristics than one which contains income streams form one nation only.

5. Reasons for going overseas may also vary from industry to industry. Petroleum and mining companies often go global to secure a reliable or cheaper source of raw materials. Some manufacturing companies, by contrast have often ventured overseas to protect old markets or to seek new ones, cheap labour in other countries may also lure foreign investors.

6. Recession hit industries resort to globalization as a strategy to overcome the crisis. Mercedes Benz is passing through lean period and has plans to cut jobs by 70,000. Mercedes has plans to shift car truck and bus production to overseas factories. In fact, the dalmies - benz is internationalizing almost every function starting from purchasing to production, sales to research and design to public relations.

7. Often the nationality of a company may affect its motives for going international. Companies based outside the US, for example may choose to go there to find political stability which is relatively good there. Similarly, it has been much more common for foreign companies to invest in the US to get technology and managerial know how than vice-versa. More recently, American companies have started looking to Japan for new technological and managerial perspectives.

8. Companies often set up overseas plants to reduce high transportation costs. The higher the ratio of the unit cost to the selling prices per unit the more significant the transportation factor becomes. The goal of lowering transportation costs, for example, played decisive role in caterpillar's manufacturing in a few centralized facilities but produces the final product in plants located in its major markets.

9. Some companies set-up plants overseas so to be close to their raw materials supply and to the markets for their finished products. Major oil companies, for example, have built refineries in Europe (a major market) and the middle east (a major source of oil) to help reduce the cost of their logistical chains.

10. The motivation to go global in high-tech. industries is slightly different. Companies in electronics and telecommunications must spend large sums on research and development for new products and thus may be compelled to seek ways to improve sales volume to support substantially high overhead expenditures. If domestic sales and exports and do not generate sufficient cash flow the companies naturally might look to overseas manufacturing plants and sales branches to generate higher sales and better cash flows.

11. Other developments also contribute to the increasing internationalization of business:

• US. Canada and Mexico have signed the North American free Trade Agreement (NAFTA), which will remove all barriers to trade among these countries and create a huge North American market. Chile Latin American Countries. Argentina and Brazil are likely to join NAFTA, thus creating a huge market,

• The European Union (EU) has become a reality and the only barrier remaining as the emergence of united currency. Euphonically described as the united states of Europe, EU emerging as the most integrated single market combining 15 countries. The combined gross domestic product of these 15 countries exceeds that of either the United States or Japan.

• The creation of the world Trade organization (WTO) is stimulating increased cross-border trade. The newly created WTO will have more power, than its predecessor GATT, to enforce ruling on trade disputes and create a more efficient system for monitoring trade policies. World economic powers such as the EU, US, Canada, and Japan are now part of the WTO. Collectively, all those who have joined the world trade body account for two thirds to the international trade.

• Both central and Eastern European, Russia and other republics of the former Soviet Union and converting themselves into market economies. All these countries are attracting MNC's looking for expansion opportunities. Coco-Cola for example, has pumped in more than $1.5 billion into eastern Europe.

• Some of the less developed countries are showing economic progress, India is one example. Removing all barriers, Government of India has thrown a red-carpet welcome to the MNCs as Coca-Cola, Daimler-Benz Ford Motor, GE, Kellogg’s and a host of others. Between 1991-95, the foreign direct investment rose from $ 200 million to $ 1 billion.

12.4.3 BENEFITS OF GLOBALIZATION

Benefits of globalization are enormous and can be studied under two broad heads:

1. Benefit to the host countries, and
2. Benefit to the home countries.

Benefits to the HOST Countries: To the host countries, MNCs are likely to bring the following benefits

- Transfer to technology. Capital and entrepreneurship to the host country.
- Improvement of the host country's balance of payments.
- Creation of local job and career opportunities.
- Improved competition in the local economy and better utilization of available resources.
- Greater availability of products for local consumers.
- Greater access to high quality managerial talent that tends to be scarce in host countries, particularly the developing ones.
- Encouragement to world economic unity and through that, political and economic integration - all resulting in world harmony.

It may be noted that in each of the above benefits, the opposite may occur. For example, an MNC may use local financing, thereby absorbing capital that might have financed indigenous companies. Or a few well-advertised, standardized consumer products may drive many locally products from the market, thereby reducing consumer choice.

Benefits to the Home countries is:

- Acquisition of raw materials from abroad, often from a steadier supply and at lower process than can be found domestically.
- Technology and management expertise acquired from competing in global markets.
- Export of components and finished goods for assembly or distribution in foreign markets,
- Inflow of income from overseas profits, royalties, licensing fees and management contracts.
- Job and career opportunities at home and abroad in connection with overseas operations.

Inter-nationalization/Globalization of business has become a subject of very serious discussion in the national economic policies and corporate boards rooms. The subject was assumed great significance in the light of the recent changes in the global business environment and the national economic policy changes. In fact, the very first

objective of the current export - import (1992-97) of India is to establish the framework for globalization of Indian foreign trade.

International trade is growing faster than worked output and international investment is growing much faster than the global trade. These are clear Indications of the growing internationalization of business.

1. Growth Opportunities

The enormous growth potential of many foreign markets is a very strong attraction for foreign companies. In a number of developing countries, both the population and income are growing fast. Naisbitt observes, Asians will be the consumers of the 1990's. During the decade, 80 million more will be added to the wealthiest Asian countries (versus about 10 million in Europe). That means great opportunities for north Americans and Europeans, as well as for Asian producers.

It may be noted that several developing countries, the newly industrializing countries (Nies) and the people's Republic of China in particular have been growing much faster than the developed countries. Even of the market for several goods in these countries is not very substantial at present, many companies are eager to establish a foothold there considering the future potential.

2. Domestic Market Constraints

Domestic demand constraints drive many companies to expanding the market beyond the national border. The markets for a number of products have tended to saturate or decline in the advanced countries. This often happens when the market potential has been almost fully tapped. In the United States, for example, the stock of several consumer durables like cares, TV sets etc. exceed the total number of households. Estimates are that in the first quarter of the 21st century, while the population in some of the advanced economies would saturate or would grow very negligibly, in some other there would be a decline. Such demographic trends have very adverse effects on certain lines of business, for example, the fall in the birth rate implies contraction of market for several baby products.

Another type of domestic market constraint arises from the scale economies. The technological advances have increased the size of the optimum scale of operation substantially on many industries making it necessary to have foregone market in addition to the domestic market take advantage of the scale economies. It is the thrust given to exports that enabled certain countries like South-Korea to set-up economic size plants. In the absence of foreign markets, domestic market constraint comes in the way of benefiting from the economies of scale in some industries.

Particularly when the domestic market is very small Inter-nationalization is the only way to achieve significant growth. For example, nestle derives only about two percent of its total sales from its home market Switzerland. Similarly, with only 8 percent of the sales coming from the home market, Holland many different national subsidiaries of the Philips have contributed much larger share of total revenue than the parent company. International business may help a firm to mitigate the effect of domestic recession.

3. Competition

Competition may become a driving force behind Inter-nationalization. A protected market does not normally motivate companies to seek business outside the home market. Until the liberalization which started in July 1991, the Indian economy was a protected market. Not only that the domestic producers were protected from foreign competition but also domestic competition was restricted by several policy induced entry barriers, operated by such measures as industrial licensing and the MRTP regulations. Being in a sellers' market, the Indian companies in general, did not take the foreign market seriously. The economic liberalisation ushered in India since 1991, which have, however, significantly planning to go international in by companies also take an offensive international competitive strategy by way of counter competition.

The strategy of centre competition is to penetrate the home market of the potential competitor so as to diminish its competitive strength and to protect the domestic market share form foreign penetration. Effective counter-competition has a destabilizing impact on the foreign company's cash flows. Direct market penetration can drain vital cash flows from the foreign company's domestic operations. This drain can result in lost opportunities, reduced income and limited producing, impairing the competitor's ability to make overseas thrusts.

4. Government Policies and Regulations

Government policies and regulations may also motivate inter-nationalization. There are both positive and negative factors, which could cause inter-nationalization. Many governments give a number of incentives and other positive support to domestic companies to and to invest in foreign countries. Similarly, several countries give a lot of importance to import development and foreign investment.

Sometime as was the case in India companies may be obliged to earn foreign exchange to finance their imports and to meet certain other foreign exchange requirements like payment at royalty, dividend etc. Further, in India

permission to enter certain industries by the large companies and foreign companies was subject to specific export obligation. Some companies also move to foreign countries because of certain regulations, like the environmental laws in advanced countries.

S. Spin-off Benefit

International business has certain spin-off benefits too. International business may help the company to improve its domestic business. International business also helps to improve the image of the company. Further, the foreign exchange may enable a company to import capital goods, technology etc. Which may not otherwise be possible in countries like India. Another attraction of export is the economic incentives feared by the government.

6. Strategic Vision

The systematic and growing inter-nationalization of many companies is essentially a part of their business policy or strategic management. The stimulus for internationalization comes from the urge to grow, the need to become competitive the need to diversity and to gain the strategic advantages of internationalization. There are a number of corporations, which are truly global. Planning of manufacturing facilities, logistical systems, financial and marketing policies of such corporations is considering the entire world as a single market a borderless world.

12.4.4 GLOBALIZATION OF INDIAN BUSINESS

India's international business has been confined mostly to exports. Although some developing countries like S. Korea and Taiwan, whose planned development have made substantial investment into other countries, India companies have not made any significant foreign investment so far. Although government of India has been encouraging foreign investment by Indian companies subject to certain conditions. Several factors like the domestic economic policy and the domestic economic situation have been deterrents to foreign investment by Indian companies.

By restricting the areas operation and growth the government policy seriously constrained the potential of Indian companies to make foray into the foreign countries through investment. Added to this was the attraction of the protected domestic market which was in many cases a seller market which made the Indian companies to ignore the foreign markets. The new economic policy of India is expected to encourage the inter-nationalization of India business.

The increasing domestic competition is compelling many companies to pursue antinationalization vigorously. The liberalization of policy towards foreign technology and collaboration is enabling Indian companies to upgrade their production facilities or to establish new facilities which help them enter expand the foreign market. A number of companies have thus increased foreign business. A number of Indian companies are also setting up units abroad, either alone or in collaboration with foreign firms.

Indian companies have also been acquiring firms in foreign countries. More and more Indian firms have been taking advantage of the international sourcing by becoming suppliers of parts and components to companies abroad. For example, the recent recession in the Indian automobile industry has encouraged several component manufacturers to seek buyers abroad.

Technological and marketing tie-ups with foreign will play a major role in internationalization of the Indian business, while many foreign firms are interested in such collaboration for sourcing supplies for the foreign markets many other foreign firms would like to have such collaborations for business in both the Indian and foreign markets. Indian business, however, encounters the following problems in inter-nationalization:

1. Policy and procedural problems.
2. Infrastructure bottlenecks.
3. Resource constraints.
4. High domestic costs.
5. Lack of experience in managing business abroad.
6. Limited R and ID and marketing research.

Although a number of companies are planning to substantially expand their international business a true global orientation is yet to set in.

12.5 PRIVATIZATION IN INDIA

12.5.1 Performance of Public Enterprises in India

India's public enterprises account for approximately 15 per cent of gross domestic product and 30 per cent of investment. Here are 240 central public enterprises. The performance of central public enterprises has been poor. Public enterprises place a heavy on the Indian economy. Approximately 40 per cent of the central public enterprises are chronic loss-markers. The public enterprise sector requires a budget support of 0.5 per cent of GDP and their after-tax return on capital of 5 per cent is almost entirely due to the oil-sector monopoly. The present rate of return on capital from the public enterprises is much lower than that of private films. Public enterprises have higher production costs than private enterprises. They divert resources form growth enhancing public spending. The poor quality of products and the high-cost inputs, produced by public enterprises, affect India's industrial competitiveness. Public enterprises in India are inefficient, their subsidization weakens India's fiscal position, and their poor performance adversely affects India's industry. The inefficiency of public enterprises hinders growth, and indirectly hampers the national effort to reduce poverty. If the government of India was not responsible for subsidizing public enterprises, its fiscal position would have been better. Profitability in the private sector in India is much higher than that of the public enterprises except for the Petroleum sector and a handful of firms public enterprises have been either incurring losses or earning very little profits.

From Public Enterprise Reform. and Partial Divestiture to Privatization

Neither statutory and administrative measures to reform to public enterprise nor partial divestiture of public enterprises have been successful. This suggests that privatization of these enterprises can be the method of choice for raising India industrial productivity, Divestiture of, at least, 51 per cent would provide the corporate management with operational autonomy, flexibility, and subject them to market forces because the authorities will no longer control the enterprise. Privatization of the bulk of the public enterprises in India, can be important step toward enhancing India's productive efficiency, improving its fiscal position (public savings), encouraging private sector development and above all, increasing its economic growth.

The government of india undertook partial divestiture in which it sold up to 49 per cent shares of selected profitable public enterprises, leaving control under the authorities' management. The primary objective of divestiture was to raise revenue. These divestiture programs were criticized for failing to raise enough money for the government. The revenue raised as a result of sale were less than what was anticipated. Divestiture did not pass the control of the enter-prises to the private sector since the sales of share were limited to the minor portion of the total shares of the public enterprise. Government owned financial institutions and mutual funds hold most of the divested shares which are actively traded in the market. Public enterprises remain subject to authorities directives. In spite of partial divestiture, public enterprises do not have operational autonomy and flexibility, comparable to firms in the private sector. Such divestiture cannot contribute to raising the productive efficiency of the firms.

12.5.2 MEANING AND SCOPE OF PRIVATIZATION

The term privatization connotes a wide range of ideas. In a narrow sense, it implies the induction of private ownership in publicly owned enterprises, but in a broader sense, it connotes besides private ownership (or even without change of ownership) the induction of private management and control in the public sector enterprises. It covers three sets measures:

1. Ownership Measures: The sets of measures which transfer ownership of public enterprises, fully or partially, lead to privatization. The higher the transfer to the individual, co-operative or corporate sector, the higher the degree of privatization.

2. Organizational Measures: A number of organizational measures are conceived to limit the govt. control like providing sufficient autonomy in the decision marking, thereby reducing the centralized managerial functions. Another way is that while retaining the ownership by the govt., the enterprises may be leased out to a private bidder for specified time. In addition, restructuring may also be carried out by redefining the set of commercial activities, by concentrating on the core competencies.

3. Operational Measures: These are intended to improve the efficiency of the organization. They, in fact inculcate a sense of commercialization in the enterprises. Provision of incentives to employees consistent with increase in efficiency and productivity is another way of bringing the reforms.

The Government has initiated certain steps in this direction by making a provision that 5% of the capital issues will be reserved for the employees of those organizations in 1988. Subsequently in 1991-92 budget it was announced that 20% of the equity would be disinvested to favour of mutual funds and financial institutions. These measures have been of only monetary significance but cannot after the cultural milieu of the organization. The privatization of 5% shares in the name of employees can hardly make any change in the work ethos. It can be only considered a half - hearted attempt on the part of the government.

12.5.3 RATIONALE BEHIND THE PRIVATIZATION

1. Productivity Gains from Privatization

Advocates in favour of privatization of public enterprises argue that it increases the productive efficiency and effectiveness of a firm. Private ownership of a firm leads to profit-maximizing behaviour. Privatization encourage competition; creates better corporate management, product quality and customer service: cuts down bureaucracy and expedites the development of capital projects; reduces political interference in corporate management; ensures the right economic incentives; and leads to an infusion of private capital.

2. Fiscal Impact of Privatization

There is fiscal reason for privatization, selling public enterprises raises Government revenue. The funds obtained can be used not only for severance payments for workers but also for retiring the national debt. Once the public enterprises are privatized, budgetary support for them is no longer required. This allows government expenditure to shift toward education, health, and the social services. Moreover, as productivity gains appear in the newly privatized firms, the authorities obtain corporate tax revenues from the profits. If the authorities continue to hold minority share of private enterprises, then the government will receive higher dividends than it does presently.

3. Other Reasons for Privatization

Privatization leads to less political and bureaucratic interference in the economy and in industrial management, greater autonomy in decision making by the managers, and improved motivation due to the altered incentive structure. Furthermore, competition from the private sector and the threat of privatization cause public sector managers to increase their efficiency, privatization demonstrates that the authorities have a market friendly attitude toward businesses and the authorities expect that the private sector to play a leading role in the country's development privatization sends out strong signals for investors, both at home and overseas, and thereby improves and changes investor's perception of country conditions. It serves as a mechanism for achieving widespread share ownership. There are symbiotic links between privatization and capital market development. A faster rate of privatization is associated with the broadening and the deepening of the supply of domestic and international with the broadening and the deepening of the supply of domestic and international capital. While the privatization of public enterprises is not a substitute for private sector development, it contributes to building confidence about the policy environment.

12.5.4 THE PRIVATIZATION PATH - STRATEGIC ISSUES IN INDIAN PERSPECTIVE

The path of privatization is determined by the historic, social, cultural, and institutional setting of the country - some of the strategic issues in privatization are discussed pertaining to the need for a comprehensive privatization; Policy problems in privatizing different types of firms; most structure and private declaration prospects of privatizing public enterprises by sectors.

(A) Comprehensive Privatization Policy

The Government of India needs to formulate a comprehensive policy for privatization. It can set up a central privatization agency whose task will be to formulate a comprehensive privatization policy for India.

Central privatization Agency

The criteria of a central privatization agency can accelerate the pace of privatization by streamlining and centralizing India's privatization policy. Its task should not only be to conduct analysis required for prudent privatization policy but also to ensure its effective implementation. It should be given a strong political mandate to purse the privatization of public enterprises, while being relatively independent of the authorities, it should be composed of officials supportive of privatization. The execution of privatization policy can be decentralized; once the policy and the methods (s) of privatization have been finalized by the central privatization agency and approved by the political authorities, the relevant the ministries, departments, or other appropriate authorities can immediately and independently take the steps toward privatizing the public enterprises in their own specific sectors, functional areas, or regions, within the period, criteria, and the policy framework determined by the central privatization agency.

Privatization policy statement

The comprehensive policy statement on privatization may address the following issues:

1. Define the objectives of the privatization programme in India. The design of the privatization programme in India will depend on how the authorities define their objectives, and on the foundation of their of political support. In India, the main objective of the privatization programme should be to raise the efficiency of the firms.

2. Provide a detailed strategic review of public enterprises. Policy-makers will have to determine the extent of control on industry by Government.

3. Determine the parameters of the programme, Specifically, identifying the public enterprises to be sold in India. It can announce the various stages of the privatization programme and set the goals for each stage of privatization.

4. Determine the regulatory structures for monopolies, and set the mechanism for creating and enforcing the regulatory and competition policies. Establish the Government's position of the internal restructuring of the public enterprises, and the policy with respect to public enterprises that remains under Government ownership and/or control after the privatization programme.

6. Propose and implement rational policies regarding the retrenchment of workers, bankruptcy, and land use and sale.

7. Establish an indicative time-table of privatization.

8. Win public support. The privatization programme must receive publicity not only for marketing purposes but also for gaining public support. The programme can benefit if it secures employee participation and motivation.

9. Set the selling strategy, the procedure of privatization and the method for asset valuation. In order to sell any given public enterprise, the privatization agency must pay attention to prospectus preparation; overseas issue of shares, if any; the logistics of the sale; the marketing of the enterprise; and, of course, legal matters.

The comprehensive policy statement may specify which bodies should be responsible for strategic review; preparation for sale including marketing; evaluation of tenders, sale negotiations, and tender awards, and, finally, sale and transfer to the private sector.

(B) Problems in Privatizing Different Types of Firms

There is a need to address fundamental tactical question related to the type of firms it should privatize. The selection of firms and sectors to be privatized and the appropriate timing of the programme are vital to obtain financial and political success and to win public support. Achieving success at an early stage of the programme is important. Furthermore, the authorities should focus not only on obtaining fiscal gains but also productivity gains from privatizing its enterprises.

The Importance of Early Success

It should be ensured that the first set of privatization measures is a success and showcase for later measures. Therefore, the authorities ought to be especially careful in selecting the firms for privatization in the beginning. This success is necessary to convince critics, employees, trade unions and a sceptical public of the significant economic benefits from privatization and ensure support for implementing deeper reforms. The failure of divestiture

programmes to generate public support business community's interest and obtain enough revenue has led to the lack of progress on India's privatization programme.

Privatizing Profitable Enterprises

The star performers are easier to privatize than loss - making enterprises, since the firm is profitable even under authorities' control, buyers would be eager to purchase it. However, the financial success of the firm may rest on the monopoly status granted by the authorities. The financial success of a public enterprise could also suggest that it is already being efficiently run and there is not much scope for productivity gains. Indeed, the public may doubt the need to privatize profitable enterprises. Hence, it will be incumbent upon the authorities to convince the public that private management of such firms can bring about greater efficiency and higher rate of return, and the sale of profitable public enterprises is necessary to improve its fiscal position. The authorities should deregulate monopolies before privatizing enterprises in those sectors.

Privatizing Unprofitable Enterprises

The firms that are operating at a loss are the ones girth the greatest need for privatization. The Loss - marking and troubled firms have the highest potential for gains in productivity due to privatization. But the firms whose operation cannot be justified on economic grounds should be simply showdown because, even under private ownership, these firms will not be economically profitable.

Privatizing Large or small Firms

There are "symbolic or strategic (political} reasons for choosing to privatize one firm rather than another, and one sector instead of another. The authorities may decide to start its privatization programme by selling large public enterprise monopolies in, what is perceived as, strategically important sectors, to emphasize its commitment to reform, attract the attention of international capital and so on. Although starting with large firms involves risks, it signals to the public and the markets that the authorities are serious about reducing state intervention in the economy.

The authorities can decide to play a more cautious role by selling small and noncontroversial firms in the beginning the models for small scale privatization are based on individual choice; simplicity; and the fairness of the deal. After achieving success, building confidence, and learning how to privatize, the authorities can embark on more ambitious programmes of privatizing large firms and firms in key sectors of the economy. The authorities might start with the privatization of small and medium-sized, firms because of low political risk and the ease of implementation and transfer. It also prepares the public for larger privatization.

The privatization of bigger firms offers bigger welfare gains; the privatization of smaller firms offers smaller gains. However, large enterprises size in terms of the net worth can make a public firm difficult to privatize due to the death of potential buyers. Enterprises with larger number of workers involved in trade unions, may face stiff opposition to privatization: enterprises with smaller number of workers not encounter trade union opposition to privatization.

Dangers of Imprudent Approaches to Privatization and the Importance of Productivity Gains

The main purpose of the privatization programme should be to raise the productivity and performance rather than raising revenue. The authorities should not decide to privatize a firm solely on the basis of its financial condition and the impact of the sale to the Government's fiscal position, The sale of any public enterprises is a part its overall privatization and reform strategy. The authorities must consider the potential for gains in productivity under private ownership.

If the objective in the privatization programme is to solely raise funds, there is a danger that the Government may authorize the restriction of competition by permitting the privatized firms to inherit the monopolistic features of public enterprises. It is possible that the authorities can raise plenty of funds by refusing to remove barriers to entry at the expense of the social welfare of the public. Potential buyers would be willing to pay high price for the public enterprises because of their market power. Such an approach toward prevacation is unsound since the main purpose of privatization is to increase the country's productive efficiency and the level of output, Thus, for instance, privatizing the Indian petroleum sector might raise considerable revenue for the government mainly because it would transfer a state monopoly to the private sector. The authorities may liberalize monopolistic sectors, initially opening them to competition and them start privatizing.

As argued earlier, early sales have to be successful but the authorities need to liquidate non - viable firms and privatize loss - marking and otherwise troubled but viable firms as possible because these are the firms with highest levels of inefficiency and are a financial burden on the Government However, in order to get financial success, the authorities are likely to sell its monopolies and profit-marking firms. But clearly state monopolies should be sold after establishing an adequate regulatory body and competition policies to obtain the maximum gains from privatization.

(C) Market structure and Privatization

It may be argued here that it is better to distinguish sectors on the basis of externality and market structure rather than on a priority notion of what constitutes the industrial core of an economy. The market structure of an industry determines the scope of productivity gains from privatization. "Core and "Non-Core" Sectors.

The Indian authorities have often identified certain sectors as "core" and have argued that enterprises in these sectors ought to remain under public ownership and control. There is no theoretical basis of drawing a distinction between "core and "hon-core" sectors. It relies on a priority notion, influenced by concepts from central planning which emphasized heavy industries. However, from the advantage point of economic rationality, it is sensible to identify sectors with positive or negative externality and to determine the market structure of an industry. The authorities can support sectors with positive externality and regulate sectors with negative externality. But the appropriate tools for supporting and regulating are subsidies and taxes rather than public ownership of enterprises. In case of monopolistic industry, the authorise should deregulate and encourage competition. In case of natural monopolies, the authorities can set appropriate regulation to assure the optimal level of output and price.

Market Structure

Even if a public enterprises firm is properly regulated and well-managed, privatization on can yield benefits. Ownership change by itself yields gains in productivity. It is also possible that replicating public monopoly by private monopoly will increase productive efficiency because, of reduced political and administrative interference; changed property rights; and more efficient financial management. However, in order to obtain maximum gains from privatization in non-competitive sector industry regulation must be in place and be implemented rigorously. Regulatory systems can protect consumer's interests. Monopolies, in property regulated industries, have limited ability to abuse market power. The private provider of a monopoly service needs to be governed by a goods set of incentive. Regulations should be justifiable in terms of cost-benefit analysis. In a monopolistic market structure, welfare gains from private direction are large. Provided regulation can offset the opportunity for the appropriate economic rents. In industries with monopoly structure, privatization works best accompanied by appropriate regulation. The regulation regime must have a credible regulatory framework of contracts impartial resolution of conflicts rather than ministerial decrees. The purpose of regulation should be to improve resource allocation in markets where firms have potential, not to increase the scope of authorities' intervention in the economy. In essence, privatization and proper regulation are better than mere privatization,

Privatizing public enterprises in competitive markets can be beneficial. In a competitive environment, however, efficiency gains from privatization are smaller but still positive. The privatization of the industry can yield large aggregate gains. Competition is a desirable objective in privatization process.

12.6 ANSWER TO SELF-CHECK EXERCISE

1. Sensex

2. Tenure

12.7 SHORT QUESTIONS

1. Define economic reforms.

2. Discuss liberalization policy.

3. Describe structural adjustment programme.

4. What do you mean by privatization?

12.8 LONG QUESTIONS

1. Write a detailed note on the structural reforms of 2002 budget.

2. Describe the impact of Economic reforms in India,

3. Discuss liberalization measures introduced in the New Industrial Policy 1991.

4. Explain Privatization policy statement in detail.

12.9 KEY WORDS

Economic reforms, New Industrial Policy 1991, liberalization, Privatization

12.10 SUGGESTED READING

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WORLD TRADE ORGANISATION AND INTELLECTUAL PROPERTY RIGHTS

STRUCTURE

13.1 Objectives
13.2 Introduction andMeaning
13.3 Features ofWTO
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13.11 Summary
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13.13 Glossary
13.14 Keywords
13.15 SuggestedReadings
13.16 Answers to Self Check Exercise

13.1 OBJECTIVES

After reading this chapter, the student should be able to :

(i) Understand the meaning, features, objectives, scope and functions ofWTO.
(ii) To understand some leading agreements made byWTO.
(iii) To understand Intellectual PropertyRights.
(iv) To understand arguments in favour and againstWTO.

13.2 INTRODUCTION ANDMEANING

World Trade Organisation (WTO) was formulated to promote free trade among its member nations. Its main objective is to promote multilateral trade (trade among many nations)ingoodsandservicesbyeliminatingtariffandnon-tariffbarriers.Eliminatingtariff barriers means removing import duties and eliminating non-tariff barriers means removing import quotas, quantitative restrictions, import licensing etc. In eighth round of General Agreement on Tariffs and Trade (GATT), popularly known as Uruguay Round, member- nations of GATT decided to set up a new organisation, in place of GATT. The new organization was named as World Trade Organisation. WTO was formed on 1stJanuary,

1995. It took over GATT.

At the time of its establishment on 1st January, 1995, WTO had membership of 124 nations. In the year 2004, its membership increased to 148. India is one of the founder members of WT0. Some areas like trade in services, promoting foreign investment, protecting patents, dispute settlement, trade in textiles and clothing, etc. were given specialemphasis
in WTO.

In short, WTO is a new globally recognized trade organisation with the new name
succeeding GATT on renewed agreements and having a new vision and strong enforcement power to promote international trade. WTO consists of a council for goods, a council for services and a council for intellectual property rights. WTO along with World Bank and the IMF, will greatly influence global trade policy.

13.3 FEATURES OFWTO

(1) It is an international organisation to promote multilateraltrade.

(2) It has replacedGATT.

(3) It promotes free-trade by removing tariff and non-tariff barriers in international trade.

(4) It has fixed set of rules and regulations and it has a legal status. Its rulesand regulations are mutually designed and agreed upon by member-nations.

(5) Agreements agreed by member-countries are binding on all members of WTO and if any member does not follow such agreements, then its complaint can be lodged with the Dispute Settlement Body ofWTO.

(6) It includes trade in goods, trade in services, protection of Intellectual-property- rights, trade-related investment measures,etc.

(7) Unlike International Monetary Fund (IMF) and the World Bank, WTO is notan agent of United Nations.

(8) Unlike IMF and World Bank, there is no weighted voting (on the basis of capital). Rather all the WTO members have equal voting rights (One Country, OneVote).

(9) WTO has a large Secretariat and huge organizationalset-up.

13.4 OBJECTIVES OFWTO

Important objectives of WTO are as follows:

(i) The primary aim of WTO is to implement the new world tradeagreements.

(ii) To promote multilateral trade i.e., trade among manynations.

(iii) To promote free trade by abolishing tariff and non-tariffbarriers.

(iv) To promote world trade in a manner that benefits every membercountry.

(v) To ensure that developing countries get a better share in the advantages resulting from the expansion of international trade corresponding to their developmental needs.

(vi) To demolish all hurdles to an open world trading system and use world trade asan effective instrument to foster economic growth.

(vii) To enhance competitiveness among all trading partners so as to benefitconsumers.

(viii) To increase the level of production and productivity with a view to increase the level of employment in theworld.

(ix) To expand and utilize world resources in the most optimummanner.

(x) To improve the level of living for the global population and speed up economic development of the membernation.

13.5 FUNCTIONS OFWTO

(i) Laying down code of conduct aiming at reducing tariff and non-tariff barriersin international trade.
(ii) Implementing WTO agreements and administering the internationaltrade.
(iii) Cooperating with IMF and World Bank and its associates forestablishing coordination in Global Economic Policy-Making.
(iv) Settling trade related disputes among member nations with the help ofits Dispute Settlement Body (DSB).
(v) Reviewing trade related economic policies of member countries with the help ofits Trade Policy ReviewBody(TPRB).
(vi) Providing technical assistance and guidance related to management offoreign trade and fiscal policy to its member nations.
(vii) Acting as forum for tradeliberalization.

13.6 SCOPE OFWTO

GATT was mainly concerned with promotion of trade of goods. Trade in services was not given much emphasis. While in WTO trade in services has also been promoted. It has following main areas:

(i) Trade inGoods
(ii) Trade Related Intellectual Property Rights(TRIPs)
(iii) Trade Related Investment Measures (TRIMs)
(iv) General Agreement on Trade in Services(OATS).

The WTOhas stronger implementation power and wider acceptance for the implementation of the Agreements as compared to GATT. Its principal agreements areas under :

13.7 WORLD TRADE ORGANISATION-SOMEAGREEMENTS

13.7.1 Trade in Agriculture

WTO imposes following disciplines on agriculture:

(1) Reduction in Domestic Subsidies: WTO urged the member countries to reduce subsidies in the agriculture sector. Agricultural subsidies are of twotypes:
  (a) Subsidy on Agriculture inputs like subsidy on seeds, fertilizers, pesticidesetc.
  (b) Subsidy on Agricultural output. It refers to fixing support price in theinterest of farmers.
(2) Reduction in Export Subsidies: Some countries are providing export subsidiesfor promoting agricultural exports. WTO agreements urged the member-countries to abolish these export subsidies in phased manner. ln Doha Agreement, in the year 2001, WTO urged the members to abolish all forms of export subsidies onagricultural products.
(3) Improvement in Market Access: To improve market access for internationaltrade, following suggestions were made by WTO:
  (a) Reductionintariffonagriculturalproducts.WTOhasputtarifflimitsfor different products. Member countries cannot impose tariff (custom duty on imports) beyond that limit, although they can fix tariff below this limit.
  (b) Non - tariff barriers will beabolished
  (c) Developing and least developed countries are given some concessions regarding removal of tariff and non-tariffbarriers

(4-)Public Distribution System: It refers to distributing food grains by government at confessional rates to the people living below the poverty line

13. 7.2 Trade in Textile andClothing

In trade in textiles clothing 'Multi-Fibre Arrangement (MFA) was prevalent form last many years. WTO agreements with regard to trade in textiles and clothing provide for the following provisions :

(I) EliminationofMFA:TheimplementationoftheagreementbytheWTOontextile and clothing would mean 'the elimination of MFA' or in other words the elimination of all non-tariff measures (Import quota/Quantitative restrictions)in textile and clothing industries over a period of IO years (I995-2004) and thus integration of textile and clothing sector on 1st January, 2005 into free trade system underWTO.

(2) Reduction in Tariff on Textiles and Clothing: It will be done in followingphases.

(a) 16% of Imports will be made tariff free on 1st January,1995.

(b) Further17%ofImportswillbemadetarifffreeon1stJanuary,1998.

(c) Further 18% of Imports will be made tariff free on 1stJanuary, 2002.

(d) Remaining 49% of Imports will be made tariff free by 1st January,2005.

It means that import of textiles and clothing will be tariff free by 1st January, 2005. It will benefit textile exporting countries likeIndia.

(3) Safeguard Mechanism: The interest of developing countries has been kept safe under certain safeguard mechanism which can be applied for a maximum period ofthreeyears.Thedevelopingcountriesareallowedtoimposetariffandnon-tariff measuresincertaincircumstancesifimportsarethreat totheirdomesticindustries i.e.thedevelopingnationscanimposeimportrestrictions toprotecttheirdomestic industry.

13.7.3 Trade Related Intellectual Property Rights(TRIPs)

TRIPs agreements are related to of intellectual property rights. These intellectual property rights can be with regard to copyright, trade mark, patents etc. Under TRJPs owner of patent gets patent registered for a particular period of time. Any person who wants to use that patent, can use it by paying royalty to the owner of the patent. TRIPs agreement gives this right on various types of intellectual properties. Those countries who do not have patent rules in their countries, are to enact patent rules within a period of 10 years. Only those intellectual properties can be patented which are new, involve research and can be put to industrial use. But plants cannot be patented. For safeguarding the rights of plant breeders, GAIT has recommended the system of 'Sui Generis System'. Under this system plant breeders will have exclusive rights over the new plant breeds that they have invented. India has accepted 'Sui Generis System'. It is different from 'patents' and commonly refers to the system of protection of 'Plant Breeders Right' (PBR). It allows farmers to retain the seed, from their own cultivated crop (farm saved - seeds). The farmers can use these farm-saved -seeds on their own farms Le., after purchasing the patented seeds for once the farmer can use farm saved seeds in their future crops, without paying subsequent royalty. The commercial sale of seeds can only be done by plantbreeders.
Only the owners of the ' Plan t Breeders Right' (Plant Breeder) will produce and market their breeded plants.

Under TRIPs life of patents has been fixed as follows:

(a) General patents - 20 years
(b) Copyrights - 50years
(c) Trademarks - 7years
(d) Industrial designs - 10 years
(e) Medicines - 10years

However, certain articles like life saving medicines are exempted from the provisions of patents in the public interest. The intellectual property rights which are patented can be used by the manufacturers/consumers by making payment of royalty to patent-holders.

13.7.4 Trade Related Investment Measures(TRIMs)

TRIMS are investment related measures proposed by to ensure free flow of investment allover the world. In these measures, foreign investment is treated at par with domesticinvestment It will abolish all forms of protection to domestic investment. The mainfeaturesof TRIMs are:

(i) To offer fair treatment and all such facilities to all foreign investors: as areavailable to their domestic investors.
(ii) To remove restrictions on repatriation of dividend, interest and royaltyof multinational companies (Repatriation here means sending money back to the parent country)
(iii) To allow 100 per cent foreign equity participation in certaincases.
(iv) No restriction on any area of foreign investment, i.e., foreign companies canmake investment in any area.

In short, this provision of TRIMs under opens up the opportunity to foreign investorsto investanywhere in the world in any economic activity. The Agreement further ensures that all the units whether 'indigenous'or 'foreign' will be treated at par without anydiscriminationin terms of regulations and policies.

13.7.5 General Agreement on Trade in Services (OATS)

The General Agreement on Trade in Services (OATS) is the first multilateral agreement in services whose objective is progressive of trade in services. It provides for free flow of services among the member nations. OATS is designed for free flow of services on the same lines as it was for trade in goods among the member nations. The Agreement covers trade in all types of services like insurance, travel, tourism, hotel, banking, shipping, telecommunication, software, media etc. Services constitute about fifty percent of thetotalproductive-activity of the world.

Trade in services has been brought within the purview of WTO for the first time.Now foreign services will be treated at par with domestic services. By allowing free entry to foreign services, advanced technology of the Foreign Service sector will be available to developing countries.

13.7.6 Dispute Settlement

For settlement of disputes relating to international trade, WTO has set up Dispute SettlementBody(DSB).Infirststage,DSBconsultspartiesunderdispute.ThenDirector General of WTO will act as mediator for the settlement of dispute. The complainant country can also ask OSB to set up a panel for dispute settlement. The panel will be constituted by DSB whose decision will be unconditionally acceptable to both parties. This panel will have to give its report within 60-90 days. The OSB will take the final decision on the basis ofthisreport within 30 days.

13.7.7. Agreement on Export Subsidies

WTOagreementsprohibitexportsubsidiestopromotefreeandfairglobalcompetition in the world trade. But in this agreement developing countries are exempted from giving export subsidies; i.e. developing countries can give export subsidies. But only those developingcountriescangrantexportsubsidieswhosepercapitaincomeislessthandollars and the share of that country in world trade is less than 3.25 percent.

13.7.8 Anti-Dumping Agreements

Dumpingis a practice of selling a product abroad at an unreasonably lower price. The objective of dumping is to sell surplus production in the foreign market initially at low price with a view to damage the domestic industry and later charge higher prices. The WTO Agreements stipulate that dumping measures will be curbed and no country will be allowed to dump its products in another country, but if volume of dumpedimportsfrom a particular country is less than 1 % of domestic market sale of that product, then this dumping will be, treated as insignificant and WTO will not entertain such complaint ofdumping)

13. 7.9 Monitoring or Trade Policies of MemberCountries

TheTradePolicyReviewMechanism(TPRM)providesforaTradePoliciesReviewBody (TPRB) to regularly examine the economic trade policies and practices of member-nations.' It examines economic and trade policies every two years for the four major traders (the EC, US, Japan and Canada), every four years for the next sixteen leading traders, and every six years for the remaining traders, although longer intervals may be prescribed for leastdeveloped

countries. Every member has to report to TPRB regularly about the trade policies and practices pursued by it.

13.8 ARGUMENTS AGAINSTWTO:

Critics are of the opinion that agreements on the provisions of WTO will be beneficial to developed countries alone and underdeveloped countries like India will stand to lose. Moreover entry of foreign companies in India will rob our culture andtradition.

(1) Disadvantage to Agricultural Sector: It is apprehended that by including agriculture in WTO, Indian farmers will become dependant on multinational companies for improvedseedsandagriculturaltechnology.FarmerswillhavetopayhugeamounttoMNCs forbrandedseeds,fertilizersandpesticides.Bigfarmersalonewillbeabletotake advantage ofcostlyfarmtechnology.Thecumulativeeffectofallthiswillbethatsmallfarmers,whoare

large in number, will be forced to sell their lands. This will further aggravate the problem of unemployment in rural sector.

(2) Reduction in Subsidy : Critics are of the opinion that in consequence toWTO

Agreements, subsidy to agricultural sector will be slashed. It will adversely affect the poor farmers.

(3) Import or Food Grains : It is apprehended that by entering into WTO Agreements, surplus food grains of developed countries will be imported on a large scale. The domestic farmers will face competition from imported foodgrains.

(4) Plant Breeding Protection: According to WTO protection of breeding has been determined by Sui-Generis system. Indian farmers will have to spend large amount ofmoney

to get new and improved variety of plants and their dependence on multinational companies will further increase.

(5) LosstoDomesticIndustries:AccordingtoWTOagreements,Indiawillnotimpose any restriction on foreign investment. Multinational corporations have a free entry inthe

Indian market. This will adversely affect the domestic industry, as domestic industry will not be able complete with MNCs. The small scale sector will be worst hit as it has poor marketing and technological capabilities in comparison to MNCs. As consequence domesticinvestors

will be competed out of their own market.

(6) PatentofIndianherbsbyforeigncompanies:Someforeigncompanieshavetaken patentofIndianherbs/foodgrainlikeHaldi,Neem,Tutsi,Basmatiriceetc.AnAmerican company had taken patent of haldi in 1995. India challenged it, and then WTO cancelled the patent of Haldi to American company. So India will have to make heavy payments as royalty to patent- holders for using these herbs/ foodgrains.

(7) Effect on Prices : If patents for common products like medicines, foodgrains, chemicals etc. are recognized, then developing countries like India will have to pay huge royalty to the patent holders. It will result in price rise. Indian Pharmaceutical Industry will

be hit hard by patent agreements.

(8) Increased Litigation Costs : Multinational companies may file a claimagainst Indian companies for copying of any patent before World Trade Organization. Indian researchers will have to face difficulties to prove their non-involvement in imitation case. Theywillhavetowastetheirtimeandmoney.Inthiscontextitmaybenotedthat acomplaint will be filed by the complainant in his owncountry.

(9) Issue of Social Clause, Environment Clause and LabourCost:Developed countries argue that social cost, Jabour cost and environment cost are high in developed countries in comparison to developing countries. They argue that cost of production in developed countries is high because of high labour cost and high social costs; while labour cost and social cost is low in developing countries. So developed countries should be allowed to impose tariff on imports to neutralize the difference in such cost. If this decision is taken, then developing countries will be at disadvantage as they will find it difficult to export their products in developed countries, because of tariff barriers imposed by developedcountries.

(10) LosstoRegionalGroupings:Withthepromotionofmultilateraltrade,thetradeof regional·groupingslikeSAARC,NAFI'A,ASEANetc.hascomedown.Regionalgroupspromote trade at regional level within a few countries, whereas WTO promotes trade among many nations. So the role of Regional Groupings hasreduced.

(11) Disadvantages to Service Sector : It is feared that WTO will adversely affectour service sector also. Our banking, insurance, transport, education and hotel services will not be abletocompetewiththesimilarservicesoffered byMNCs.Asaresult,indigenousinstitutes engaged in these service sectors will gradually wind up and our economic freedom willbeendangered.

(12) Increase ln Unemployment: WTO will encourage the free flow of importedgoods and multinational corporations in developing countries. MNCs use capital intensive technologywhichcreateslessemploymentopportunities.Moreoverbecauseofliberalimports domestic production of developing countries will come down. Less production activity will result in Jess employmentopportunities.

13.9 ARGUMENTS IN FAVOUR OF WTO

Arguments have been advanced against WTO is quite different. A careful study reveals that these arguments present only one-sided assessment of proposals. Some of the arguments are totally baseless. Some of the main advantages likely to accrue to India by thisresolution

are as follows:

(1) Increase in Foreign Trade : WTO has helped India in increasing its foreigntrade.

Being a member of WTO, India has its trade relations with 147 countries. WTO has helped in removing tariff and non-tariff barriers and this has opened various new markets for India. Now India's foreign trade in goods as well as in services is increasing at a very fast rate.

(2) Increase in Agricultural Exports: As a result of reduction in subsidies on agriculturalgoodsgivenbydevelopedcountries,demandforvarietyofIndianfoodgrainswill rise in international market. lt will provide opportunity for India to increase export of agriculturalproducts.WTOhasrecommendedacut incustomdutiesandreductioninimport restrictions on agricultural goods. It will also promote agricultural export from India considerably.

(3) Increase in Inflow of Foreign Investment : As per TRIMs, government has removed all the barriers to foreign investment. It has attracted foreign investment in India. Many MNCs have set up their branches in India like L.O., Samsung, Sony, etc. It has improved the level of investment in the economy. With increased investment, employment hasincreased;

(4) Improvement in Services : By including trade in service sector under WTO proposals,developingcountrieslikeIndiawillstandtogain.AccordingtoWTO,developed countries will establish large number of trade and service establishments like banking, insurance,transport,hotel,etc.ByallowingMNCstosetuptheirserviceestablishmentsin the country, on the one hand, better quality services will be available in our country and,on the other hand, millions of unemployed persons in India will get ample employment opportunities.

(5) Benefits for Clothing and Textile Industry : WTO will benefit clothing and textile industry the most. Under Multi-Fibre Arrangements (MFA) our cloth and ready-made garment trade was subject to quota restrictions. As a result of WTO all these restrictions will be removed in the next few years. Export of Indian clothes and textiles will increase. Withdrawal of quota fixation will encourage our exports to America and European countries. It will boost textile industry and new employment opportunities will be created in thissector.

(6) Inflow of Better Technology and Better Quality Products : With the increase in foreign trade and foreign investment, there will be inflow of better technology and high quality products. It will improve the standard of living of masses, promote industrial growth and import of high quality seeds will promote efficiency ofagriculture.

(7) Benefits of Multilateral Trade System : Under WTO, when a trade agreement is signed between member countries, then it will promote foreign trade of one country with all other member countries who have signed this agreement. Before WTO, foreign trade was usually bilateral, i.e. between two countries. WTO promoted multilateral trade. It has increased the trade-relations of India with 147 nations.

13.10 PROGRESS FULFILLMENT OF INDIA'S COMMITMENTS TO WORLD TRADE ORGANISATION (WTO)

The progress in fulfilment of India's commitments to World Trade Organisation may be summarized as under :

(1) Reduction in Tariff and Non-Tariff-Barriers : For fulfilling India's commitment to WTO, our government has reduced tariffs (import-duty) and has adopted the policy of liberal imports by removing quantitative restrictions, and by liberalising import-licensing. In Export- Import policy, 2004-2009, and government has clearly stated that liberal imports will be allowed by reducing tariff and non-tariffbarriers.

(2) Amendment in Patent Act : As a member of WTO, India is obliged to comply with the standards of WTO and the changes should have come in latest by January 1,2005.

Accordingly, India has amended its Patent Act and conditions of WTO have been duly incorporated in Patent Act.

(3) Sui-Generis System : In respect of plant varieties, there is an obligation on Indiato provide for protection by patents or an effective Sui Generis, or by any combination therefore. The Indian government has taken a decision to adopt 'Sui Generis System' in a modified form that suits our national interest. A legislation to this effect has been tabled in the Parliament by the Ministry ofAgriculture.

(4) Copyright, Trade Marks and Industrial Designs : India has amended theCopyright Act 1957 and the Trade and Merchandise Marks Act 1958 in 1999 and a new bill has been formulated to protect industrial designs, so as to meet the requirements set up by WTO.

(5) Geographic Indications :It means indicating the correct geographical place of origin of a product. The member countries are to make necessary legislation to ensure that wrong geographical place is not indicated. To follow this clause of WTO Agreement, Government of India enacted a new law in December 1999 on geographical indications. As per this law, the correct geographical origin of the product is to be given. So it will put a check on the wrong practice, adopted by domestic manufacturers, like using the words - 'Made in USA', 'Made in Japan' etc. whereas actually the produce is produced in thedomestic economy.

(6) Trade Related Investments Measures (TRIMs) : To adopt the TRIMs clause ofWTO, India has allowed 100 percent foreign equity participation in many areas like 'advertising, tea,power,oilrefining,coalprocessingplants,hotels,resorts,ports,airports,developmentof townships,drugsandpharmaceuticalsetc.InIndia,foreigninvestmentistreatedatparwith domestic investment. It has resulted in inflow of huge foreigninvestment.

13.7.10 Self check Exercise I

1) WTO was established on _________.
2) The eighth round of GATT, known as the _________ Round, led to the formation of WTO.
3) WTO has ________ members as of the year 2004.
4) Unlike IMF and World Bank, WTO operates on a ________ voting system.
5) TRIPs agreements are related to the protection of ________.
6) The Dispute Settlement Body (DSB) of WTO settles trade-related disputes among member nations with the help of a ________.

True/False:

7) WTO was formed on January 1, 1994. (True/False)
8) GATT was replaced by the World Trade Organization (WTO). (True/False)
9) WTO has a weighted voting system based on capital. (True/False)
10) TRIPs agreements cover intellectual property rights related to copyright, trademark, and patents. (True/False)
11) The Dispute Settlement Body (DSB) of WTO acts as a mediator for dispute resolution. (True/False)
12) Export subsidies are allowed for all developing countries under WTO agreements. (True/False)

13.11 SUMMARY

World Trade Organisation (WTO) was formulated to promote free trade among its member nations. Its main objective is to promote multilateral trade (trade among many nations) in goods and services by eliminating tariff and non-tariff barriers. The main agreements of WTO are agriculture related, in textile and clothing, Trade Related Intellectual Property Rights (TRIPs), Trade Related Investment Measures (TRIMs) andGATs.

13.12 PRACTICEQUESTIONS

Short Questions:

Q.1. What is the main objective of the World Trade Organization (WTO), and how does it differ from its predecessor, GATT?

Q.2. What does TRIPs stand for, and how does it impact intellectual property rights in the context of international trade?

Q.3. Explain the concept of dumping in international trade, and what measures does the WTO have in place to address this practice?

Q.4. How does the Trade Policy Review Mechanism (TPRM) function within the WTO, and what role does it play in examining the trade policies of member nations?

Long Questions:

Q.5. What do you mean by WTO? Why it was established? What are itsadvantages?

Q.6. Explain TRIPS and TRIMS agreements of WTO?

13.13 GLOSSARY

(i) Equal voting right = means one country, one vote

(ii) MFA = Multi- fibrearrangement

(iii) Dumping = Dumping is a practice of selling a product abroad at anunreasonably lower price.

13.14 Keywords: WTO, TRIPs, Dumping, Trade Policy Review Mechanism (TPRM)

13.15 Answers to Self Check Exercise:

Fill in the Blanks:

1) January 1, 1995
2) Uruguay
3) 148
4) One Country, One Vote
5) Intellectual Property Rights
6) Dispute Settlement Body (DSB)

True/False:

7) False
8) True
9) False
10) True
11) True
12) False

13.16 SUGGESTEDREADINGS

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COMPETITION ACT,2002

STRUCTURE

14.1 Introduction
14.2 Objectives
14.3 Restrictive practices under the purview of competitive law.
14.4 The Competition Act 2002.
14.5 Government policies related to competition.
14.6 The Competition Commission.
14.7 Anti-competitive agreements.
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14.10.A A Self-check exercise
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14.16 RecommendedReadings.
14.17 Answers to Self Check Exercise

14.1 INTRODUCTION

The Monopolies and Restrictive Trade Practices Act, 1969 has been an important economic legislation designed to assure that the operation of the economic system does not result in the concentration of economic power to the common detriment. The authority for thishasbeenderivedfromtheDirectivePrinciplesofStatePolicycontainedinArticle39of the Constitution of India, which requires the State to secure that "the operation of the economic system does not result in the concentration of wealth and means of production to the commondetriments.

The Act came into force from 1st June, 1970 end has been amended in 1974, 1980, 1982, 1984 and 1991. The MRTP Act was a very controversial legislation. The High Level Committee on Competition Policy and Law, appointed by the Government of India, recommendedthatanew CompetitionActmaybeenactedandtheMRTPActmayberepealed.

The principal objectives of MRTP Act, 1969, were :

1. Prevention of concentration of economic power to the commondetriment.
2. Control of Monopolistic, Restrictive and Unfair Trade Practices which are prejudicial to publicinterest.

The economic reforms initiated in 1991 repealed the provisions of the Act related to concentration of economic power excluding the provisions empowering the government to defuse concentration of economic power to the common detriment. The main focus of MRTPAct now is the achievement of prevention of monopolistic, restrictive and unfair trade practices. Large companies have been liberated from MRTP Act requirement of priorprovision

of the government for substantial expansion of existing undertakings, establishing new undertaking and M&As.

142 OBJECTIVES

The main objective of this chapter is to discuss the establishment of the Competition Act 2002, functions and powers of the Competition Commission of India and provisions relating to anti-competitiveagreements.

The economic liberalisation has increased the relevance of competition policy. Fair Competition is inherent in a free enterprise economy. Economic reforms have heralded competition.Thisrequiressafeguardsagainstcompetitorscrushingsmallfirmsthroughunfair means, mergers and acquisition detrimental tocompetition.

The Competition Act, enacted in December 2002, following the recommendations of the High Level Committee on Competition Policy and Law aims at fostering competition through prohibition of anti-competitive practices, abuse of dominance and regulation of combinations beyond a certain size.

With the coming into effect of the Competition Act, 2002, the Monopolies and Restrictive Trade Practices Act (MRTP) Act, 1969, was repealed and the Monopolies and Restrictive Trade Practices Commission was dissolved.

ThisAct,whichextendstothewholeofIndiaexceptthestateofJammuandKashmir, deals mainly with anti-competitive agreements, combinations and abuse of dominance and it provides for the establishment of a Competition Commission to controlthese.

The economic reforms have unleashed liberalisation and globalisation and enhanced the need and relevance of competition policy. The main objective of competition laws is to preserve and promote competitions as a means to ensure the efficient allocation of resources in an economy so that the consumers get supplies at lowest prices and of good quality. In addition, may competition laws refer to allied objectives, such as control of concentration of economic power in the hands of few, promoting the competitiveness of indigenousindustries,
encouraging innovations, supporting small and medium sized enterprises and encouraging regional development.

Mostcompetitionlawscontaincertainexceptions(mostlysectoral)andexemptionsis most cases related to categories of practices) to the application of their provisions. The logic behind exemptions differ. In some cases (market failures for eg.) competition and market forces are not viewed as the best tools leading to the maximisation of economic efficiency; rather direct regulation of prices is used. A number of countries, however, are reviewing the soundness and validity of those across the board exemptions. The stress is more on applying competitionlawtoallbusinesspracticesnotexplicitlyimposedonfirms·bylegalprovisions. It is then the task of competition authority/courts to consider business practices and emphasise on those that have the highest probability of anti-competitive effects and least justification based on efficiency. Usually, such cartel practices as price fixing, collusive tendering and market allocation are prohibited without need for market analysis. On the contrary,distribution,jointventuresandmergeragreementsareassessedina marketcontext and increasingly under a rule-of - reason standard taking into account the efficiencies and economies likely to be achieved and passed on toconsumers.

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These are main types of business practices that can have anti-competitive effects by a firm enjoying dominant position.

HORIZONTAL RESTRAINTS

Price Fixing	Competing suppliers enter into cooperative agreements regarding prices and sales conditions.
Restraint of Output	Competing suppliers enter into agreements regarding output and product quality.
Market Allocation	Competing suppliers allocate customers amongst themselves, who therefore cannot benefit from competition by other suppliers.
ExclusionaryPractices	Competing suppliers employ practices that inhibit or preclude the ability of other actual or potential suppliers to compete in the market for a product.
Collusive Tendering (bid-rigging)	Competing suppliers exchange commercially sensitive information on bids and agree to take turns as to who will make the most competitive offer.
ConsciousParallelism	Competing suppliers generally set the same prices, but without an explicitagreement.
OtherRestraintson	Generally characterized by suppliers entering into co-operative Competition agreements not to undertake certain actions of competitivevalue **(e.g.,** advertising).

VERTICALRESTRAINTS

Exclusive Dealing	**A** producer supplies distributors and guarantees not to supply other distributors in a givenregion.
Reciprocal Exclusivity	A producer supplies on the condition that the distributor does not carry anybody else'sproducts.
Refusal to Deal	A supplier refuses to sell to parties wishing to buy.
Resale Price maintenance	A producer supplies distributors only on the condition that the distributor sells at a minimum price set by the supplier.
Territorial Restraint Maintenance	A supplier sells to distributors only on the condition that the distributordoesnotmarkettheproductoutsideaspecifiedterritory.
Discriminatory Pricing	**A** supplier charges different parties different prices under similar circumstances.
Predatory Pricing	. Suppliers sell at a very low price (or supply intermediate inputs to competitors at excessive price) in order to drive competitor out of business.
Premium Offers or Loyalty Rebate	A dominant supplier offers discounts or other inducements only to certain parties on the condition they, do not sell someone else's products.
Tied Selling	Producer force purchases to buy goods they do not want as condition to sell them those they dowant.
Full time Forcing	A supplier requires distributors, for access to any product, to carry all of **the** supplier's products.
Transfer Pricing	It can involve over-involving or under involving of intermediate inputs between foreignaffiliates.

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In the present phase of economic reforms based on the three pillars of liberaljsation, privatization and globalisation, the Act, as seen in its original spirit, appeared redundant. A

number of its provisions in the present-day context lost relevance and required to be substituted with new provisions in tune with the contemporary trends in business environment. The Act did not address a number of present-day issues like the abuse of intellectual property rights. In many respects its provisions were draconian and the implementation and control structure was heavily bureaucratic in nature. The Act was often cited as one of the main hindrances to foreign direct investment in the country.

The MRTP Act has been replaced by the Competition Act 2002 on the recommendations of the SVS Raghvan Committee. As already pointed out, all the cases pertaining to RTPS and MTPS under the MRTP ACT have been transferred to the competition commission of India established under the new Act and will be decided according to the provisions of the repealed MRTP Act. The major provisions of the Competition Act 2002 are as follows :

MAJOR SECTIONS OF THE MRTP ACT

Section	Provisions
2(0)	Defines an RTP.
33(1)	Gives 'deemed' RTPs.
33(1)(f)	Defines resale price maintenance.
33(1)GI	Defines price control arrangement.
35(h)	Provides for registration requirement of RTPs.
38	Provides 'gateways' to RTPs.
36A	Defines UTPs.
2(i)	Define MTPs
31(2)	Specifies Powers of the Central Government in respect of MTPs. Defines
2(g)	interconnected undertaking.
27(2)	Powers of the Central Govt. for division of undertakings.
5	Relates to formation of MRTPC by Central Government.
l0(a)	Relates to power of MRTP Commission to enquire RTP.
l0(b)	Relates to power of MRTP Commission to enquire into MTP. Relates to
36B	power of MRTP Commission to enquire into UTP. Confers powers of a
12(2)	Civil Court to MRTPCommission.
12(8)(1)	Relates to power of the Commission to award Compensation.
37(1)	Power to the Commission to issue 'cease and desist' order.
37(2)	Power to the Commission to issue order to the contending parties to make amends.
15(a) to 15(c)	Restrictions on the powers of the Commission regarding MTPs, RTPs and
12(c)	UTPs.
11	Enforcement of Commission's order through civil courts.
3.	Relates to power of the DGIR regarding preliminary investigation. Provides
	exemptions from MRTP provisions

COVERAGE AND APPLICABILITY

The Act like the earlier MRTP ACT applies to the whole of India except the state of JammuandKashmir.TheActhoweverempowersittoexempt anyclassofenterprisesfrom theActininterestofpublicornationalsecurity.Itcanalsoexemptanypracticeoragreement arising out of and is accordance with any obligation assumed by the country under any treaty, agreement or convention with other countries. Under the Act, no civil court has jurisdiction to entertain any suit or proceeding, which the competitionCommission

established under the Act is empowered by the Act to determine. However, the provisions of the Act are in addition to and not in derogation of, the provisions of any other law in force.

14.5 GOVERNMENT POLICIES RELATED TOCOMPETITION

Many government policies and guidelines designed to serve socio-economic objectives tend to distort competitions. It has been observed that multiplicity of law and rules in India have protected favoured players, reduced competition. and given discretion in decision making to politician and bureaucrats in the name of public interest. Public interest has been frequently invoked to favour specific interest group (unionized labour, small scale industries, handloom weavers) with no justification as to how the interest of this group transcendsall.

Restrictive policies have slackened competition like reservation of industries for the public sector (Coal, Railways Postal Services, Insurance) canalization of exports and imports through the public sector reservation of items for the small-scale sector and handloom sector. All governmental policies have to be viewed through the angle of competition to ensure that consumer interest and economic efficiencies are notsacrificed.

Governmentsrelyonseveralpolicytoolstoensurethattheirmarketsarecompetitive. Thetoolsincludetradepolicy,FDIpolicy, regulatorypolicywrtdomesticeconomicactivity and competition policy. Competition policy relates specifically to the rules and regulations implemented by competitions authorities wrt arrangements among firms/suppliers and the conduct of individual firm/suppliers generally and not exclusively, in national markets Consistencyandcoherencebetweenthedifferentpoliciescouldservecompetitiveobjectives. This is evident from the fact that in many developing countries, trade liberalisation, FDIliberalisation and domestic deregulation are taking placesimultaneously.

14.6 ESTABLISHMENT OF COMPETITIONCOMMISSION

The Competition Act provides for the establishment of the Competition Commission of India, by the Central Government, consisting of a chairperson and not less than two and not more than ten other members.

The chairperson and other members shall be whole-time members and every one of them shall be a person of ability, integrity and standing and has who, has been or is qualified to be, a judge of a High Court; or has special knowledge and professional experience of not less than fifteen years in international trade, economics, business, commerce, law, finance, accountancy, management, industry, public affairs, administration or in any other matters which in the opinion of the Central government, may be useful to beCommission.

The Act also provides that the central government may appoint a Director General and as many Additional, Joint, Deputy or Assistant Directors General or such other advisers, consultants or officers, as it may think for, the purposes of assisting the CommissioninconductinginquiryintothecontraventionofanyoftheprovisionsoftheAct and for the conduct of cases before the Commission and for performing such other functions under this Act.

The functions of the Commission are to:

- Eliminate the practice having adverse effect ascompetition.
- Promote and sustaincompetition.
- Protect the interests ofconsumers.
- Ensure freedom of trade carried on by other participant, in market inIndia.

For the purpose of discharging its duties the Commission is authorized by the Act to enter into any memorandum or arrangements, with the prior approval of theCentral

Government, with any agency of any foreign country.
In discharging its duties, the Commission shall be bound by such directions on matters of policy, other than those relating to technical and administrative matters, as the Central Government may give in writing from time to time. However, the Commission shall as far as practicable, be given an opportunity to express its views before any such direction is given. The Central Government is also empowered to supersede the Commission, for any period not greater than six months, in certain circumstances such as when the Commission Is unable due to situations beyond its control, to discharge its functions or perform its duties; or the commission has continuously made default in complying with any direction given by the Central Government under this Act, Before issuing any notification superseding the Commission, the Central Government shall give a reasonable opportunity to the Commission to make representations against the proposed supersession and shall consider representations, if any, of the commission.

147 ANTI-COMPETITIVEAGREEMENTS

The Competition Act declares void any agreement in respect of production, supply, distribution, storage, acquisition or control of goods or provision of services, which causes or **is** likely to cause an appreciable adverse effect on competition withinIndia.

According to Sub-section 3 of Section 3 of the Competition Act, anti-competitive agreements include the following :

1. Any collusive agreement which-
   (a) Directly or Indirectly determines purchase or **sale**prices;
   (b) Limits or controls production supply, markets, technical development, investment or provision ofservices;
   (c) Shares the market or source of production or provision of services by way of allocation of geographical area of market, or type of goods or services, or numberof customers in the market of any other similarway;
   (d) Directly or indirectly results in bid rigging or collusive bidding..
2. Any agreement, which causes or is likely to cause an appreciable adverse effect on competitioninIndia,amongstenterprisesorpersonsatdifferentstagesorlevelsofthe production chain in different markets, In respect of production, supply, distribution, storage, sale or price of, or trade in goods or provision of services, including-
   (a) tie-in arrangement **(i.e.,** an agreement requiring a purchaser of goods, as a condition *of* such purchase, to purchase some othergoods);
   (b) exclusive supply agreement (i.e., an agreement restricting in any manner the purchaser in the course of his trade from acquiring or otherwise dealing in any goods other than those of the seller or any otherpersons;
   (c) exclusive distribution agreement **(i.e.,** an agreement to limit, restrict or withhold theoutputorsupplyofanygoodsorallocateanyareaormarketforthedisposalor sale of thegoods);
   (d) refusal to deal **(i.e.** an agreement which restricts, or is likely to restrict; by any methods the persons or classes of persons to whom goods are sold or fromgoods arebought);
   (e) resale price maintenance (i.e., an agreement to sell goods on condition that the prices to be charged on the resale by the purchaser shall be the prices stipulated by the seller unless it is clearly stated that price lower than those prices may be charged).

14 .7 SELF-CHECK EXERCISE I: True/False:

- The Monopolies and Restrictive Trade Practices Act, 1969, was amended in 1991 to focus on the prevention of monopolistic, restrictive, and unfair trade practices. (True/False)
- The Competition Act, 2002, replaced the Monopolies and Restrictive Trade Practices Act, and the Monopolies and Restrictive Trade Practices Commission was dissolved. (True/False)
- The Competition Commission of India has the power to supersede itself in certain circumstances for a period not greater than six months. (True/False)

- Section 5 of the Competition Act deals with combinations, considering acquisitions, mergers, or amalgamations that result in assets or turnover above specified threshold limits. (True/False)
- The Commission is authorized to enter into any memorandum or arrangements with any agency of any foreign country with the prior approval of the State Government. (True/False)

14.8. Regulation ofDominance

Section 4 of the Competition Act lays down that no enterprise shall abuse its dominant position. Dominant position means a position of strength, enjoyed by an enterprise, in the relevant market, in India, which enables it to (i) operate independently of competitive forces prevailing in the relevant market; or (ii) affects its competitors or consumers or the relevant market in its favour.The following cases are regarded as an abuse of dominant position, viz., an enterprise :-

(a) directly or indirectly, imposes unfair or discriminatory:-
  (i) condition in purchase or sale of goods or service;or
  (ii) price in purchase or sale (including predatory price, i.e. price which is kept below the cost with a view to reduce competition or eliminate the competitors) of goods orservice. However, such discriminatory condition or price which may be adopted to meet the competition is excluded from the application of this Section.

(b) limits or restricts-
  (i) production of goods or provision of services or market therefore;or
  (ii) technical or scientific development relating to goods or services to the prejudice of consumers;or

(c) indulges in practice or practices resulting indenial of market access; or

(d) makes conclusion of contracts subject to acceptance by other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts;or

(e) uses its dominant position in one relevant market to enter into, or protect, other relevantmarket.

Where the commission finds that any agreement causes or is likely to cause an appreciable adverse effect on competition or action of an enterprise is or is likely to be an abuse of its dominant position, it may pass all or any of the following orders, namely:-

(a) direct any party involved in such agreement, or abuse of dominant position, to discontinue and not to re-enter such agreement or discontinue such abuse of dominant position, as the case maybe;

(b) imposesuchpenalty,asitmaydeemfitwhichshallbenotmorethantenpercent of the average of the turnover for the last three preceding financial years, upon each of such person or enterprises which are parties to such agreement orabuse.

(c) award compensation to parties in accordance with the provisions contained in the Act;

(d) direct that enterprises concerned to abide by such other orders as the Commission may be specified in the order by the Commission;

(e) direct the enterprises concerned to abide by such other orders as the Commission may pass and comply with the directions, including payment of costs, ifany;

(f) recommending to the Central Government for the division of an enterprise enjoying dominantposition;

(g) pass such other order as it may deemfit.

Even if an anti-competitive agreement has been entered into outside India; or any party to such agreement is outside India; or any enterprise abusing the dominant position in and

outside India. Commission shall the have power it inquire into such agreement or abuse of dominant position or combinations if such agreement or dominant position or combination has, or is likely to have, an appreciable adverse effect on competition in the relevantmarket
in India.

14.9 DETERMINING DOMINANTPOSITION

The Commission shall, while inquiring whether an enterprise enjoys a dominant position or not shall have due regard to all or any of the following factors, namely:-

(a) market share of theenterprise;
(b) size and resources of theenterprise.
(c) size and importance of the competitor; (d) economic power of theenterprise;
(e) vertical integration of the enterprise;
(f) dependence of consumers on theenterprise;
(g) monopoly or dominant position whether acquired as a result of any statute or by virtue of being a Government company or a public sector undertaking or otherwise;
(h) entry barriers including barriers such as regulatory barriers, financial risk, high capital cost of entry, marketing entry barriers.
(i) countervailing buying power;
(j) market structure and size ofmarket;
(k) social obligations and social costs;
(l) relative advantage, by way of the contribution to the economicdevelopment;
(m) any other factor which the Commission may consider relevant for the inquiry.

14,10 REGULATIONS OFCOMBINATIONS:

Section 5 of the Act, which deals with combinations, considers only those acquisitions, mergers or amalgamations which results in assets or turnover above the specified threshold limits or control of enterprise with assets or turnover above the specified threshold limits. Accordingly the following fall under combination.

Any acquisition, merger or amalgamation which result in combined assets of the value of more than rupees one thousand crores or turnover more than rupees three thousand cores in India; or asset of the value of more than five hundred million US dollars or turnover more than fifteen hundred million US dollars or outside India. When a group of enterprises is involved, the respective future assets of more than rupees four thousand crores or turnover more than rupees twelve thousand crores, and assets of more than two billion US dollars or turnover more than six billion USdollars.

Section 6 of the Competition Act declares void any combination which causes oris likely to cause an appreciable adverse effect on competition within the relevant marketin India.

Subject to the above provision, any person or enterprise proposing to enter into a combination, may, at his or it option, give notice to the Competition Commission, disclosing the details of the proposed combination, as prescribed in the Act.

Where the Commission is of the opinion that the combination has, or is likely tohave, an appreciable adverse effect on competition, it shall direct that the combination shallnot take effect. The provisions of Section 6 shall not apply to share subscription or financingfacility or any acquisition, by a public financial institution, foreign institutional investor, bank or venturecapitalfund,pursuanttoanycovenantofaloanagreementorinvestmentagreement.

14.9. SELF-CHECK EXERCISE II :

- The Monopolies and Restrictive Trade Practices Act, 1969 has been replaced by __________ in the context of economic reforms initiated in 1991.
- The main objective of Chapter 14 is to discuss the establishment of __________, functions and powers of the __________, and provisions relating to __________ agreements.
- Section 4 of the Competition Act lays down that no enterprise shall abuse its __________ position.
- According to Sub-section 3 of Section 3 of the Competition Act, anti-competitive agreements include collusive agreements that directly or indirectly determine __________ or __________.
- The Commission may impose a penalty of not more than __________ percent of the average turnover for the last three preceding financial years on each of the parties involved in anti-competitive agreements

14.11. Exemptions under theAct

The Central Government is empowered to exempt from the application of this Act, or any provision thereof, and for such period as it mayspecify:

(a) any class of enterprises if such exemption is necessary in the interest of security of the State or publicinterest;

(b)any practice or agreement arising out of and in accordance with any obligation assumed by India under any treaty, agreement or convention with any other country or countries;

(c) any enterprise which performs a sovereign function on behalf of the Central Government or a State Government, provided that in the case an enterprise in engaged in any activity including the activity relatable to the sovereign functions oftheGovernment,the CentralGovernmentmaygrantexemptiononlyinrespect of activity relatable to the sovereignfunctions.

14.12. SUMMARY

The economic liberalisation has increased the need for and relevanceofcompetitionpolicyandlawbecausewhiletheliberalisationunleashescompetitiveforc es,intheabsenceofsafeguards,thismay alsoprovidescopeforunfaircompetition,likepowerfulcompetitorscrushingsmallfirmsthroughunfairmeans,collusion,andM&Asdetrimentaltocompetition.Competition policy refers to the government policy designed to ensure contestability and fair competition by removing/preventing factors and forces that tend to distort fair competition.

According to the High Level Committee on Competition Policy and Law, appointed by Government of India, competition process is likely to run smoothly and thus lead to desirable results, only if several pre-requisites are met. Micro-industrial Governmental policies that may support or adversely impinge on the application of competition policy would include the industrial policy; reservation for the small scale industrial sector; privatization and regulatoryreforms, including tariffs, quotas, subsidies, anti-dumping action etc.; state monopolies policy; and labour policy.

The focusformostCompetitionLawsintheworld todaybeinginthethreeareas.viz. agreementamongenterprises;abuseofdominance;mergersor,moregenerally,combination amongenterprises,theCommitteecentereditsrecommendationsonthesame.Horizontaland Vertical agreements between firms have the potential of restricting competition. The Committee, therefore, recommended that both these types of agreements should be covered bytheCompetitionLaw.The Committeefeltthatabuseofdominanceratherthandominance should.bethekeyforCompetitionPolicyLaw.Abuseofdominancewillincludepracticeslike restriction of quantities, markets and technical development. Abuse of dominance which prevents, restricts or distorts competition needs to be frowned upon by Competition Law. Relevant market need to be an important factor in determining abuse ofdominance.

CompetitionPolicy/Lawneedstohavenecessaryprovisionsandteethtoexamineand adjudicate upon anti- competition practices that may accompany or followdevelopmentsarisingoutoftheimplementationofWTOAgreements.Inparticular,agreementsrelatingto foreign investment, intellectual property rights, subsidies, countervailing duties, anti- dumping measures, sanitary and phytosanitary measures, technical barriers to trade and Governmentprocurementneedtobereckonedinthe CompetitionPolicy/Lawwith aviewtodealing with anti competition practices.

As a follow-up of the Report of the Committee, the Union Cabinet proposes to set up a 10-member multidisciplinary Trade Related Competition Commission of India (TRCCI) to replace the existing Monopolies and Restrictive Trade Practices Commission (MRTPC).

14.13 GLOSSARY

1. **TRCCI**: Trade Related Competitive Commission ofIndia.
2. **Tie-In arrangement** : An agreement in requiring a purchaser of goods, as a condition of such purchase, to purchase some othergoods.
3. **Exclusive supply agreement** : An agreement restricting in any manner thepurchaser in the course of trade from acquiring/ dealing in any goods other than there of seller or any other persons.
4. **Dominant Position** : A position of strength enjoyed by an enterprise, in therelevant market, in India, which enables it to
   (a) operate independently of competitive forces prevailing in the relevantmarket.
   (b) affect its competitors or consumers or relevant factors in itspower.
5. **Exclusive distribution agreement** : An agreement to limit, restricts, without the output or supply of any goods or allocate any area or market for the disposal/sale of thegoods
6. **M & As** : Merger andAcquisition
7. **RTP**: Restrictive TradePractice.
8. **UTP**: Unfair TradePractice.
9. **MTP**: Monopolistic TradePractice.

14.14. Keywords:

Monopolies and Restrictive Trade Practices Act, 1969, Competition Act, 2002, Abuse of dominant position, Anti-competitive agreements

14.15. QUESTIONS

Short Questions:

1. What has been the need to frame the competition Act is place *of* MRTP Act,1969?
2. When did the Competition Act, 2002 come into effect, and what did it replace?
3. According to Section 4 of the Competition Act, what is considered an abuse of dominant position?
4. Enumerate the types of anti-competitive agreements mentioned in Sub-section 3 of Section 3.
5. What powers does the Competition Commission have in regulating combinations under Section 5?

Long Questions:

6. CompareandcontrasttheprovisionsofCompetitionAct2002andMRTPAct,1969.
7. Discuss the powers & functions of the CompetitiveCommission.

14.15 Answers to Self Learning Activities:

True/False:

1) True
2) True
3) False
4) True
5) False

Fill in the Blanks:

6) Competition Act 2002
7) the Competition Act 2002, Competition Commission of India, anti-competitive
8) dominant
9) purchase or sale prices
10) ten

14.16 RECOMMENDEDREADINGS

1. Business Environment By FrancisCherunilam
2. Essentials ofBusinessEnvironment By K.Aswathappa

Lesson No.15 AUTHOR : TARANNUMMOHAN

INFORMATION TECHNOLOGY ACT - 2000

STRUCTURE

15.0 Introduction
15.1 History of theAct
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15.0 INTRODUCTION

Thebusinesstransactionsthroughelectronicformhaspopularlycometobeknownas electroniccommerceore-commerce.Atpresentwehavemanylawswhichgovernpaperbased records and documents which are signed and witnessed by individuals. The Indian Contract Act 1872, and the Negotiable Instruments Act, 1881 are two such examples. But with the onset of e-commerce, there is a need for some new laws to tackle the unique problems involved therein and for its smoothfunctioning.

Cyber law refers to the law which is concerned with communications and automatic control systems. Thus cyber law may be classified as Communication Law and Information Technology Law. The former regulates telecommunications and broadcasting, including radio, television, telephony and cable. The latter regulates transactions relating to computer and the internet.

The Information Technology Act 2000 (ITA-2000) is an Act of the Indian Parliament (No 21 of 2000) notified on October 17,2000.

15.1 HISTORY OF THEACT

The United Nations General Assembly by resolution A/RES/51/ 162, dated the 30 January 1997 has adopted the Model Law on Electronic Commerce adopted by the United NationsCommissiononInternationalTradeLaw.ThisisreferredtoastheUNCITRALModel LawonE-commerce.

The said resolution recommended inter alia that all States give favorable consideration to the said Model Law when they enact or revise their laws, in view of the need for uniformity of the law applicable to alternatives to paper-based methods of communication and storage of information.

The Ministry of Commerce Government of India created the first draft of the legislation following the UNO termed as "E Commerce Act 1998".

After the formation of a separate ministry of Information Technology, the draft was taken over by the new ministry which re-drafted the legislation as "Information Technology Bill1999".

This draft was placed in the Parliament in December 1999 and passed in May 2000. After the assent of the President on June 9, 2000, the act was finally notified with effectfrom

October 17, 2000 vide notification number G.S.R788(E).

Amajor amendment was made to the Act with effect from 6th February 2003 consequent to thepassageof a related legislation called Negotiable Instruments Amendment Act2002.

15.2 SCOPE OF THE ACT

15.2.1 Objectives of the Act

The aim and objectives of the Act include enabling or facilitating the use of electronic commerce and providing equal treatment to users of paper-based documentation and to users of computer based information. It is to promote efficient delivery of governmentservices by means of reliable electronic records

Information Technology Act 2000 addresses the following issues

- To grant legal recognition to transactions carried out by means of electronic data interchange and other means of electronic communication commonly referred to as "electronic commerce" in place of paper based methods ofcommunication.
- To give legal recognition to digital signature for authentication of anyinformation or matter which requires authentication under any law.
- To facilitate electronic filing of documents with governmentdepartments
- To facilitate electronic storage ofdata
- To set up licensing, monitoring and certifying authorities to oversee issueslike jurisdiction, origin, authentication, privacy protection and computer crimes.
- To establish Cyber Regulations Appellate Tribunal for hearing appealsagainst decisions of the adjudicating officers.
- To facilitate and give legal sanction to electronic and transfers between banksand financial institutions.
- To give legal recognition for keeping books of account by Bankers inelectronic form.
- To make amendments in the Indian Penal Code, Indian Evidence Act andReserve Bank of India Act, so that the offences relating to documents and paper based transactions are made equal to the offences in respect of transactions carried out through the electronic media.

15.2.1 Commencement andApplication

It extends to the whole of India and save as otherwise provided in this Act, it applies to any offence or contravention thereunder committed outside India by any person.

TheinformationTechnologyAct2002isnotApplicabletothefollowing

1. Negotiable Instrument (other than cheque). Negotiable instruments means a promissory note, bill of exchange or cheque payable either to the order or the bearer. Negotiable instruments can be transferred by delivery in the case of bearer instrument and by endorsement and delivery in the case of other instruments. Negotiable instruments represents money. eg, in case a cheque is dishonoured, the payee can file a criminal complaint in a Magistrate 's court under Section 138 of the Negotiable Instruments Act. In case he wants to invoke section 138, he has to produce the bounded cheque along with his complaint to the Magistrate. Hence, the Act has rightly excluded 'negotiable instruments from the purview of thelaw
2. A power of Attorney. Power of attorney is an instrument empowering the specified person to act for and in the name of the person who executes it. Section 33 of the Indian Registration Act states that if the principal at the time of executing the power of attorney resides at any part of India, a power of attorney executedbefore and authenticatedby the district registrar or sub-registrar within whose district orsubdistrict,theprincipalresides,willberecognizedaepowerofattorneyforregistrationpfdocumentbyanagent.Therefore,powerofattorneyrequiresattestation.Itisnotpossibletogotattestationfor an electronic record in themannercontemplated undersection33oftheregistrationAct.

3. a trust aa defined by section 3 of the Indian Trusts Act 1882. a trust can be createdby a will. If the trust is created by a will, the will required attestation. Attestation isnotpossibleifthetrustiscreatedbywillexecutedbyelectronicrecord.
4. a will.A will require a attestationbyat least 2witnesses.If a will is executed bymeansofelectronicrecord,itmaybepossibletogetthe attestation of the 2witnesses,hencewillsareexcludedfromthepurviewoftheAct.
5. any contractfor the sale of conveyance of immovable property or any interest insuchproperty.

15.2.3 Self Check Activity I

i. The ____________ Act 2000 is an Act of the Indian Parliament (No 21 of 2000) notified on October 17, 2000.
ii. The United Nations General Assembly adopted the Model Law on Electronic Commerce, referred to as the ____________ Model Law on E-commerce.
iii. The Information Technology Act 2000 addresses issues related to electronic commerce and aims to provide equal treatment to users of ____________ and computer-based information.
iv. The Act enables electronic filing of documents with government departments and the electronic storage of ____________.
v. The Information Technology Act 2000 consists of ____________ sections segregated into 13 chapters.

15.3 HIGHLIGHTS OF THEACT

Information technology Act 2000 consists of 94 sections segregated into 13 chapters.

Four schedules form part of the Act.

- **Chapter- II** of the Act specifically stipulates that any subscriber may authenticate an electronic record by affixing his digital signature. Authentication of records- The authentication of the electronic record shall be effected by the use of asymmetric crypto system and hash function which envelop and transform the initial electronic record into another electronic record. (section 3(2)1. Verification of digitalsignature
  -Any person by the use of a public key of the subscriber can verify the electronic record. (section3(3)). Theprivate key andthepublic key areunique to the subscriber and constitute a functioning key pair. [section 3(4)1.The idea is similar to locker key inabank. You have your 'private key· while bank manager has 'public key'. The locker does not open unless both the keys come togethermatch.

- **Chapter-III** of the Act details about Electronic Governance. Electronicrecords acceptable unless specific provision to contrary - Where any law provides that

  information or any other matter shall be in writing or in the typewritten or printed form, then, notwithstanding anything containedinsuch law,such requirement shallbedeemedtohavebeensatisfiedifsuchinformationormatteris(a)rendered ormadeavailableinanelectronicform;and(b)accessiblesoastobe usableforа subsequent reference. [Section 4).The said chapter also details the legal recognition of Digital Signatures. DEPARTMENT OR MINISTRY CANNOT BE COMPELLEDTO

  ACCEPTELECTRONICRECORD-Section8makes**it**clearthatnodepartmentor ministry can be compelled to accept application, return or any communication in electronic form. Legal recognition of digital signatures - Where any law provides thatinformationoranyothermattershallbeauthenticatedbyaffixingthesignature or any document shall be signed or bear the signature of any person then, notwithstanding anything contained in such law, such requirement shall be deemed to have been satisfied, if such information or matter is authenticatedby

  means of digital signature affixed in such manner as may be prescribed by the Central Government.[section 5].

- **Chapter-VI** of the said Act deals with attributions, acknowledgement and dispatch of electronic records. An electronic record shall be attributed to the originator if it was sent by the originator himself or by a person who had the authority to act on behalf of theoriginator. Where the originator has stipulated that theelectronic

record shall be binding only on receipt of an acknowledgment of such electronic record by him, then unless acknowledgment has been so received, the electronic recordshallbedeemedtohavebeenneversentbytheoriginator.Theactalsocovers time and place of dispatch and receipt of electronicrecord.

- **Chapter-V** of the Act deals with securing electronic records and secure digital signatures. Secure electronicrecord.
  Where any security procedure has been applied to an electronic record at aspecific
  point of time. then such record shall be deemed to be a secure electronic record from such point of time to the time of verification. [Section 14). Secure digital signature • If, by application of a security procedure agreed to by the parties concerned, it can be verified that a digitalsignature, at the time it was affixed, was(a) unique to the subscriber affixing it (b) capable of identifying such subscriber (c) created in a manner or using a means under the exclusive control of the subscriber and is linked to the electronic record to which it relates in such a manner that if the electronic record was altered the digital signature would be invalidated, then such digital signature. shall be deemed to be a secure digital signature. [Section15).
- **Chapter-VI**ofthesaidActgivesaschemeforRegulationofCertifyingAuthorities. The Act envisages a Controller of Certifying Authorities who shall perform the functionofexercisingsupervisionovertheactivitiesoftheCertifyingAuthoritiesas also laying down standards and conditions governing the Certifying Authorities as alsospecifyingthevariousformsandcontentofDigitalSignatureCertificates.The ActrecognizestheneedforrecognizingforeignCertifyingAuthoritiesanditfurther details the various provisions for the issue of license to issue Digital Signature Certificates. The central government may appoint a controller of Certifying authorities (work under the general control and direction of the central government), Deputy Controllers and Assistant Controller (work under thecontrol of Controller) by notification in the official gazette. The qualifications, experience and termsandconditionsofserviceofController,DeputyControllersandAssistant ControllersshallbesuchasmaybeprescribedbytheCentralGovernment.TheHead OfficeandBranchOfficeoftheofficeoftheControllershallbeatsuchplacesasthe Central Government may specify, and these may be established at such places as the Central Government may think fit. There shall be a seal of the Office ofthe Controller.
- **Functions ofController.**
  The Controller may perform all or any of the following functions, namely :
  (a) exercising supervision over the activities of the CertifyingAuthorities;
  (b) certifying public keys of the CertifyingAuthorities;
  (c) laying down the standards to be maintained by the CertifyingAuthorities;
  (d) specifying the qualifications and experience which employees of the Certifying Authorities shouldpossess;
  (e) specifying the conditions subject to which the Certifying Authoritiesshall conduct their business;
  (f) specifying the contents of written, printed or visual materials and advertisementsthatmaybedistributedorusedinrespectofaDigitalSignature Certificate and the publickey;
  (g) specifying the form and content of a Digital Signature Certificate and thekey,
  (h) specifying the form and manner in which accounts shall be maintained by the CertifyingAuthorities;

(i) specifying the terms and conditions subject to which auditors may be appointed and the remuneration to be paid tothem;

(j) facilitatingtheestablishmentofanyelectronicsystembyaCertifyingAuthority eithersolelyorjointlywithotherCertifyingAuthoritiesandregulationofsuch systems;

(k) specifying the manner in which the Certifying Authorities shall conduct their dealings with thesubscribers;

(l) resolving any conflict of interests between the Certifying Authorities and the subscribers;

(m) laying down the duties of the CertifyingAuthorities;

(n) maintaining a data base containing the disclosure record of every Certifying Authority containing such particulars as may be specified by regulations, which shall be accessible topublic.

- **Chapter-VII** of the Act details about the scheme of things relating to Digital Signature Certificates. Certifying Authority to issue Digital SignatureCertificate.

(1)AnypersonmaymakeanapplicationtotheCertifyingAuthorityfortheissueof a Digital Signature Certificate in such form as may be prescribed by the Central Government(2) Every such application shall be accompanied by such fee not exceedingtwenty-five thousand rupees as may be prescribed by the Central Government, tobepaidtotheCertifyingAuthority:Providedthatwhileprescribing fees under sub-section (2) different **fees** may be prescribed for different classes of applicants'.(3) Every such application shall be accompanied by a certification practice statement or where there is no such statement, a statement containing such particulars,asmaybespecifiedbyregulations.(4)Onreceiptofanapplicationunder sub-section(1),theCertifyingAuthoritymay,afterconsiderationofthecertification practice statement or the other statement under sub-section (3) and after making such enquiries as it may deem fit, grant the Digital Signature Certificate or for reasons to be recorded in writing, reject the application: Provided that no Digital Signature Certificate shall be granted unless the Certifying Authority is satisfied that-(a) the applicant holds the private key corresponding to the public key to be listed in the Digital SignatureCertificate;

(b) the applicant holds a private key, which is capable of creating a digital signature;

(c) the public key to be listed in the certificate can be used to verify a digital signature affixed by the private key held by theapplicant:

Provided further that no application shall be rejected unless the applicant has been given a reasonable opportunity of showing cause against the proposed rejection. **Suspension of Digital SignatureCertificate.**

(1)Subjecttotheprovisionsofsub-section(2),theCertifyingAuthoritywhichhas issued a Digital Signature Certificate may suspend such Digital Signature Certificate,-onreceiptofarequest tothateffectfrom•(i)thesubscriber listedintoe Digital Signature Certificate;or

(ii) any person duly authorized to act on behalf of that subscriber, if it is of opinion that the Digital Signature Certificate should be suspended in public interest(2) A Digital Signature Certificate shall not be suspended for a period exceeding fifteen days unless the subscriber has been given an opportunity of being heard in the matter.(3) On suspension of a Digital Signature Certificate under this section, the Certifying Authority shall communicate the same to the subscriber.

- **Chapter VIII** of the said Act deals with Generating key pair. The duties of subscribers are also enshrined in the saidAct.

  Where any Digital Signature Certificate, the public key of which corresponds to the private key of that subscriber which is to be listed in the Digital Signature Certificate has been accepted by a subscriber, then, the subscriber shall generate the key pair by applying the security procedure. Acceptance of Digital Signature Certificate.

  (1) A subscriber shall be deemed to have accepted a Digital Signature Certificate if he publishes or authorizes the publication of a Digital SignatureCertificate-

    (a) to one or morepersons;

    (b) in a repository, or otherwise demonstrates his approval of the Digital Signature Certificate in any manner.[2) By accepting a Digital Signature Certificate the subscriber certifies to all who reasonably rely on the information contained in the Digital Signature Certificate that-(a) the subscriber holds the private key corresponding to the public key listed in the Digital Signature Certificate and is entitled to hold the same; (b) all representations made by the subscriber to the Certifying Authority and all material relevant to the information contained in the Digital Signature Certificate aretrue;

    (c) all information in the Digital Signature Certificate that is within the knowledge of the subscriber is true.[section 41] Control of privatekey.

  (1) Every subscriber shall exercise reasonable care to retain control of the private key corresponding to the public key listed in his Digital Signature Certificate and take all steps to prevent its disclosure to a person not authorised to affix the digital signature of the subscriber.(2) If the private key corresponding to the public key listed in the Digital Signature Certificate has been compromised, then, the subscriber shall communicate the same without any delay to the Certifying Authority in such manner as may be specified by .theregulations.

- **Chapter-IX** of the said Act talks about penalties and adjudication for various offences. The penalties for damage to computer, computer systems etc. has been fixedasdamagesbywayofcompensationnotexceedingRs.1,00,00,000toaffected persons.TheActtalksofappointmentofanyofficersnotbelowtherank ofaDirector to the Government of India or an equivalent officer of state government as an Adjudicating Officer who shall adjudicate whether any person has made a contravention of any of the provisions of the said Act or rules framed there under. The said Adjudicating Officer has been given the powers of a CivilCourt.

- **Chapter-X** of the Act talks of the establishment of the Cyber Regulations Appellate Tribunal, which shall be an appellate body where appeals against the orders passed by the Adjudicating Officers, shall be preferred. Establishment of Cyber Appellate Tribunal.

  (1) The Central Government shall, by notification, establish one or more appellate tribunals to be known as the Cyber Regulations AppellateTribunal.

  (2) The Central Government shall also specify, in the notification referred to in sub-section (1). the matters and places in relation to which the Cyber Appellate Tribunal may exercise jurisdiction. Composition of Cyber AppellateTribunal.

  A Cyber Appellate Tribunal shall consist of one person only (hereinafter referred to as the Residing Officer of the Cyber Appellate Tribunal) to be appointed, by notification, by the Central Government. Qualifications for appointment as Presiding Officer of the Cyber Appellate Tribunal. A person shall not be qualified for

appointment as the Presiding Officer of a Cyber Appellate Tribunal unless he-(a) is, or has been. or is qualified to be, a Judge of a High Court; or (b) is or has been a memberoftheIndianLegalServiceandisholdingorhasheldapostinGrade lof that Service for at least three years. Term of office

The Presiding Officer of a Cyber Appellate Tribunal shall hold office for a term of five years from the date on which he enters upon his office or until he attains the age of sixty-five years, whichever is earlier. Filling up of vacancies.

If, for reason other than temporary absence, any vacancy occurs in the office n the Presiding Officer of a Cyber Appellate Tribunal, then the Central Government shall appoint another person in accordance with the provisions of this Act to fill the vacancy and the proceedings may be continued before the Cyber Appellate Tribunal from the stage at which the vacancy is filled. Resignation and removal. (1) The Presiding Officer of a Cyber Appellate Tribunal may, by notice in writing under his hand addressed to the Central Government, resign his office: Provided that the said Presiding Officer shall, unless he is permitted by the Central Government to relinquish his office sooner, continue to hold office until the expiry of three months from the date of receipt of such notice or until a person duly appointed as his successor enters upon his office or until the expiry of his term of office, whichever is the earliest.(2) The Presiding Officer of a Cyber Appellate Tribunal shall not be removed from his office except by an order by the Central Government on the ground of proved misbehavior or incapacity after an inquiry made by a Judge of the Supreme Court in which the Presiding Officer concerned has been informed of the charges against him and given a reasonable opportunity of being heard in respect of these charges.(3) The Central Government may, by rules, regulate the procedure for the investigation of misbehaviour or incapacity of the aforesaid PresidingOfficer.

- **Chapter-XI** of the Act talks about offences which include tampering with computer source documents, publishing of information, which is obscene in electronic form, and hacking. The Act also provides for the constitution of the Cyber Regulations Advisory Committee, which shall advice the government as regards any rules, or for any other purpose connected with the said act. Power of Controller to givedirections.

(1) The Controller may, by order, direct a Certifying Authority or any employeeof such Authority to take such measures or cease carrying on such activities as specified in the order if those are necessary to ensure compliance with the provisions of this Act, rules or any regulations made thereunder.

(2) Any person who fails to comply with any order under sub-section (1) shall be guilty of an offence and shall be liable on conviction to imprisonment fora term not exceeding three years or to a Fine not exceeding two lakh rupees or toboth.

Directions of Controller to a subscriber to extend facilities to decrypt information.

(1) If the Controller is satisfied that it is necessary or expedient so to do in the interest of the sovereignty or integrity of India, the security of the State, friendlyrelationswithforeignStalesorpublicorderorforpreventingincitement to the commission of any cognizable offence, for reasons to be recorded in writing, by order, direct any agency of the Government to intercept any information transmitted through any computer resource.(2) The subscriber or any person in-charge of the computer resource shall, when called upon by any agency which has been directed under sub-section (1), extend all facilities and technical assistance to decrypt the information.(3) The subscriber orany

person who fails to assist the agency referred to in sub-section (2) shall be punished with an imprisonment for a term which may extend to seven years.

- **Chapter-XII** of the Act talks about various offences and the said offences shall be investigated only by a Police Officer not below the rank of the Deputy Superintendent of Police. The said Act also proposes to amend the Indian Penal Code,1860,theIndianEvidenceAct,1872,TheBankers'BooksEvidenceAct,1891, The Reserve Bank of India Act, 1934 to make them in tune with the provisionsof the IT Act.

15.4 ADVANTAGES OF THEACT

The IT Act 2000 attempts to change outdated laws and provides ways to deal with cyber crimes. We need such laws so that people can perform purchase transactions over the Net through credit cards without fear of misuse. The Act offers the much-needed legal framework so that information is not denied legal effect, validity or enforceability, solely on the ground that it is in the form of electronic records.

In view of the growth in transactions and communications carried outthrough electronic records, the Act seeks to empower government departments to accept filing, creating and retention of official documents in the digital format. The Act has also proposed a legal framework for the authentication and origin of electronic records / communications through digital signature.

- From the perspective of e-commerce in India, the IT Act 2000 and itsprovisions contain manypositiveaspects.Firstly,theimplicationsoftheseprovisionsforthee- businesses would be that email would now be a valid and legal form of communication in our country that can be duly produced and approved in acourt of law.
- Companies shall now be able to carry out electronic commerce using thelegal infrastructure provided by the Act.
- Digital signatures have been given legal validity and sanction in theAct.
- The Act throws open the doors for the entry of corporate companies in the business of being Certifying Authorities for issuing Digital SignaturesCertificates.
- The Act now allows Government to issue notification on the web thus heraldinge-governance.
- The Act enables the companies to file anyform, application or any other document with any office, authority, body or agency owned or controlled by **the** appropriate Government in electronic form by means of such electronic form as may be prescribed by the appropriate Government.
- The IT Act also addresses the important issues of security, which are so criticalto the success of electronic transactions. The Act has given a legal definition to the concept of secure digital signatures that would be required to have been passed throughasystemofasecurityprocedure,asstipulatedbytheGovernmentatalater date.
- Under the IT Act, 2000, it shall now be possible for corporates to have astatutory remedy in case if anyone breaks into their computer systems or network and causes damages or copies data. The remedy provided by the Act is in the form of monetary damages, not exceeding Rs. 1 crore.

15.5 SHORTCOMINGS OF THEACT

_ The Act does not cover certain aspects of e-commerce. Theseare:

1. The Act deals only with the commercial and criminal areas of law as affected information technology and does not deal with certain other issues, such as intellectual property rights. Thus infringement of copyright on e-commerce will be governed by the copyright Act,1957
2. The act does not address itself to internet related issues such as domain names and cyber squatting. Thus under IT act, neither any protection for domain names nor action against cybersquatting isavailable.
3. The act is not applicable to negotiable instruments, power of attorney, trusts testamentary dispositions(wills), contracts for sale or conveyance of immovable property or any interest in suchproperty.
4. The IT Act 2000 is silent as regards taxation of goods and services traded through e-commerce.
5. The IT Act makes no provision for jurisdictional aspects of electronic contracts, i.e., jurisdiction of courts and taxauthorities.
6. No provision has been made for payment of stamp duty on electronicdocuments

15.6 GLOSSARY

- "affixing digital signature" with its grammatical variations and cognate expressions means adoption of any methodology or procedure by a person for the purpose of authenticating an electronic record by means of digitalsignature;
- "asymmetric crypto system" means a system of a secure key pair consisting of a private key for creating a digital signature and a public key to verify the digital signature;
- "Certifying Authority" means a person who has been granted a license to issue a Digital Signature Certificate under section24;
- "Controller" means the Controller of Certifying Authorities appointed under sub- section (I) of section17;
- "digital signature" means authentication of any electronic record by a subscriber by means of an electronic method or procedure in accordance with the provisions of section3;
- "electronic form" with reference to information means any information generated, sent, received or stored in media, magnetic, optical, computer memory, micro film, computer generated micro fiche or similardevice;
- "private key" means the key of a key pair used to create a digitalsignature;
- "public key" means the key of a key pair used to verify a digital signature and listed in the Digital SignatureCertificate;

15. 7 PRACTICEQUESTIONS

Short Questions:

1. What is the main objective of the Information Technology Act 2000?
2. When was the Information Technology Act 2000 notified?
3. What model law did the United Nations General Assembly adopt related to electronic commerce?
4. What are the key objectives of the Information Technology Act 2000 regarding electronic commerce?

Long Questions

5. Describe the objectives of the IT Act,2000
6. Enumerate the instruments, documents or transactions to which IT Act is not applicable.
7. Describe the provisions as regards secure electronic records and secure digital signatures.

15.8 Keywords: Electronic Commerce (e-commerce), Information Technology Act 2000, Digital Signature

15.9 Answers to Self Check Activities:

Fill in the Blanks:

i. Information Technology

ii. UNCITRAL

iii. paper-based documentation

iv. data

v. 94

15.10 Recommended Readings

- Kapoor N.D, Mercantile Law, Sultan Chand and Sons, New Delhi,2002
- Gulshan S.S, Business Law, Excel Books, New Delhi,2003
- http://www.mp.gov.in/dit/itbi112000.pdf

FEMA

STRUCTURE

16.1 Introduction
16.2 Objectives of theAct
16.3 Definitions
16.4 Regulation and Management of Foreign Exchange
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16.5 AuthorisedPersons
16.6 Contravention andPenalties
16.7 Adjudication andAppeal
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16.12 Answers to Self Check Activities

16.1. INTRODUCTION

India has for long time adverse balance of payment position, i.e. imports are more than the exports due to which there was shortage of foreign exchange in India. Hence, it was thoughtnecessarytoexercisestrictcontroloverIndianforeignexchangeresources.Foreign exchange control was first introduced in the year 1939 under defense of India Rules. Foreign exchange Regulation Act was introduced in 1947. It was later replaced with theForeignExchange Regulation Act, 1973. The Act provided for various controls over foreign exchange transactions.

TheGovernmentofIndiastartedtheprocessofliberalisationoftheeconomyin1991. Foreigninvestmentinvarioussectorswaspermitted.Thisresultedinincreasedflowofforeign exchangetoIndia.Alsorepresentedweremadebytheindustrytotheeffectthatthe Foreign ExchangeRegulationAct(FERA)washamperingthegrowthofexternaltradeofitssuffocating provisions, where every step that had anything to do with foreign exchange was to be taken withutmostcare.Amorefacilitatingandenablingapproachwasrequired.Hence,theCentral Government enacted the Foreign Exchange Management Act in1991.

16.2. OBJECTIVES OFTHEACT

The objectives of the Foreign Exchange Management Act, 1991 (FEMA) have been specified as to consolidate and amend 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 market inIndia.

While FERA was a law, which sought to 'control' foreign exchange transactions, FEMA seeks to manage and control. FERA prohibited almost all foreign exchange transactions unless there is a general or specific permission to do so. Under FEMA, all current account transactionsarepermissiblebythelawitself.Thus,approachofFEMAisradicallydifferentfrom FERA -from conservatism to facilitation and from control to regulation. Many drastic penal provisions in FERA have been removed in FEMA. FEMA is a positive law to thisextent.

The Act came into effect from June l, 2000 and extends to the entire country. It also applies to all branches, offices, agencies outside India and those owned or controlled by a person residing in India. Any contravention of the precisions of law committed outside India
will attract action under the Act.

16.3 DEFINITIONS

It is necessary to understand some words or terms defined or used in FEMA.

1. **Currency**:Accordingtosection2(h)oftheAct,currencyincludesallcurrencynotes, postalnotes,postalorders,moneyorders,cheques,drafts,traveler'scheques,lettersof credit, bills of exchange and promissory notes, credit cards or such other similar instruments, as may be notified by the Reserve Bank. Reserve Bank of India has notifieddebitcards,ATMcardsoranyotherinstrumentbywhatevernamecalledthat can be used to create a financial liability as'currency'.
2. **Currency notes** :- It means and includes cash in the form of coins and banknotes. (Section (i))
3. **Indian Currency** :- It means currency expressed or drawn in Indian rupees butdoes not include special bank notes and special one rupee notes issued under section 28A of RBI Act. (Section 2(Q))
4. **Foreign Currency** :- It means foreign currency other than Indian currency.(Section 2(m))
5. **Foreign exchange** :- It means foreign currency and includes:-
   (i) deposits, credits and balances payable in any foreigncurrency;
   (ii) drafts, travellers cheques, letters of credit, bills of exchange expressed or drawn in Indian currency but payable in foreigncurrency;
   (iii) drafts, traveller's cheques, letters of credit or bills of exchange drawn bybanks, In tutions or persons outside India, but payable in Indian currency (Section 2(n)).
6. **Person** :- The Act applies to all persons. The term 'person' includes:-
   (i) anindividual,
   (ii) a Hindu undividedfamily,
   (iii) acompany,
   (iv) afirm,
   (v) an association of persons or a body of individuals, whether incorporated ornot,
   (vi) every artificial individual person, not falling within any of preceding,subclauses, and
   (viii) any agency, office or branch owned or controlled by such person (Section 2(u)).
7. **Personresident in India**:-The term person resident in India is defined in clause (v) of the Act. The term includes the following:-
   (i) A person residing in India for more than 182 days during the course of preceding financial year. However, it does not include a person who has gone out of India or who stays outside India for employment outside India or carrying on business or vocation outside India.
   (ii) A person who has come to or stays in India for any of the purposesmentioned above.
   (iii) Any person or body corporate registered or incorporated inIndia.
   (iv) An office, branch or agency in India owned or controlled by a person residentout aide India.
   (v) An office, branch or agency outside India owned or controlled by a personresident in India.
8. **Security** :- It means shares, stocks, bonds and debentures, Governmentsecurities, saving certificates, deposit receipts in respect of deposit of securities and units of the Unit Trust of India or of any mutual fund and includes certificates of titles to securities

It does not include bills of exchange or promissory notes other than Government promissory notes (Section 2(za)).

9. **Service**:-Thedefinitionof'service'issimilartothedefinitiongivenintheConsumer Protection Act, 1986. This is done keeping in mind the exports of services in the software and infotech sectors (Section2(zb)).

16.4 REGULATION AND .MANAGEMENT OF FOREIGNEXCHANGE

Chapter II of the Act is the most significant part of FEMA. All the core sections are contained in this part. It deals with the dealings in foreign exchange, holding of foreign exchange, current and capital account transactions, exports, realization and tepatriation of foreign exchange and exemption in certain cases. All current account transactions are free but there are controls over capital account transactions.

Restriction on dealing in foreign exchange

Section 3 of **the** Act provides that no person shall without the general or foreign security to any person other than an authorised person, make payment outside India or receivepaymentinanymannerotherwisethroughanauthorised persononbehalfofaperson resident outside India or enter into any financial transaction in relation to acquisition of assets outside India.

The Act has also covered the possibility of an Indian receiving the payment on behalf of a person resident outside India through another person (including an authorised person) without any corresponding inward remittance form outside India. In such case, such person shall be deemed to have received such payment otherwise through an authorised person. This provision is meant to cover Hawalatrade.

Restrictions on holding or transfer of foreign exchange

Section 4 of the Act provides that no person resident in India shall acquire, hold, own, access or transfer any foreign exchnage, foreign security or any immovable property situated outside India, except as provided in the Act.

No restrictions on current account transactions until specified

Section5which dealswithcurrentaccounttransactions,seemstobeverywideinthe sensethatitallowssaleor withdrawalofforeignexchangefromanauthorisedpersoninallcases where it is a current account transaction. However, reasonable restrictions can be imposed by Central Government in consultation with ReserveBank.

Section 2(i) of the Act defines 'Current Account transaction' as a transaction other than a capital account transaction. It includes the following:-

(i) payments due in connection with foreign trade, other current business, services and short term banking and credit facilities in the ordinary course ofbusiness;

(ii) payments due as interest on loans and as net income frominvestments;

(iii) remittances fromlivingexpensesofparents,spouseandchildrenresidingabroad, and;

(iv) expenses in connection with foreign travel, education and medical care of parents, spouse andchildren.

Capital account transactions

Section 6 of the FEMA deals with the boundaries or limits within which capital account transactions will be allowed to take place. The limits which may be specified by the Reserve Bank in consultation with the Central Government are :-

I. Class/classes or permissible transactions, and

2. Admissible limit of foreign exchangne for suchtransactions.

However, the Reserve Bank shall not impose any restriction on the drawal of foreign exchange for payments due on account of amortization of loans or for depreciation of direct investments in the ordinary course of business. Section 6(3) of the Act specifies a long list of cross-border transactions which can be prohibited or regulated by Reserve Bank. It provides that the Reserve Bank may, by regulations, prohibit, restrict or regulate **the** following :-

(a) transfer or issue of any foreign security by a person resident in India; (bl transfer or issue of any security by a person resident outsideIndia;

(c) transfer or issue of any security or foreign security by any branch,office or agency in India of a person residentoutsideIndia;

(d) any borrowing or lending in foreign exchange in whatever form or by whatever name called;

(e) any borrowing or lending in rupees in whatever form or by whatever namecalled between a person resident in India and a person resident outsideIndia;

(f) deposits between persons resident in India and persons resident outsideIndia;

(g) export import or holding of currency orcurrency notes;

(h) transfer of immovable property in India other than a lease not exceeding fiveyears, by a person resident in India;

(i) acquisition or transfer of immovable property in Indiaotherthan a leasenot exceeding five years, by a person resident outside India,

(j) givingof a guarantee or surety in respect of any debt, obligation or there liability incurred:-

(i) by a person resident in India and owed to a person resident outside India;or

(ii) by a person resident outsideIndia.

However, sub-sections 4 and 5 of section 6 exclude cross-border ownership of property if it was acquired during the residence in respective countries.

Section6(4)providesthatapersonresidentinIndiamay hold,own,transferorinvest inforeigncurrency,foreignsecurityoranyimmovablepropertysituatedoutsideIndiaifsuch currency, security or properly was acquired, held or owned by such person when he was resident in India or inherited form a person who was residentin India.

Section 6(5) provided that a person resident outside India may hold, own transfer or invest in Indian currency security or any immovable property situated in India, if such currency, security or property was acquired, held or owned by such person when **he** was resident in India or inherited form a person who was resident in India.

But establishment of a place of business and carrying on of business activity in India non-residents **are** restricted (Section6(6)).

Export of goods and services

Section7of the Act deals with exports of goods and services. It requires the exporter to furnish the Reserve Bank or to such other authority a declaration containing true and correct material particulars including the export value of goods and where it is not ascertainable, value which the exporter expects to receive on the sale of goods in a market outside India. The exporter of goods shall also furnish to the Reserve Bank such other information as may be required by the Reserve Bank for the purpose of ensuring realization as may beexportproceeds by such exporter.Reserve Bank can direct any exporter to comply with prescribed requirements to ensure that full export value of the goods is received without delay.

Realization and repatriation of foreign exchange

Section 8 of the Act requires any resident to realise and repatriate the amount of foreign exchange due or accured to him within such period and in such manner as may be specified by the Reserve Bank.

Exemption from realization and repatriation

Section4oftheActprohibitsholdingofforeignexchnagebyresidentsinIndia.Section 8 requires that the foreign exchange can be held or need not be repatriated toIndia.

(a) Possession of foreign currency or foreign coins by any person upto such limit such as the Reserve Bank mayspecify.
(b) Foreign currency account held or operated by such person or class of persons and the limit upto which **the** Reserve Bank mayspecify;
(c) Foreignexchangeacquiredorreceivedbefore8thJuly,1947orincomearisingor accruing thereon can be held outsideIndia;
(d) If foreign exchange, as is referred to in clause c above, is acquired as a gift or inheritance,thatexchangeorandincomearisingthereformcanbeheldasforeign exchange in India or held abroad and need not berepatriated;
(e) Foreign exchange acquired from employment, business trade, vocation,services, honorarium, gifts, inheritance or any other legitimate means upto such limit as may the Reserve Bank may specify;and
(f) Such other receipts in foreign exchange as The Reserve Bank mayspecify.

16.4.1 Self Check Exercise I

1) The Foreign Exchange Management Act (FEMA) replaced the Foreign Exchange Regulation Act in the year ___________.
2) Under FEMA, all current account transactions are permissible by the law itself; however, reasonable restrictions can be imposed by the Central Government in consultation with ___________.
3) Section 5 of FEMA deals with ___________ transactions, which are wide-ranging and include payments due in connection with foreign trade, interest on loans, and expenses related to foreign travel.

16.5 AUTHORISEDPERSONS

Reserve Bank cannot do all transactions in foreign exchange itself. So, it delegates its power to the 'authorised persons' with suitable guidelines.•

Definition

Section 2(c) of the Act defines the term 'authorised person'. It states that authorised person means an authorised dealer, money change, off shore banking unit or any other person authorised under section 10(1) to deal in foreign exchange and foreign securities.

Generally, commercial banks are appointed as 'authorised dealers' to deal in foreign exchange. 'Money Changers' are authorised by Reserve Bank to sell and purchase foreign exchange as per guidelines issued by Reserve Bank.

Procedure of appointing authorized persons

The Reserve Bank appoints any person to be known as authorised person. Under Section 10, any person who has made an application to the Reserve Bank may be authorised by the Re'serve Bank to act as an authorised person to deal in foreign exchange orforeignsecurities. This authorization shall be in writing and shall be subject to the conditions laid down by the Reserve Bank.

Revocation of authorisation

The Reserve Bank may revoke the authorisation granted to any person at any time in public interest. It may also revoke the authorisation after giving an opportunity if the authorisedpersonfailedtocomplywiththeconditionssubjecttowhichtheauthorisationwas granted or contravened any of the provisions of the Act, rules, regulations, direction, notification or order made these under (Section10(3)).

Duties of authorised person

The authorised person shall comply with the directions or orders of the Reserve Bank in all his dealings in foreign exchange security. He shall not engage in any transaction involving any foreign exchange or foreign security which is not in conformity with thetermsof his authorisation(Section10(4)).

Before undertaking any transaction in foreign exchange on behalf of any person, a declaration and information have to be taken from person to the effect that the transaction will not contravene or evade the provisions of the Act. If such information or declaration is not given to the authorised person, the transaction can be refused. Under such circumstances;theReserveBankshallbenotified(Section10(5)).Ifanypersonusesforeign exchangeforpurposesotherthanthosedeclaredtotheauthorised person,heshallbedeemed to have committed a violation of the Act (Section10(6)).

Reserve Bank's power to issue directions to authorised person

Section II of the Act empowers the Reserve Bank to issue directions to authorised person in regard to making of payment of doing or resisting from doing any act relating to foreign exchange or foreign security. Reserve Bank has also been empowered to issue directions to the authorised persons to furnish such information in such manner as it deems fit. If any authorised person contravenes any direction given by the Reserve Bank or fails to file the return as directed by RBI; may be liable to a fine not exceeding, Rs. 10,000/· and in the case of continuing contravention with an additional penalty which may extend to Rs. 2000 for everyday during which such contraventioncontinues.

Power of Reserve Bank to inspect authorised person

Section 12 empowers the Reserve Bank to inspect the business of any authorised person for the purpose of verifying the correctness of any statement or information or particulars furnished. In case the authorised person fails to furnish the information sought, the Reserve Bank an initiate inspection of the authorised person for obtaining such information. RBI can also inspect the business of an authorised person for securing compliance with the provisions of the Act or any of the rules, regulations or directions.RBI may make an order in writing authorising any of its officers for thispurpose.

Authorised person is duty bound to produce all records, books and accounts at the time ofinspection.

16,6 CONTRAVENTION AND PENALITIES

Chapter IV of the Act containing sections 13 to 15 deals with contravention and penalties.

Section13providesthatifany personcontravenesanyprovisionsofthe Act,or contravenes any rule, regulation, direction or order issued in exercise of the powers under this Act, or contravenes any conditions subject to which an authorisation is issued by the RBI,heshall,uponadjudication,beliabletoa penalty,whichmayextenduptothricethe sum involved in such contravention where such amount is not quantifiable. If the contravention continues the penalty of Rs, 5,ooo per day during the period in whichcontravention continues, shall be imposed (Section 13(1)).

TheAdjudicatingAuthorityadjudicatingthecontraventioncanalsoorderconfiscation of any currency, security or any other money or property in respect of which the contravention has taken place. He can also direct that foreign exchange holdings of any personcommittingthecontraventionshallbebroughtbacktoIndiaorretainedoutside

 India as per direction (Section 13(2)).

Enforcement or the orders of Adjudicating Authority

According to section 14, if any person fails to make full payment of thepenaltywithina period of ninety days from the date on which the notice of payment is served onhim,heshall be liable for civil imprisonment (Section 14(1)). For this civil imprisonment canbeuptosix months, if demand is far less than Rs. One Crore. If demand exceeds Rs. One Crore,civil

imprisonment can be upto three years.

Order for the arrest and detention cannot be made unless a show cause notice is issued to the defaulter. However, arrest can be made without show cause notice if the Adjudicating Authority is satisfied (a) that the defaulter has dishonestly transferred, concealedorremovedhispropertyorheisrefusingorneglectingtopayevenifhehasmeans to pay, (b) he is likely to abscond the local Units (Section 14(3)).

Ifa person to whom show cause notice is issued does not appear before Adjudicating

Authority, warrant of arrest can be issued.

Power to co1npound contravention

Section 15 empowers the Directorate of Enforcement of Officers of the Reserve Bank to compound the offences. Any contravention can be compounded if a person who has committed contravention makes an application. Compounding can be done within 180 days from the date of receipt of application. Compounding is a compromise, where the defaulter agrees to pay certain amount as compounding fee and the authority agrees to drop further

proceedings in the matter after payment of compounding fees.

16.7 ADJUDICATION AND APPEAL

Appointment or Adjudicating Authority

Section16empowerstheCentralGovernmenttoappointbynotificationintheOfficial Gazette as many Adjudicating, authorities as it may think fit for holding enquiries, for the purpose of Section 13. The Central Government Shall specify the jurisdiction of the Adjudicating Authority. The Adjudicating Authority cannot hold any enquiry, unless a complaint is made in writing by an officer authorised by the CentralGovernment.

It is mandatory for adjudication proceedings to be completed within one year from the date of receipt of complaint. In case **the** complaint is not disposed of within the prescribed time, the Adjudicating Authority shall record thereasons.

Appeal to Special Director (Appeal•)

The Act makes provision for appeal against order of Adjudicating Authority. If the Adjudicating Authority is Assistant Director of Enforcement of Deputy Director, appeal will lie with Special Director (Appeals). Second appeal lies to 'AppellateTribunal'.

Appeal against order of Assistant Director or Deputy Director can be filled with special Director under Section 17 within forty five days from the receipt of copy of the order of Adjudicating Authority. The Special Director will hear the parties and then pass his ord.er

Appeal to Appellate Tribunal

Appellate Tribunal for Foreign Exchange is established by the central Government under Section 18 of the Act. It is the final fact finding authority and final departmental

Remedy of appeal .

The central Government or any person aggrieved by an order made by anadjudicating Authority or the Special Director (Appeals) may prefer an appeal to the AppellateTribunal

within 45 days from the date of receipt or order (Section 19).

Appeal to High Court

According to Section 35, appeal to High Court can be made against order of the Tribunal or Special Director within 60m days from the date of acommunication of order. Appeal to High Court can be filed only on question of law.

Directorate of Enforcement

The central Government shall establish a Directorate or Enforcement with a director and other Officer for the purposes of the enforcement of the Act (Section36).

The Director of Enforcement and such other offices as may be authorised are vested with the powers of search and seizure (Section37).

In addition the Central Government may by notification, authorise any officer or class of officers in the Central Government, State Government, Reserve Bank of India, not below the rank of under secretary to Government of India to investigate anycontravention.

Presumption as to documents in certain cases

If any document is produced by any person or seized from any person or is received from any place outside India duly authenticated, it shall be presumed that the signature is
trueandhandwritingisoftheparticularperson.Itwillalsobepresumedthatthecontentsof document are true (Section39).

16.8 Glossary:

- Foreign Exchange Management Act (FEMA): Legislation enacted in 1991 to consolidate and amend the law relating to foreign exchange in India, facilitating external trade and payments.
- Foreign Exchange Regulation Act (FERA): The predecessor to FEMA, introduced in 1973, which sought to control foreign exchange transactions with strict provisions.

16.9 Keywords: Foreign Exchange, Regulation, Capital Account, Remittances

16.10 PRACTICE QUESTIONS

Short Questions

1. How is an authorised person appointed and what are the duties and obligations of an authorisedperson?
2. Discuss the role of Reserve Bank of India in capital accounttransactions.

Long Questions

3. Discuss the provisions of FEMA regardingpenalties.
4. What are the objects of FEMA 1999, is it applicable to individualsonly?
5. What are the main Provisions ofFEMA?

16.11 Recommended Readings

- Kapoor N.D, Mercantile Law, Sultan Chand and Sons, New Delhi, 2002
- Gulshan S.S, Business Law, Excel Books, New Delhi, 2003

16.12 Answers to Self Check Activities:

1) 1991
2) Reserve Bank
3) current account

MBA- DISTANCE EDU.(First Year) Semester-I

BE 106

BUSINESS ENVIRONMENT

Lesson No.17

AUTHOR : RAKESHKUMAR

MONEY MARKET AND ITS DEVELOPMENT IN INDIA

STRUCTURE

17.0 Objectives
17.1 Introduction
17.2 Characteristics of a Developed Money Market 17.3 Instruments of MoneyMarket
17.4 Features of a Developed MoneyMarket
17.4.1 Self Check Activity I
17.5 Money Market inIndia
17.6 Major Reforms in Indian MoneyMarket
17.7 Summary
17.8 Glossary
17.9 Keywords
17.10 PractiseQuestions
17.11 SuggestedReadings
17.12 Answers to Self Check Activity

17.0 OBJECTIVES

After reading this chapter, the student should be able to :

(i) Understand the characteristics of a developed MoneyMarket.
(ii) Understand various investments of MoneyMarket.
(iii) Understand the major reforms in Indian MoneyMarket.

17.1 INTRODUCTION

Financial markets may be broadly classified as negotiable loan markets and open markets. The negotiable loan market is a market in which lenders and borrowers personally negotiate the terms of the loan agreement. A business person borrowing from a bank and an individualborrowingfromasmallloancompanyareexamplesofnegotiatedloans.Incontrast, theopenmarketisanimpersonalmarketinwhichstandardizedsecuritiesaretradedinlarge volumes.Buyersandsellersmaynevermeet.Stockmarketisanexampleofanopenmarket. The open market provides the binding that ties the country's financial institutions together intoanintegratedwhole.Itisonlywiththeopenmarketthatwewillbeconcernedwithinthis and the nextlesson.

This lesson is divided into three sections. Basic knowledge about money market and

characteristics of a developed money market are discussed in the first section. Section II deals with the various components of money market. Money market in India and its development is a part of sectionIll.

I

Moneymarketisamarketforshortterm(lessthanone year)loans.Infact,itsveryname suggests that it is money which is being bought and sold. It is used by business firms for purchase and shipment of inventories, by finance companies to finance consumer credit, by bankstofinancetemporaryreserveshortage,andbygovernmenttobridgethegapbetweentax receipts and expenditure. The money market is not a place but anactivity.

A supplier of funds to the money market can be virtually any one with atemporary

excessoffunds,forexample,acorporationmaybeaccumulatingfundsforaquarterlyincome tax payment, and rather than holding the funds in demand deposits (non-interest bearing), the corporation may decide to lend them out for short term. A commercial bank may know fromexperiencethatitwillhavelargeseasonaldepositwithdrawalsshortlybutinthemeantime

it may invest the money in earning assets.

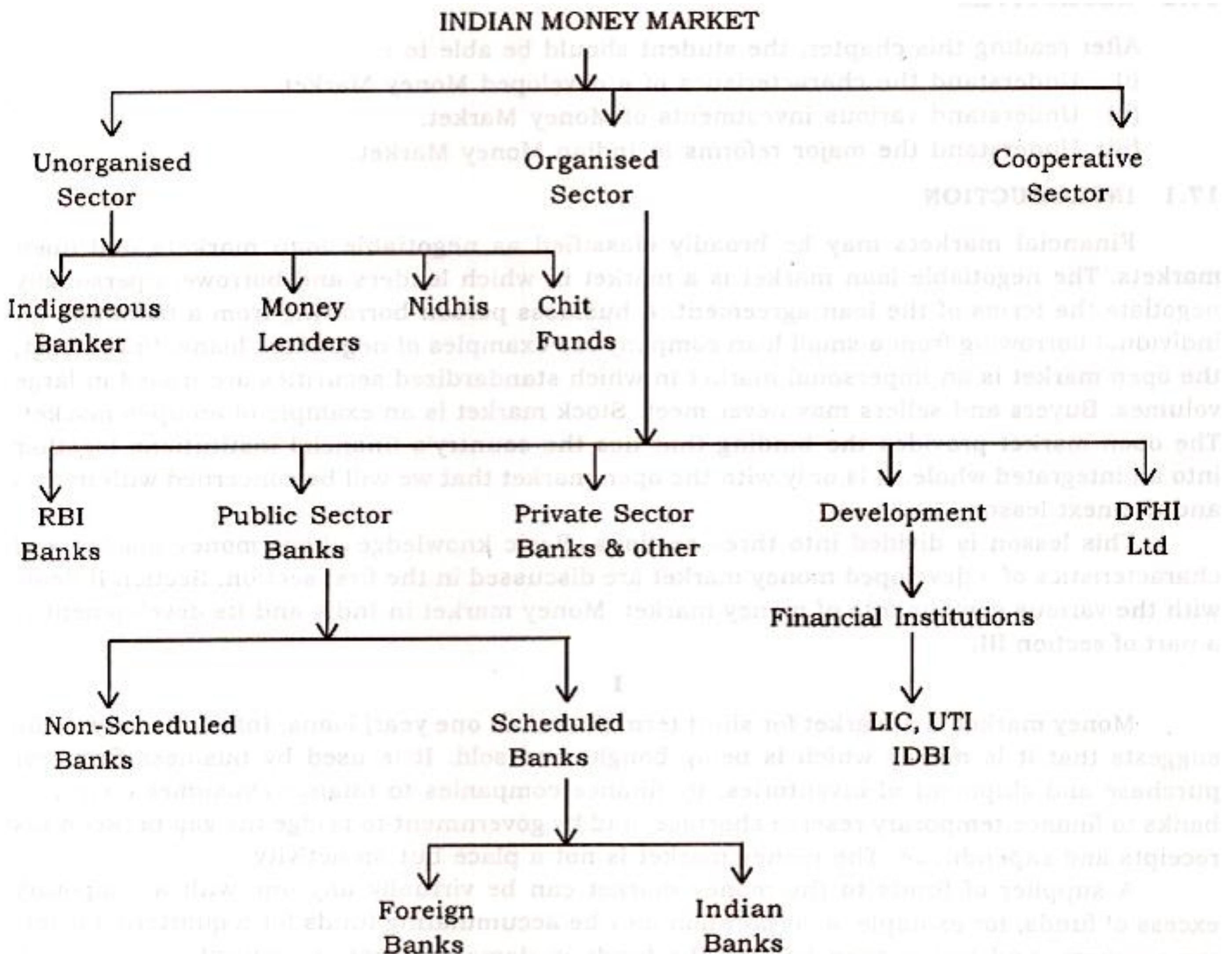
The best way to a clear impression of the money market is to understand the mechanism of the various debt instruments traded in it. The description of the money market involves both the instruments and institutions. All the money markets, though constituted differently, have institutions which have somewhat similarcharacter.

17.2 CHARACTERISTICS OF A DEVELOPED MONEYMARKET

A developed money market is one which is comparatively efficient in the sense that it is responsive to changes in demand for and supply of funds in any of its segments. The effects initiated in any part of it, quickly spreads to others without significant time lag. In order to satisfy tl1ese criteria it should have the following characteristics :

(a)Presence of Central Bank

Central bank has a greater capacity of judging the needs of the market as regards its financial requirements and can-devise its monetary policy to suit the objectives. It can vary the supply of cash and easily meet the seasonal variations in demand for liquidity by rediscovering the commercial paper. It- can supplement this task by varying the minimum



Source : "Financial Markets and Services" by Gordon and Natrajan, Himalaya Publishing House, 2006 edition, p60.

reservestobemaintainedbythebanks,thebankrateanduseofselectivecreditcontrolsetc.

(b) A Developed Commercial BankingSystem

For a developed money market not only the banks should be well- developed and organised, but the public should also have widespread banking habit. Widespread banking habits of the public enable banks to operate on low fractional reserves.

(c) Variety and Quantity or FinancialAssets

It is essential that there should be an adequate supply of a variety of short maturity financialassets.Indevelopedmoneymarketsthereisanabundanceofcommercialbills,bills of exchange, treasury bills and soon.

(d) Sub-markets

A developed money market will have developed and sensitive sub- markets. Absence of such markets or lack of their responsiveness to small changes in interest and discount rates, does not make it a developed money market.

(e) Existence of Specializedinstitution

The existence of institutions specializing in particular types of assets help in making the money market competitive and efficient. Acceptance houses and discount houses are importantexamples.

(f) Contributory Legal and EconomicFactors

Appropriate legal provisions go a long way in the development of money market. The transaction costs of commercial bills should be quite nominal- In India, one of the reasons for non-development of bill market happens to be the high stamp duty payable on them. Similarly, the dealers in bills should have a legal protection against default of payment and remedial provisions should not be very time-consuming.

Money market would remain undeveloped if one or more of above conditions are not satisfied.

II

17.3 INSTRUMENTS OF MONEYMARKET

Money market works through market instruments. Let us now discuss various instruments of money market one by one.

Call Money

Call money loans are extremely short term loans which are repayable on demand within a day. They are made by commercial banks and other financial institutions who can afford to spare funds in large amounts, though for short periods. The demand for such loans comes from those financial institutions which specialize in discounting, or rediscounting bills.

The call money market operates through brokers who keep in constant touch withbanksandbringtheborrowingandlendingbankstogether.Themainfunctionof themarketistoredistributethepoolofday todaysurplusfundsofbanksamongother banksintemporarydeficitofcash.Thecallmoneymarketisahighlycompetitiveand sensitivemarket.Itregistersveryquicklythe pressureofdemandandsupplyforfunds operating in the moneymarket.

Treasury Bills

The market which deals in treasury bills is termed as treasury bill market. These bills are short-term liability of the government. They are issued to meet temporary needs for funds of the government arising from temporary excess of expenditure over receipts. Treasury bills are of two kinds : adhoc and regular. Adhoc means for the particular end or case at hand. Adhoc treasury bills are issued for providing investment outlets to state governments, semi- government departmentsetc.

They are sold to general public and banks. They are freely marketable. In India, their buyers are almost entirely commercial banks.

Treasury bills are bought and sold on discount basis. The amount of interest due on it is paid in the form of discount in the price charged for the bill. This price is, thus, lower than its face value by the amount of interest due on the bill. For the government, treasury bills are an important source of raising funds. In India, treasury bill rates are very low, which in turn, keep the interest cost of treasury bill debt to the government verylow.

Commercial Bills

The market dealing in commercial bills is known as commercial bill -market. These bills are issued by firms engaged in business. Generally, they are of three months' maturity. They are like post-dated cheques drawn by sellers of goods on the buyers of goods for value received.

An example of typical bill of exchange is given below :

Patiala, Oct. 15, 1996

Mr. Sharma,

Three months after date please pay to the undersigned or order of the sum of Rupees thirty thousand for value received.

Mr. Khurana In

this example, Mr. Khurana is the drawer of the bill and Mr. Sharma is the drawee.

The former has sold the latter goods worth Rs. 30.000/- on three months credit. The seller may need cash now, so he draws a bill and sends it to the buyer for acceptance. The latter in acknowledgement of his responsibility to make payment on the due. date writes 'accepted' on the bill, or arranges to get the bill accepted on his behalf by his bank. Once the bill has been so accepted, it becomes a marketable Instrument. On receipt, the drawer can now sell it in the market for cash. The bank, again, normally comes into picture. The drawer goes to his bank and gets the bill discounted. This simply means that he sells it for cash to the bank which pays him the face value of the bill less collection charges and interest on the amount for remaining life of the bill. The rate of interest charged is known as the discount rate on bills.

While in developed economies, commercial bills are a major portion of the money market, in underdeveloped countries this is not the case, for various reasons. These economieshaveapracticeoftradingthroughpaymentratherthanbuyingoncredit.Also,for a genuine bill market to develop it is essential that the bills should be drawn in a largely accepted conventional form and the banks and other agencies of repute should be ready to stand guarantee for the credit worthiness of the drawee of thebills.

Commercial Paper (CP)

Commercial paper consists, very simply, of the unsecured promissory notes of large

corporations. The corporations are sufficiently well-known so that their credit worthiness is not in doubt. Their promise to pay can. consequently be bought and sold in an organised market.Thecommercialpapergenerallycarriesamaturityof4to6monthsandisusedbythe issuersasasupplement toborrowingfromcommercialbanks.CPsaresoldeitherdirectlyby the issuers to investors or through agents like merchant banks and security houses. In India, CPs are privately placed with investors through banks or financial institutions. These are used to raise short term finance to meet working capitalneeds.

Certificates of Deposits (CDs)

ACDisadocumentoftitletoatimedeposit.Acertificateofdepositisacertificategiven by a commercial bank that certifies that a deposit has, infact, been made. The certificate stipulatesthatthedepositcannotbewithdrawnbeforeacertaindateandthat,uponthatdate, thebankwillrepaythedepositplusinterest.Thisperiodisgenerallythreemonths.Certificates of deposit are of two kinds : non-negotiable and negotiable. A non-negotiable certificate of deposit must be redeemed by the original depositors. A negotiable certificate of deposit, however,mayberesoldbythedepositorinthemoneymarketandmaychangehandsseveral timesbeforeitmatures.Whosoeverownsthenegotiablecertificateofdepositonitsmaturity date, of course, claims the deposit and interest from thebank.

The above mentioned instruments **are the** basic constituents of the money market. The market operates through these instruments. Development of any economy can also be judged from the development of its money market.

III

17.4 FEATURES OF A DEVELOPED MONEYMARKET

(i) **Highly Organised Banking System**

The commercial banks are the nerve centre of the whole money market. They are the principal suppliers of short-term funds. Their policies regarding Joans and advances have impact on the entire money market. In an underdeveloped money market, the commercial banking system is not fully developed.

(U)Presence of a Central Bank

The central bank acts as the banker's bank. It keeps their cash reserves and provides them financial accomodation in difficulties by discounting their eligible securities. Through its open market operations, **the** central bank absorbs surplus cash during off seasons and provides additional liquidity in the busy seasons. In an underdeveloped money market,
the central bank is in its infancy and not in a position to influence and control the money market.

(iii) Availability of Proper CreditInstruments

A continuous availability of readily acceptable negotiable securities such as, bills of exchange, treasury bills is necessary for the existence of a developed money market. There is absenceofadequateandpropercreditinstrumentsaswellasdealerstodealintheseinstruments in as underdeveloped moneymarket.

(iv) Existence ofSub-Marketa

The number of sub-markets determines the development of a money market. The larger the number of sub-markets, the broader and more developed will be the structure of moneymarket.

(v) AdequateResources

There must be availability of sufficient funds to finance transactions is the sub-markets. These funds may come from within the country and also foreign countries.

(vi) Existence or SecondaryMarket

There should be an active secondary market in these instruments.

(vii) Demand and Supply ofFunds

There should be a large demand and supply of short-term funds.

17.4.1 Self Check Activity I

(i) A developed money market is characterized by its efficiency and responsiveness to changes in ___________ and ___________ of funds.

(ii) The presence of a ___________ is crucial in judging the needs of the market and devising monetary policies.

(iii) In a developed money market, there should be an abundance of commercial bills, bills of exchange, treasury bills, and other short-term ___________ assets.

(iv) The existence of specialized institutions such as acceptance houses and discount houses contributes to making the money market ___________ and efficient.

(v) Appropriate ___________ provisions play a significant role in the development of the money market.

17.5 MONEY MARKET ININDIA

Until 1935, the country had no central bank. The government had the right to issue currency. The banking structure was very fragile and bank failure was very common. The money market that existed in pre- independence period was far more undeveloped, than what **it** is today. Now the Indian money market is a leading money market in third world countries.

Indian money market is broadly divided into two parts, viz. the unorganised and the organised. The unorganised sector of money market comprises the indigenous bankers and money-lenders.Theychargecomparativelyhighratesofinterest.Unlikethemodernbanking system there are little business relations among them. The organised sector is fairly integrated. Both private and public sectors constitute the organised sector. The RBI is the central bank, and it is the apex organisation in theIndian. money market.

No doubt, the organised sector of the Indian money market is fairly developed and organised, yet it is not comparable to the New York or London money market.

Broadly, the principal constituents of Indian money market are : (i) The call money market,(ii)Thetreasurybillmarket,(in)thecommercialbillmarket,(iv)CertificateofDeposit market and (v) The commercial papermarket.

(I) The Call MoneyMarket

Scheduled commercial banks, cooperative banks and Discount and Finance House of India operate in it. As a special case, institutions like Unit Trust of India, Life Insurance of India, General Insurance of India, Industrial Development Bank of India and the NABARD are allowed to operate in the call money market. Among the banks, the State Bank of India, on account of a strong liquid position is invariably on the lender side of the market. The call moneymarket,onaccountofitshighlysensitivenature,isconsideredtobethe mostappropriate indicator of the liquidity position of the money market. The RBI, therefore, takes note of it in adjusting day to day monetarypolicy.

(U) The Treasury BillMarket

The treasury bills are short term (91 days, 182 days, 364 days, and 14- days) liability of the central govern me nt. In these days, in India, treasury bills have become a permanent source of funds for the central government, as every year more new bills are issued than those that are retired. Further, every year a part of treasury bills held by RBI is converted into long term bonds. The treasury bill market in India is very underdeveloped. Except RBI there are no major holders of these bills. Infact, even the RBI is a passive or captive holder of these bills which implies that it is under an obligation to purchase all the treasury bills presented to it by banks and others for this purpose. This has resulted in monetization of public debt andhas

become a major source of inflationary expansion of money supply.

(iii) **The Commercial BUI Market**

In India, this market is highly undeveloped. Generally, cash credit system of bank lending is popular. Among other factors which have prevented growth of genuine bill market are lack of uniformity in drawing bills, high stamp duty on time bills and the practice of selling on credit without specified time limit. RBI has made efforts to develop a bill market in this country and popularise the use of bills. Its two specific bill market schemes, however, had limited success. The old bill market scheme introduced in January 1952 was not correctly designed to develop a bill market. It merely provided for further accommodation of banks in addition to facilities they had already enjoyed. In order to encourage use of bills the RBI offered loan at a concessional rate of interest and met half the cost of stamp duty incurred by banks on converting demand bills into usance bills- This scheme, however, failed to make anyimpact.

Not satisfied with the old scheme, the RBI introduced a new bill market scheme in November 1970. The noteworthy features of new scheme are:

(i) The bills covered under the scheme are genuine trade bills and (ii) the scheme providesfortheirrediscounting.Thisschemereallyaimedatdevelopingabillmarketinthe country but has not been verysuccessful.

(iv) **The Certificate of DepositMarket**

Thecertificatesofdepositswereintroducedin Indianmoneymarketin1989,withthe objectiveofwideningtherangeofmoneymarketinstrumentsandtoprovideinvestorsgreater flexibility in deployment of their short term surplus funds. The CDs can be issued by the scheduledcommercialbanksCPsaresubjecttoSLRandCRRrequirement.Thereisnoceiling onamounttoberaisedbybanks.MinimummaturityofCDhasbeenreducedto15daysw.e.f. 2000-01. Minimum size of issue has been reduced from Rs. 5 lakhs to Rs. 1 lakh in June 2002. In 1992 other financial institutions like IDBI, IFCI etc. were permitted to issue CDs with maturity of 1-3yrs.

(v) **The Commercial PaperMarket**

The commercial papers were introduced in Indian money market in January, 1990. ThecommercialpaperisissuedbycompanieswithatangiblenetworthofRs.4crores.TheCP was to be issued in multiples of Rs. 25 lakhs subject to a minimum issue of 1 crore. The maturityofCPswasbetween3to6months.However,nowtheminimumsizestandsreduced toRs. 5lakhs,thematurityperiodismodifiedto15days•lyear;guidelinesforissueofCPs have been relaxed ; CP issues are now delinked from working capital. The minimum credit ratingshallbeP2ofCRISILorsuchequivalentratingby otherapprovedagencies.TheCPsare issued at a discount to face value and the discount rate is freely determined. The purpose of CPs in Indian money market is to enable high level corporate borrowers to diversify their sources of short term borrowings on the one hand and provide an additional instrument to banks and financial institutions in the money market, on theother.

In its organisation and development, the Indian money market is not comparable to either the London money market or the New York money market. It suffers from a number of defects such as lack of integration because the organised and unorganised segments are working separately. The structure of interest rate is not rational due to the lack ofadequate

coordination between different banking institutions and policy of RBI. The bill market is not fully organised and there is shortage of funds in the money market. Moreover, there are inadequate banking facilities in India.

It is clear from the foregoing discussion that the money market in India does not satisfy the criteria of a developed money market.

17.6 MAJOR REFORMS IN INDIAN MONEYMARKET

Asystematicreviewof theIndianmoneymarketwasundertakenbytheVaghulworking group in 1987. Since then, a number of steps have been taken to improve the efficiency of the Indian money market. Some of these steps are as follows:-

1. Ceiling on call money rate has been withdrawn. All money market interest rates are, by and large, determined by marketforces.
2. Selected institutions are allowed to borrow from the money market on a termbasis.
3. The base of call money market has been widened by selective increase in the participants aslenders.
4. CDs were introduced in 1989, CPs in 1990, and guidelines relating to them are modified from time totime.
5. A number of institutions have been set up like Discount and FinanceHouse of India (DFHI), Securities Trading Corporation of India (STCI) to promote orderly development of money market. They are allowed to participate both as lenders and borrowers in the call moneymarket.

The DFHIwasset upinJanuary,1988jointlybytheReserveBank,PublicSectorBanks, and the All India Financial Institutions to deal in short term money market instruments, enlarge the number of participants in the call, short notice, and term money market by allowing financial institutions and mutual funds to participate as lenders. It moderates the volatility in the inter bank call money market by providing liquidity in the market as and when required. The STCI was set up on June 7, 1994 to develop an institutional infrastructure to act as base for an active secondary market in govt. dated securities and public sector bonds. It can also hold short-term money market assets likeTBs.

6. Issue of adhoc 91 day TBs to finance the budget deficit of the government was discontinued, and a scheme of Ways and Means Advances (WMA) by the RBI to the Central Govt. was introduced with effect from April 1, 1997. Auction of 91- days TBs commenced from 1993. Also, TBs of various maturities such as 14- days, 28-days have beenintroduced.
7. In April 1991, RBI announced the introduction of Money Market Mutual Funds (MMMFs). The main objective was to provide small investors an investing opportunity yielding market related returns, help in broad basing money market by providing more participants, and help in mobilising household savings. The privatesectorwasallowedtosetupMMMFsin1995.Also,UTI,IDBI,ABNAmro Bank and Bank of Madura Ltd. have been given clearance to set up MMMFs. Since march 2000, MMMFs have been brought under the purview of SEBI regulation.
8. The minimum lock-in period for Money market instruments was brought down. to 15days.

9. The 182 day and 14-day treasury bills were discontinued w.e.f. May, 2001. Despite these reforms, the Indian money market is yet to acquire depth. Interest rates continue to be highly volatile. Moreover, the grand scheme of liberalisation and globalisation of money market has brought up many distortions without enhancing efficiency of institutions and allocation of resources. In our economy where the rural sector dominates, and the unorganised money market still plays an important role, money market reforms should start from reorganising rural financialstructure.

17.7 SUMMARY

The above are the major developments in the money market that have taken place in recent years. However, the Indian money market has a long way to develop. In particular,thereisneedforalargernumberofplayersinthemarketandgreatervarietyofinstrumen ts.

17.8 Glossary

- Money Market: A financial market where short-term loans and financial instruments are bought and sold, typically with maturities of less than one year.
- Negotiable Loan Market: A market where lenders and borrowers personally negotiate the terms of a loan agreement, as opposed to standardized securities traded in open markets.

17.9 Keywords: Money Marke, Central Bank, Commercial Bills, Money Market Reforms

17.10 PRACTICALQUESTIONS

Short Questions :

Q.1. What are the various money marketinstruments?

Q.2. What is the primary function of the negotiable loan market?

Q.3. Define the term "money market" and explain its essential characteristics.

Q.4. List three examples of instruments in the money market.

Long Questions:

Q.5. Discuss the characteristics of a developed money market and explain why efficiency and responsiveness are essential.

Q.6. Describe the various instruments of the money market, focusing on their features and functions.

Q.7. WhatmeasureshavebeentakeninrecentyearstowidenanddeepenIndianmone y market?

17.11 SUGGESTEDREADINGS

- Bedi, Suresh, *Business Environment,* Excel Books, New Deihl,2004.
- Cherunilam, Francis, *Business Environment,* Himalaya Publishing House, Mumbai, 2006.

17.12 Answers to the Self Check Exercise

(i) demand; supply
(ii) Central Bank
(iii) financial
(iv) competitive
(v) legal

LessonNo.18

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DEVELOPMENT BANKS

STRUCTURE

18.0 Objectives of theLesson
18.1 Introduction
18.2 Definition
18.3 Feature of DevelopmentBank
18.4 Growth of DevelopmentBanks
18.5 Need for DevelopmentBanks
18.6 Functions of DevelopmentBanks
 18.6.1 Self Check Activity I
18.7 Lending Procedure of DevelopmentBanks
18.8 Risk Management By DevelopmentBanks
18.9 PrudentialNorms
 18.9.1 IncomeRecognition
 18.9.2 AssetClassification
 18.9.3 Provisioning
 18.9.4 Valuation of Investments AccountingStandards
 18.9.5 CapitalAdequacy
 18.9.6 Self Check Activity II
18.10 Relevancy to IndianBusiness
18.11 Conclusion
18.12 Glossary
18.13 Keywords
18.14 Practice Questions
18.15 Answers to Slef Check Activities

18.0 OBJECTIVE

This chapter aims to give the students an insight into (1) The problems faced by at developing country in the overall development (2) The need, functions, features, growth, lending procedure of development banks; (3) The focus on the importance of development banks in areas of project appraisal, financial assistance, underwriting and guarantee operations; (4) The risk management and capital adequacynorms.

18.1 INTRODUCTION

Finance plays most important role in the development of a country alike the role of blood soul in human body. But proper management of finance and its disbursement in well organized way increased the pace of development. One of the vital branches of planned development is Development Banks. Development banks or institution are specified financial institutions provide all type of financial assistance, underwriting investment and guarantee operations as well as promotional activities for economic development.

18.2 DEFINITION

I. A.G. Kheradjou defines that “a development bank is like a living organism that reacts to the socio-economic environment and its success depends on reaching most apply to thatenvironment".

II. Another eminent economist says "A development bank is a multipurpose institution which shares entrepreneurial risks, changes its approach in time with industrial climate and encourage new industrial projects to bring aboutspeedier economicgrowth."

III. Dr. Desai rightly describe that “A development bank is a financialinstitution concernedwithprovidingalltypesoffinancialassistancetoenterprisesintheform of loans, underwriting investment and guarantee operations and promotional activitiestoacceleratetheprocessofsustainablesocialeconomicdevelopmentand faster growth acooperation."

18,3 FEATURE OF DEVELOPMENT BANK

Development bank differs from the ordinary banking system in several aspects from the basic concept and about definitions pertains the features of development bank.

1. Development banks are 'project oriented' rather than of old 'securityoriented' approach.
2. Development banks not only provide finance for the establishmentof Industrial units, but maintain close liaison with them, guiding, supervising and advising the entrepreneurs throughout the period of the loan.
3. Developmentbankswhileprimarilyprovidelongandmediumterm Joansitalso helps industrial undertakings in raising funds through equity shares and debentures by undertaking suchissues.
4. These banks provide cheap financial assistance with low rates ofinterest.
5. On **the** first foot, the development banks are to serve public interest **i.e.** to develop socio-economic environment instead of profit earnings.

18.4 GROWTH OF DEVELOPMENTBANKS

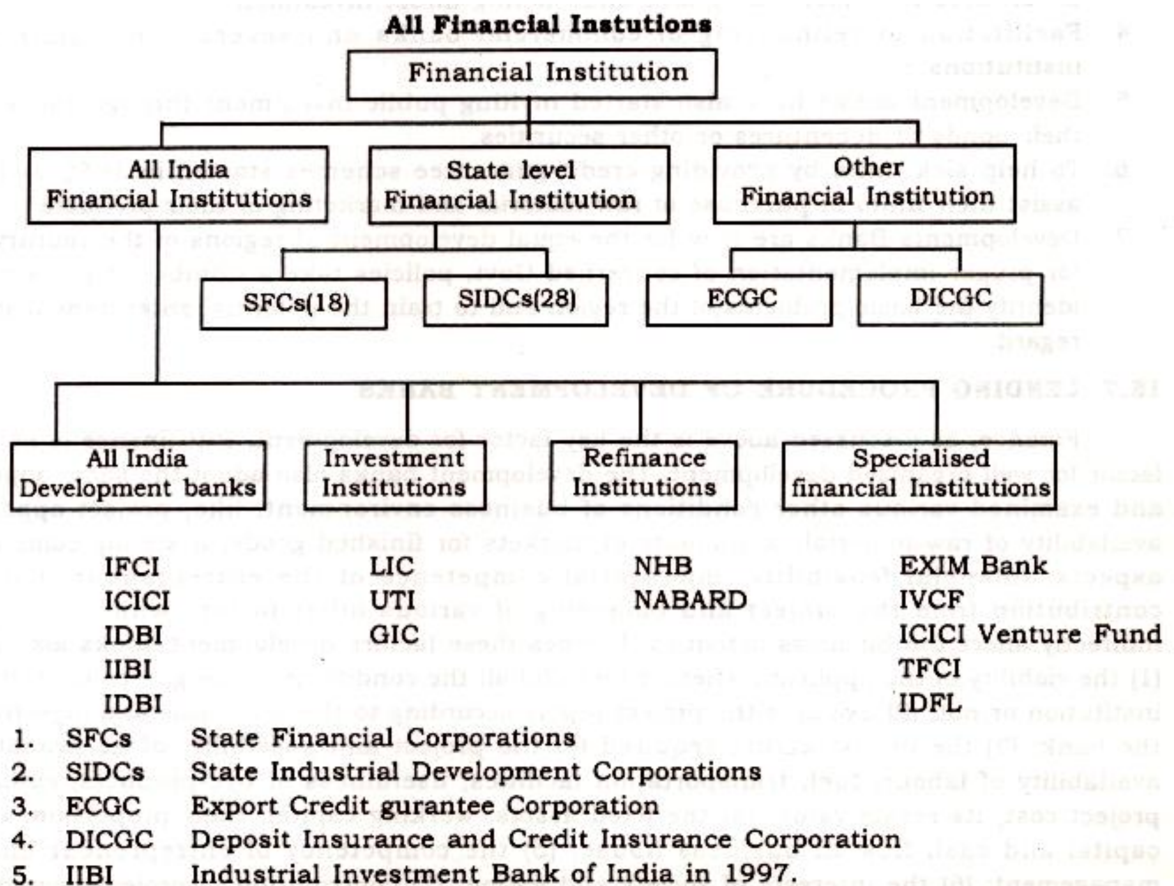
Nodoubt,thegrowthofdevelopmentbankinghasbeenstartedafterWorldWar-II. But there were some banks at world level with the same features and objectives, i.e. the Societa De Generate DeBalrgique established in 1822 at Belgium one of the first development bank of its own type. Credit Mobiliser of France established in 1852, IndustrialBankofJapanestablishedin1902,aresomeexamplesoforiginofdevelopment banking in the world. It was only after the independence was achieved when serious thoughts were given to the development aspect of the country because the British rules even did not implement. The recommendation of Central Banking Enquiry Committee proposedintheyearof1931.Aftertheindependencetheneedforindustrialdevelopment led to the need for development banks in the country and the first development bank named as Industrial Finance Corporation of India (IFCI) was established in 1948. It was the year of 1949, when Reserve Bank of India (RBI) prepared a full fledge report on the need of specialized financial institutes for the development of economy of the country. Thus in 1951 the central Government passed the Financial Corporation Act 1951 vide which the State Governments were authorized to establish the state level financial institution. Since then the country has not seen back. At present there exists a vast networkofanumberofcentralandstaffleveldevelopmentinstitutionswhichprovidewide range of services for the development of all type of industries in India, by providing financial as well as other promotionalassistances.

WiththeassistanceofWorldBankCommonWealthDevelopmentFinancecorporations. TheReserveBankofIndiaestablishedin1955,theIndustrialCreditandInvestmentCorp.of India(ICICI),wasemergedwiththelCICIBankin2001.Althoughthecorp.wasestablishin private sector but it was deemed to be a public company, to assist the entrepreneur in creation, expansion and modernization of industries to expand industry market. In 1958 RefinancingCorp.ofIndiaLtd.wasestablishedtorefinancethecommercialbanksandstate

level financial institutes on the basis of their loans to industry. But still there was a need of apex body to control the promotional means and in 1964 with the creation of the Industrial Development Bank of India (IDBI) the thrust was satisfied. IDBI earlier was subsidiary of RBI, later on its ownership transferred to 0.0.I and further with amendment in basic act in Oct. 1994. IDBI was permitted to raise funds from public issue of equities, subject to the Govt. holding not falling below 51% of **the** issued capital. IDBI has set up a host of subsidiaries and associates with a view to expand the function reach of IDBI i.e. Small Industrial Development BankofIndia(SIDBI),IDBICapitalMarketServicesltd.(IDBICapital)IDBIBank,IDBIlntech Led (INTECH), IDBI Trusteeship Services Ltd(ITSL)

To deal with the problem of industrial sickness Govt. of India established industrial

Reconstruction Corp. of India in 1971, which was later on merged into Industrial ReconstructionBankofIndia.In1997againstIRBIwasconvertedintoacompany-transferred into a full fledged financial institution known as Industrial investment Bank of India Ltd. (HBI).Toidentifythestateproblemsandtheareasofitsdevelopment,intheyearof1951State FinancialCorp.Act-1951wasenactedbywhichnumberofstatelevelcorp.wasestablished. In the mean time, with development of economy number of other corporations, financial institutes and banks also started participation in the economy promotional functions, such as Unit Trust of India-1964, Life Corp of India, 1956 General Insurance Corp. -1973, RehabilitationofSickUnits1971,NationalAgriculturalandRuralDevelopmentBank-1982 Exim Bank - 1982. Small Industrial Development Bank of India- 1989, National Small Industrial Corp. Ltd. .etc. wasestablished.



1. SFCs State Financial Corporations
2. SIDCs State Industrial Development Corporations
3. ECGC Export Credit gurantee Corporation
4. DICGC Deposit Insurance and Credit Insurance Corporation
5. IIBI Industrial Investment Bank of India in 1997.

1. TFCI Tourism Finance Corporation of India Ltd.
2. ICICI Industrial credit and Investment Corporation if India was merged with ICICI Bank in 2002.

18.5 NEED FOR DEVELOPMENTBANKS

1. Economicdevelopmentwasthebasicquestionafterindependenceandproperinstitute to manage the problems was necessary which gave birth to thereinstitutions.
2. Growth of industrialization is necessary for development of country. Financial assistance for the industries and refinancing of sick units is also one of the important logic behind growth of developmentbanks.
3. The entrepreneur in India were not much potential in each field of business, thus the requirement of expertise opinion become logic behind growth of developmentbanks.
4. For planned, proper and equal development of all the regions of the country under the supervision of Penal ofexperts.

18.6 FUNCTION OF DEVELOPMENTBANKS

1. The main functions of development banks are to provide long and medium term financial assistance at the cheap rate of interest to theindustries.
2. To guide, supervise and advise the entrepreneurs about the changing concepts of economy in the present era ofcompetition.
3. To help, the industrial undertakings in raising funds through equity shares and debentures by underwriting and undertaking directinvestments.
4. Facilitation of refinancing of commercial banks and several other state level institutions.
5. Development banks have also started inviting public investment through the sale of their bonds or debentures or othersecurities.
6. To help sick units by providing credit guarantee schemes started in 1960 and also assist their units in purchase of raw material and marketing of theirproducts.
7. DevelopmentsBanksarenowfortheequaldevelopmentofregionsofthecountryand for proper implementation of concerned Govt, policies take a number of measures to identify the basic problems of the region and to train the potential entrepreneur is this regard.

18.6.1 Self Check Activity I

1 A.G. Kheradjou defines that "a development bank is like a living organism that reacts to the socio-economic environment and its success depends on reaching most apply to that __________."

2 Development banks are 'project oriented' rather than of old 'security oriented' __________.

3 No doubt, the growth of development banking has been started after __________.

4 The main risks that the development banks face are __________.

18.7 LENDING PROCEDURE OF DEVELOPMENTBANKS

Finance,asdiscussedaboveisthekeyfactorfordevelopment.Butfinanceisnotonly factorforwellorganizeddevelopment.Thedevelopmentbanksalsoadoptthesameapproach and examined various other conditions of business environment, like, project appraisal, availabilityofrawmaterial,availabilityofmarketsforfinishedgoods,assistingcommercial aspects, financial feasibility, managerial competence of the entrepreneur, national contribution from the project and balancing of various other factors which directly or indirectly affect the business activities. Besides these factors development banks alsocheck (1)**the**viabilityoftheapplicantwhetherhefulfillalltheconditionsofthegovernment/Boards institutionornot;(2)examinetheprojectreportaccordingtotheset-normsandobjectivesof the bank; (3) the infrastructure required for the project and possibility of its availability, availability of labour, fuel, transportation facilities, usefulness of bye-products, estimated project cost, its resale value; (4) the fixed assets, working capital, their proportion, equity capital and cash flow in business house; (5) the competency of entrepreneur and his management; (6) the interests of society and nation; (7) contribution of project towardsthe

national economy. If the banks satisfied with all the stipulated conditions, in that event development bank may sanction the loan and disbursed accordingly.

Disbursement of loan in not thelast step in modern lending process but a proper follow-up and technical as well as managerial advice by the development banks is also one of the unique functions of these banks. Development Banks gets full knowledge with the help of 'follow-up' step. In this ways long process has been adopted by the development banks to finance a project, which includes a detailed investigation about each and every aspect of the project, entrepreneur and the basic economic conditions concerned with the project.

18.8 RISK MANAGEMENT BY DEVELOPMENTBANKS

Development Banks are exposed to certain risks which arise out of their business and the environment within which they function. The main risks that the development banks face as follows:

1. **Credit Risk** : Credit risk means risk default of repayment of loan with interestas per the loan agreement. This risk arises when the borrower is unable to achieve success in his endeavor to earth profits. Development Banks have tried to reduce this risk by making comprehensive appraisal of the projects and thereafter stringent monitoring and supervision. They have also tried to reduce this risk by lending over a large number of borrowings in different types ofindustries.
2. **Interest Rate Risk** : This risk arises from maturity mismatches between interestrate sensitive assets and liabilities of a financial institution. This means that maturity period of assets in which they are invested. The risk can be minimized by closely monitoring the maturities of its assets and liabilities During recent years, the lending institutions have substantiallyreducedthe asset/liabilitymismatchbydiversifyingtheirresourcesraisinginto shorter maturityinstruments.
3. **Liquidity Risk**: The liquidity risk implies inability of financialinstitution to fruitfully employ the resources for appropriate maturities and carrying adequate rate of interest i.e financing institution is unable to meet its contractual obligations as a borrower. They should possess large investments which add to their liquidity when need arises and should try to increase their port folio of liquid assets.
4. **Foreign Exchange Risk**: Foreign exchange risk arises in case of borrowingsin foreign currencies at certain rates which are lent with in the country. The rate of exchange at the time of repayment of foreign exchange loans may differ, thereby causing lose to financial institutions The financial institutions generally as a matter of policy do not bear thisrisk,asforeign currencyloansaremadeontermsparallel totheunderlyingborrowings.

18.9 PRUDENTIALNORMS

Withashiftinfocusfromdevelopmentalfunctiontofinancialviability,theoperations of DFIs/PFIs have to confirm to RBI framework of prudential norms based on Narsimha Committee's and II recommendations. These relatedto

(i) IncomeRecognition;
(ii) Assetclassification.
(iii) Provisioning.'
(iv) Valuation of Investments/Accounting standards;and
(v) Capitaladequacy.

18.9.1 Income Recognition:

The policy of income recognition should be

(a) Objective

(b) Based on the record ofrecovery

Income from Non-performing asset should not be recognized on accrual basis but booked as income only when actually received. An asset becomes NPA when it ceases to generate income for a development bank. As asset becomes NPA if interest and/or principal remain overdue for 180 days. In case of a borrower who has been granted more than one loan/credit facility, all the dues should be treated as NPA only if 50 of its total interest and/or principal dues for all credit facilities remain overdue for more than 2 quarters. As income recognition is based on record of recovery, availability of security, net worth of borrow/guarantee should not be taken into account for treating an advance as NPA or otherwise. If any advance becomes NPA at the close of any year, interest credited to the income account in the corresponding previous year should be reversed including the Govt. guaranteedaccounts.

18.9.i Asset Calculation:

All financial institutions have to classify their loans/ advances into 4 board groups : standard, sub-standard, doubtful and loss. The categorization of assets should be done on the basis of well defined credit worthless and the extent of dependence on collateral security for the realization ofdues.

(1) Standard Assets are those which do not disclose any problem and which does not carrymorethannormalriskattachedtothebusiness.SuchanassetisnotNPA.

(2) Substandard assets are those which have been classified as NPA for a period upto 2 years. It has well defined credit weakness that jeopardize the liquidation of the debt and is characterized by the distinct possibility that the Financial Institutions would sustain someloss.

(3) Doubtful Assets are those which have been classified as NPAs for a period exceeding 2 years and they have all the weaknesses that make collection highly questionable andimprobable.

(4) In loss Assets has been identified by the PI's internal or external auditors and RBI but the amount has not been written off wholly orpartly.

18.9.3 Provisioning

Financial institutions are required to make provisions in respect of their assets as follows :

(i) StandardAssets - 0.25% of total outstandingassets.

(ii) SubstandardAssets - 10% of total outstandingassets.

(iii) DoubtfulAssets - 20% to 50% depending upon the period which the advance has been considered asdoubtful.

(a) Secured:

(ii) Upto1year - 20%

(ii) 1-3years - 30%

(iii) More than 3years- 50%

(b) Unsecured: - 100% of suchassets

(iv) LossAssets - The entire asset should be written off it theseare permitted to remain in books then 100% provision should be made.

18. 9.4 Valuation or the Investments/AccountingStandards

For the purpose of balance sheet, investments should be classified into the following categories:

1. Govt.securities.
2. Other approvedsecurities.
3. Shares.
4. Debentures/Bonds.
5. Subsidiaries and JointVentures.
6. SponsoredInstitutions.
7. Others (Mutual fund units and commercial papers and soon)

I. Valuation of Govt. Securities should be done based on market quotations on March 31, each year. Where the market quotations are not available these are valued on the basis of yield to maturitymethod.

II. Shares should be valued at market price where available and if notthen the same should be taken at book value based on the latest balance sheet.

Ill. Debentures are to be valued at year end rates.

IV. Mutualfundunitsaretobe valuesbasedonthelatestNetAssetvaluedeclared in respect of each particularscheme.

V. Treasury Bills/commercial papers have to be valued at carryingcost.

18.9.5 Capital Adequacy

Financial Institutions have to maintain with effect from March 1996, 8% capital adequacy ratio. The minimum capital to risk asset ratio should be 9% from the year ending March 31, 2000. The capital funds of Fl's consists of Tier I capital should not be less than 50%ofthetotalandtotalofTierIIcapitalelementsshouldnotexceed100%oftotaloftierI capital. Tier I capital also known as core capital provides the most permanent, and readily available support to a financial institution against unexpected loses. Tier II capital contains elements that are less permanent in nature. Tier I capital means paid up capital, statutory reservesandotherdisclosedfreeresources.TierIIcapitalconsistofundisclosedreservesand cumulative perperual preference shares, revaluation Reserves, General provisions and Less Reserves,HybridDebtCapitalInstrumentsandsubordinateddebts.SBIhasprescribed that the aggregate investment by a financial institution in such bonds issued by Banks and Fis should not exceed 10% of investing financial institution's totalcapital.

18.9.6 Self Check Activity II

True/False:

5. The growth of development banking started after World War-II.
6. Economic development was not a basic question after independence.
7. Development banks provide short-term financial assistance with high rates of interest.
8. Credit risk arises when the borrower is successful in earning profits.

18.10 RELEVANCY TO INDIANBUSINESS

Notonlythefinancebutanumberofotherobstaclesalsocomebeforethedevelopment of under-development countries. Even if a sufficient amount of finance available, study of growth potentials, infrastructure and the availability of natural resources is one other important aspect of development. Diversification of finance into proper areas and in an organised way is also most vital aspect of developments. This is what a development bank performs for the Indian Economy and Enterprises. In India Development banks performs promotional activities along with the finance facilities. In the year of 1970 the Industrial entrepreneur with the help of development banks organized a serve to investigate demand potentials, infrastructural environment and other basic needs fordevelopment of industry in specified areas. Entrepreneurs should be well-qualified and must possess the potential to overcome each and every hindrance of business, to face such problems, IDBI organized programs to educate the business entrepreneurs with the help ofTCOs.

18.11 CONCLUSION

DevelopmentBanks are thefinancial institutions which have helped alot in the balanced development of a country. These institutions are the backbone of a country. These have helped a lot in guiding the entrepreneurs in fighting competition with other countries by properly guiding them through project appraisal and underwriting. In order to strengthen their working capital adequacy norms have beendecided.

18.12 GLOSSARY

1. SIDBI- State Industrial DevelopmentBank
2. IDBI- Industrial Development Bank ofIndia.
3. NSIC· National Small IndustrialCorporation
4. TCO· Technical ConsultancyOrganisation
5. IFCI- Industrial Finance Corporation ofIndia.
6. SFC- State FinanceCorporation

18.13 Keywords: Environment Approach, World War-II, Appraisal, Credit, Interest Rate, Liquidity, Foreign Exchange

18.14 PRACTICEQUESTIONS

Short Answer type

1. What do you understand by Development Bank? What are its distinctivefeatures?
2. How risk is managed by Development Bank? What are its capital adequacynorms?

Long Answer type

3. How Development Banking develop in Inda? What are its basicfunctions?
4. Discuss briefly about the lending procedure of theDevelopmentBanks?
5. What is the relevance of Development Banks in Indian businesssystem?

18.15 SUGGESTED READINGS

- Bedi, Suresh, Business Environment, Excel Books, New Deihl, 2004.
- Cherunilam, Francis, Business Environment, Himalaya Publishing House, Mumbai, 2006.

18.16 Answers to Self Check Exercises

Fill in the Blanks:

1. Environment
2. Approach
3. World War-II
4. Credit, Interest Rate, Liquidity, Foreign Exchange

True/False:

5. True
6. False
7. False
8. False

FOREIGN TRADE

STRUCTURE

19.1 Objectives
19.2 Regulation of ForeignTrade
19.3 The Foreign Trade (Development and Regulation) Act,1992
19.3.1 Self-Check Exercise-I
19.4 Export - ImportPolicy
19.5 ExportPromotion
19.6 ExportIncentives
19.7 EPZs, EOUs, TPs &SEZs
19.7.1. Export ProcessingZones/EOUs
19.7.2. SEZ
19.7.3. Export Houses and TradingHouse
19.7.4. Self-Check Exercise -II
19.8 Summary
19.9 PracticeQuestions
19.10 Keywords
19.11 Glossary
19.12 SuggestedReadings
19.13 Answers to Self Check Exercise

19.1 OBJECTIVES

After reading this chapter, the student should be able to :

(i) Understand the main provisions of the Foreign trade (Development and Regulation} act,1992.

(ii) Understanding the features of EXIMpolicy.

(iii) Understanding the objectives of export promotion measures in India and incentives attached toit.

(iv) UnderstandingtheprovisionsofEPZs,EOUs,TPs,SEZs, Exporthousesandtrading houses.

19.2 REGULATION OF FOREIGNTRADE

Control of foreign trade in India dates back to the early years of the Second World War. Import Control was introduced in 1940 as a war time measure under the Defense of India Rules with the primary objective of conserving the feign exchange resource and restricting physical imports so as to reduce the pressure on the limited available shipping space. Initially, the imports of only 68 commodities, mainly consumer goods, were brought under control. Subsequently with the increasing pressure on the foreign exchange resources, import control was extended to other commodities aswell.

The major concern of Government in the past was restriction of imports with a view to controlling the trade deficit and protection of domestic industries against foreign competition, Imports there, therefore, very much restricted by prohibition of imports of many items, import licensing very high import duties and foreign exchange restrictions. The foreign trade policy was characterised by the overtone of negativism.

19.3 THE FOREIGN TRADE (DEVELOPMENT AND REGULATION) ACT,1992

This Act which replaced for export (control} Act, 1947, came into force on 9th June 1992. No export or import shall be made by any person except in accordance with provisions

of this Act, the orders and rules made under this Act, and the export and import policy.

Objective

The objective of the FTDR Act is to provide for the development and regulation of foreign trade by facilitating imports into, and augmenting exports from India and for matters connected therewith or incidental thereto.

Main Provisions

The main provisions of the FTDR Act are the following :

1. **Prohibition and Restriction** : The Act also empowers the Central Government to make provisions for prohibiting, restricting or otherwise regulating the import or export of goods as and whenrequired.
2. **Exim Policy** : The Act lays down that the Central Government may, from time to time, formulate and announce the export and import policy and many also amend thatpolicy.
3. **Director General of Foreign Trade** : The Act provides for the appointment by the Central Government, of a Director General of Foreign Trade for the purpose of this Act. The DGFT shall advise the Central Government in the formulation of the export and import policy and shall be responsible for carrying out thatpolicy.
4. **Importer-Exporter Code Number** : The Act lays down that no person shall make any import or export except under an Importer-Exporter code (IEC)Numbers granted by the DGFT the officer authorized by him in hisbehalf.

S. **IssueandSuspension/Cancellationoflicence**:TheDirectorGeneraloranyother Officer authorised under this Act is empowered to suspend or cancel a licence issued for export or import of good in accordance with this Act for good and sufficientreasons,aftergivingthelicenceholderareasonableopportunityofbeing heard.

6. **Search Inspection a Seizure** : Where any contravention of any condition of the licence of authority under which any goods are imported is suspected or made, any person authorised by the Central Government may search, inspect and seize such goods, documents,things and conveyancessubject to suchrequirements and conditions as may beprescribed.
7. **Penalty for contravention** : Where any person makes or abets or attempts to make any export or import in contravention of any provisions of this Actor any rules or orders made under this Act or the Exim policy, he shall be liable to a penalty not exceeding one thousand rupees or five time the value of the good s involved, whichever ismore.

19.4 EXPORT - IMPORTPOLICY

The Export-ImportPolicy(EximPolicy),announcedundertheForeign Trade (Developmentand RegulationAct),1992, wouldreflecttheextentof regulationor liberatlization of foreign trade and indicate the measures for export promotion. It may be noted that although the Exim Policy is announced for a five year period, announcing a Policy on March 31st of every year, within the broad frame of the Five Year Policy, for the ensuing year is a practice in India.

A very important feature of the Exim policy since 1992 is freedom. Licensing, quantitative restrictions and other regulatory and discretionary controls have been

substantially eliminated

Exim Policy, 2002-2007

The Exim Policy announced on March 31. 2002, effective from April 1, 2002, contains a bouquet of concessions for exports, focusing sharply of SEZs, industrial clusters, agri- exports, infrastructural developments and reduction in transactioncosts.

While popular export-promotion tools like the Duty entitlement Pass Book (DEPB)

scheme and the Export Promotion Capital Goods (EPCG) scheme have been retained and made more flexible, new incentives have been granted to the cottage sector, handicrafts, chemicals and pharmaceuticals, textiles and leather industries. The time granted for fulfillment of export obligation has been increased to 12 years in the case of EPCG imports worth more than RS. 100 crore.Outlines of some of the important features/proposal are given below.

The Mission : The Exim Policy 2002-2007 , which coincides with the Tenth Five Year Plan period, aims at increasing India's share in the global exports from 0.67 per cent to one per cent over this period. This implies that the total exports will have to nearly doublefrom$46 billion to over S30 billion achieving a compound annual growth rate of (CAGRJ of 11.9 per cent in dollar terms.

Agricultural Exports : Promotion of agricultural export has been given considerable

attention by the Policy. Agri Export Zones Scheme which embodies ' a farm to port' approach andunder which 20 zones were sanctioned, under the Agri-ExportPolicy, prior to the announcement of the new Exim policy, are proposed to be supported with development of necessary infrastructure, flow ofcredit andother facilitiesforpromotingagroexports. Trans port assistance would bemade available for export of fresh andprocessedfruits, vegetables, floriculture, poultry, dairy products and products of wheat and rice. Packaging; registration and'quantities restrictions in respect of export of a number of agricultural products to Russia werei:emoved.

SEZ : Under the Special Economic Zone Scheme announced in 2000, 4 existing EPZs

were converted into SEZ and 13 new SEZs were given approval (as on 31-03-2002). The current Exim Policy offers several fiscal incentives to units in the SEZs. Other proposals include exemption to SEZ units from External Commercial Borrowings restrictions, and freedom to make overseas investment and carry out commodity hedging.

Towns of Export Excellence : A number industrial cluster-towns are exporting a substantial portion of their products, which are world class.

Special Focus on Cottage Sector and Handicrafts : The following facilities will be made available to them: Initially an amount of Rs,5 crore has been earmarked for promoting cottage . Sector exports coming under the KYlC. The units in the handicrafts sector elm also

access funds from Market Access Initiative (MAI) scheme for normally permissible activities including development of website for virtual exhibition. Under the EPCG scheme, these units will not be required to maintain average level ofexports.

ReductioninTransactionTime,Costs:Thenewpolicycontainsseveralinitiativesto initiatives to immunize the export sector against our disadvantages arising from the state of infrastructure, power tariffs Interest rates, industrial relations, taxation structure etc, Further somestateshavetakensipstowardsdifferentialtreatmentforexport-orientedunitsinmatters pertainingtoindustrialrelationstoenablethemtoadheretorigorousdeliveryschedules.The simplification of Exim policy schemes being announced in the new policy will more effectively rebate all indirect taxes onimports.

Assistance to States for infrastructural Development for Exports : During 2000 Government had announced a scheme for participation of States in the export endeavour. This new Scheme• ASIDE" would provide funds to the States based on the twin criteria of grossexportsandtherateof growthofexportsfromdifferentStates.80percentofthetotal funds would be allotted to the States based on the above criteria and the remaining 20per cent will be utilized by the Centre for various infrastructure activities that cut across state boundaries etc.

An Evaluation of the Polley

The Exim Policy and the associated measures of economic reforms or liberalisation have far reaching implications.

1. TheIndianeconomyhasbeenexposedtomoreforeigncompetition.Theregimeof high protection is gradually vanishing. The tariff cuts and several other liberalisation measures are likely to continue in future. This means that the Indianfirmsshouldbecomecompetitiveiftheyshouldsurvive.Theyhavetopay dueattentiontocostandprice,quality,deliver-yschedules,aftersalesserviceetc.
   In fact, a buyer's marketing is emerging in several industries which in the past were sellers' markets.
2. Another important implication of the liberalisation is that now Indian firms can obtain their raw materials and the like more competitively, including from abroad. This would help them to control costs and improvequality.
3. The liberalisation of capital goods imports will help reduce project and production cost and may encourage technological upgradation.
4. The increasing competition from abroad as we)) as from within is provoking many Indian firms to give an added thrust to exports. Some companies even view exports as a counter competitivestrategy.
5. Because of the imports which they can make with their foreign exchange earnings several companies pay special attention toexports.
6. A very important implication of the exim policy is its intention to encourage the globalization of India's foreign trade. This has been given support by the policy which seeks to augment India's exports by facilitating access to raw materials, intermediates, components, consumable and capital goods from the international market. Indeed, facilitation of global sourcing is a. prerequisite for globalizationof exports, for increasing the competitiveness of the exports and for globalization of the business.
7. In the past, India followed an indiscriminate import substitution which was propped up by heavy protection. The lowering of the protection 'byimport liberalisation is an open, declaration that undue protection will not be granted any more.
8. The progressive decimalization implies more scope and freedom for 'private enterprise. The decanalisation seriously affects the business of state trading organisationsliketheStateTradingCorporation'of.India(STC)andMineralsand MetalsTradingCorporationofIndia,Thesecorporationsneedtoredefinethescope of their business and reorient their strategies for success in future. Indeed they have been doing that.
9. A commendable aspect of the currant Exim Policy is the importance given to elimination or minimization of quantitative, licensing and otherdiscretionary

controls, However, we are yet to go a long way to procedural simplification,

10. The recent import liberalization has substantially changed the competitive environment in India making it very difficult for a large number of Indian companies to survive the competition. Many companies have reformulated their strategies.Anumberof themareresortingtoglobalsourcinginsteadofmakingor sourcingdomestically.

19.S EXPORTPROMOTION

Government of India, like almost all other nations, has been endeavoring to develop exports. Export development is important to the firm and to the economy as a whole. Government measures aim, normally, at the general improvement of the export performance of the nations for the general benefit of the economy. Such measures help exporting firms in several ways. The benefits of exports to the economy aremany.

When the domestic market is small, foreign market provides opportunities to achieve economies of scale and growth, Secondly, the supply of many commodities. As ill the case of a number of agricultural products in India, is more than the domestic demand, thirdly, exports enable certain countries to achieve export-led growth. Thirdly, export markets may help mitigate the effects of domestic recession, Fifthly, a country may need 10 boost its exports to earn enough foreign exchange to finance its imports and service its foreign debt. It may be noted that many countries are suffering from trade deficit and foreign debt. Lastly, even in the case of countries with trade surplus, export promotion may be required to maintain its position against the international competition and the level of domestic economicactivity.

The principal objectives of export promotion measures in India have been to :

- Compensate the exporters for the high domestic cost ofproduction.
- Provide necessary assistance to the new and infant exporters to develop the export business.
- Increase the relative profitability of the export business via-a-vis thedomestic business.

19.6 EXPORTINCENTIVES

Exportincentivesareawidelyemployedstrategyofexportpromotion.Themainaimof these incentives is to increase the profit Quality, of export business. Important export incentives in India .include rebate of duties, cash compensatory support, income tax concession, interest subsidies, freight subsidy etc. It has been common to describe these as incentives. However, as the Abid Hussain Committee has observed, they are more a compensationforthecomparativedisadvantagesfacedbytheIndianexporterthanincentives.
Wegivebelowaverybriefaccountofthese'incentives'whichservethefirstrationalofexport
promotion mentioned earlier in this section, viz., to compensate the exporters for the high domesticcosts.

Duty Exemption/Drawback

Theschemeofdutyexemptionisdesignedtoavoidtheincidenceofcommoditytaxes like excise duty and Customs duties on the exports so as to make the export more price competitive.Thisisaworldwidepracticeandtherationaleisstraightforward.Customsduties and excise duties on inputs raise the cost of production in export industries and thereby affect the competitiveness of exports. Therefore, exporters need to be compensated for the escalation in their costs attributable to such customs and exciseduties.

Duty exemption as an export promotion measure had its origin in India during theSecond Plan. Over the years the scheme has been enlarged and modified.

The exporters are either exempted from the payment of duty while procuring inputs like

raw materials and intermediates or, in cases where the duty is paid on the inputs, the duty is refunded. Thus, under the duty drawback system the exporters are reimbursed fortariff paid on the imported raw materials and intermediates and central excise duties on domestically produced inputs which enter into exportproduction.

Eligible exporters are entitled to interest-free bank credit against the duty drawback applicable to them up to a period of 90 days or up to the time they realise the drawback, whichever is earlier. Similarly, with the application of MODVAT, a large number of products, covered by the MODVAT, canbe exported in bond and in that event, the duty relief in the form of drawback would be restricted only to basic customs and auxiliary duties suffered, if any, by the inputs.

Awards : A number of awards have been instituted to encourage exports and to recognise excellence in exports. There are separate awards for different categories of exporters.Awardsaregivenonthebasisofcertainspecifiedcriteriasuchasdevelopmentof marketforproductswhichhavenotbeenexportedpreviously,substantialincreaseinexports, successful introduction of new products, product development, successful breakthrough in foreign markets where conditions have been especially difficultetc.

Other Incentives : Some important incentives were terminated consequent to certain measures take part of the economic liberalization. The Cash Compensatory Support (C.C.S.) was a cash subsidy scheme designed to compensate the exporters for unrebated indirect taxes and to provide resources for product/market development. The CCS enabled the exporters to increase the profit or to reduce the price to the extent of the subsidy without incurring a loss. With the devaluation of the Rupee in July 199 I, the CCS was abolished.

Another important incentive was the system of import Replenishment (REP) license, which were related to the F.O.B value exports. The new trade policy announced in July 1991 which renamed the Rep as Exim Scrip significantly modified the scheme. The Exim Scrip Scheme was, however, abolished with the introduction of the partial convertibility of Rupee since April 1992.

The International Price Reimbursement Scheme (lPRS) was designed to make available specified inputs to exporters at international prices. The scheme which was initially available to steel was later extended to aluminum also and there was a proposal to extend to other items. The IPRS has been replaced by Engineering Products Exports (Replenishment of iron and Steel Intermediates) scheme.

Production Assistance / Facilities

Exports depend, inter alia., on exportable surplus and the quality and price of the goods.Governmenthas,therefore,takenanumberofmeasurestoenlargeandstrengthenthe production base, to improve the productive efficiency and quality of products and to make the products more costeffective.

Marketing Assistance

A number of steps have been taken to assist the exporters in their marketing effort. These include conducting, sponsoring or otherwise assisting market surveys and research; collection, storage and dissemination of marketing information, organizing and facilitating participation in international trade fairs and exhibitions; credit and insurance facilities; release of foreign exchange for export marketing activities; assistance in export procedures;

quality control and pre-shipment inspection; identifying markets and products with export potential; helping buyer-seller interaction, etc. Some of the schemes and facilities which assist export marketing are mentionedbelow.

MarketDevelopmentAssistance

An important export promotion measure taken by the Government is institution of the MarketDevelopmentAssistance(MDA).AssistanceundertheMDAisavailableformarketand commodity researches; trade delegations and study teams; participation in trade fairs' and exhibitions; establishment of offices and branches in foreign countries; and grants-in-aid to EPCs and other approved organisations for exportpromotion.

Export Risk Insurance

As international business in fraught with different types of risks, measures have been taken to provide insurance covers against such risks. The Export Credit Guara nteeCorporation(ECGC)haspoliciescoveringdifferentpoliticalandcommercialrisksassociated with export marketing, certain types of risks associated with overseas investments and risks arising out of exchange ratefluctuations.

Finance

The Export-Import Bank and commercial banks and certain other financial institutions like specified cooperative banks provide pre-shipment and post shipment finance to exports. Some of these institutions also provide suppliers' credit, including line of credit, to promote Indian exports. Export credits generally carry concessional interest rate.

19.7 EPZS,EOUS,TPS&SEZS

As a part of the export promotion drive, Governments has, from time to time, introduced several schemes to promoteunitsprimarilydevotedto exports. TheseincludeExport Processing Zones (EPZs), Hundred per cent Export-Oriented Industrial Unites (EOUs), and different categories of Technology Part (TPs). In 2000, a scheme of Special Economic zones (SEZS) was also introduced.

19.7.1 Export Processing Zone s /EOUs

Export Processing Zones (EPZs) are industrial estates which form enclaves from the national customs territory of a country and are usually situated near seaports or airports. The entire production of such a zone is normally intended for exports. Such zones are provided withwell developedinfrastructural facilities.Industrialplots/shedarenormallymade available at confessional rates. Units in these zones are allowed foreign equity even up to 100 per centEPZ units can import Unites in these zones are allowed foreignequity even uplo 100 per cent. EPZ units can import Unites in these Zones are allowed foreign equity even up to 100 per cent. EPZ units can import capital goods, raw materials etc., for export production without payment of duty. Domestically procured items are also eligible for dutyexemption.

A free Trade Zone (FTZ) is different from an EPZ. goods imported to a free trade zone may be re-exported without any processing in the same form. But, goods exported by units in anEPZ are expected to have undergone some value additionby manufacturing or other processing. A Free Port is one into which imports and from which exports are free from trade barriers. A FTZ may a part of or adjacent to a port; the rest of the port being subject to the national customsregulation.

The main objectives of an EPZ are :

1. To earn foreignexchange

2. To generate employmentopportunities.
3. To facilitate transfer of technology by foreign investment and othermeans
4. To contribute to the overall development of theeconomy.

Government also introduced schemes for Electronic Hardware Technology Park(EHTP) units Software Technology Park (STP)units.

Hundred per cent export-oriented unit (EOU) refers to an industrial unit which offers for exports its entire production, excluding permitted levels of rejects. EOUs were allowed in industries in respect or' which the export potential and export targets were considered by the relevant Export Promotion Council. EOUs were not normally encouraged in respect of products subject to export control quota ceilings which can be reached by existing units in theindustry.

BeingoutsidetheEPZs,theEOUsdidnotgetthebenefitsofthebuilt infacilitiesofthezones.EOUsenjoyedmostotherfacilitiesandincentivesaswereavailabletotheEPZunits.An EPZ/EOU unit had to be a net foreign exchange earner. The levelofforeign exchange earning as a percentage of exports (NFEP) was calculatedannuallyandcumulativelyfora periodof5yearssincethecommencementorcommercialproduction.TheNFEPrequirementfordifferentproductsvariedfrom60percentforplaingoldjewelleryto60percentfor computersoftwareandtissuecultureplants.However,electronichardwareunits

were allowed 10 he set up without stipulation or a positive NFEP.

An EOU/EPZ/EHTP/STP unit could export goods manufactured by it through an Export House/ Trading House/Star Trading House/Superstar Trading House recognized under the Exim Policy or any other EOU/EPZ/EHTP/STP unit. This permission is extended only to the marketing of the goods by the above category of exporters. The manufacture of the goods shall be done in the EOUIEPZunits.

19.7.2. SEZ

While announcing the Exim Policy for 2000-01, the Commerce Minister stated that India would develop Special EconomicZones toboost thecountry's exports. Any State Government or corporate body may set up a SEZ. The only laws which will operate in these Zoneswillbethe' labourandbankinglaws.TheSEZsaredifferentfromtheEPZs:intheSEZs there will not be any inspector raj and once commodities go in, nobody will ask any questions until they come out, clarified the Minister. Units in the SEZs may also do domestic sales by paying all relevant duties. However, they have to be net foreign exchangeearners.

"WhileEPZsareindustrialestates:'SEZsarevirtuallyindustrialtownshipthatprovide appropriate infrastructure .such as housing, roads, ports and telecommunication. The scope of activities that can be undertaken in the SEZs is much wider, their linkages with the domestic economy, are stronger. Resultantly they have a diversified industrial base. Their role is not transient like the EPZs, as they intended to be instruments or regional development as well as export promotion. As such, SEZs can have tremendous impact on exports, inflow of foreign investment and employmentgeneration."

19.7.3. Export Houses and TradingHouse

An Export house is defined as a registered exporter holding a valid Export House Certificate issued by the Director General of ForeignTrade.

The objective of the scheme is to recognize established exporters as Export House, Trading'. House, Star Trading House and Superstar Trading House with a view to build marketing infrastructure and expertise required for promotion. Such Houses should operate as highly professional an d. dynamic institutions and act as important instruments of export

growth. The scheme of export houses has been modified number of times .

Merchant and manufacturer exporters EOUs an d' units located in EPZ/EHTP/STP may be recognised as Export Houses, Trading Houses, Star Trading Houses and Superstar Trading Houses subject to the fulfillment of the criteria laid down by the Government.

19.8.SUMMARY

The export-import (Exim) policy and regulation can have significant impact on the business environment on the comfy in general and the import competing, import dependent and export oriented industriesin particular.

The objective of the FTDR Act is to provide for the development and regulation of foreign trade by facilitating imports into, and augmenting exports from India for matters connected therewith or incidental thereto.

Government of India has been giving high importance to export promotion. The principal objectives of export promotion measures in India have been to: compensate the exporters for the high domestic cost of production; provide necessary assistance to the new and infant exporters to develop the export business and increase the relative profitability of the export business via-a-vis the domesticbusiness.

As a part of the export promotion drive, Governments have, from time to time, introduced several schemes to promote units primarily devoted to exports. These include Export Processing Zones (EPZs), Hundred Per cent Export-Oriented Industrial Units (EOUs), and different categories of Technology Parks (TPs). In 2000, a scheme of Special Economic Zones (SEZs) was alsointroduced.

19.9 PRACTICEQUESTIONS

Short Answer Questions:

- What is the main objective of the Foreign Trade (Development and Regulation) Act, 1992?
- Name some of the export promotion measures in India.
- What are the main provisions of the FTDR Act?
- Explain the significance of the Exim Policy in India.

Long Answer Questions

Q.1 Discuss the main provisions of The Foreign Trade (Development And Regulation) Act1992.

Q.2. Write Noteson: (i) SEZs
(ii) EOUs
(iii) EPZs

19.10. Keywords: Foreign Trade (Development and Regulation) Act, 1992, Exim Policy, EPZs, EOUs, TPs, SEZs

19.11. GLOSSARY

(i) DGFT =Director General of foreigntrade.

(ii) CCIE = Chief controller of Imports andExports.
(iii) IEC = Importer - Exportercode.
(iv) ITPO = Indian trade promotionorganization.

19.12. SUGGESTEDREADINGS

1. A. K. Kundra, *"SEZ's: How well will they perform",* The Hindu/. August16,2001.
2. M. L.Verma, *Foreign Trade Management in India,* Vikas Publishing House, New Delhi,1988.
3. Francis Cherunilam, *BusinessEnvironment*

19.14 Answers to Self Check Exercises:

Fill in the Blanks:

1 Export (Control)
2 Importer-Exporter Code (IEC)
3 Five
4 One
5 Exports

True/False:

6 True
7 True
8 True
9 True
10 True

LeasonNo.20

SECURITIES AND EXCHANGE BOARD OFINDIA

STRUCTURE

20.0 Objectives of thelesson
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20.0 OBJECTIVES OF THELESSONS

The aim of this lesson to discuss about the Government's role in controlling the matters related to shares through the governing body in form of securities and Exchange Board of India. The chapter includes the objectives of SEBI and Powers and Functions ofSEBI.

20.1 INTRODUCTION

The Government has set up the Securities and Exchange Board of India (SEBI) in April 1988. For more than three years, it had no statutory powers. Its interim functions during the period were (i) To collect the information and advice the Government on matter relating to stock and capital markets (ii) Licensing and regulation of merchant banks, mutual funds e.tc .(iii)TopreparethelegaldraftsforregulatoryanddevelopmentroleofSEBIand(iv)Toperform any other functions as may be entrusted to it by theGovernment.

20.2 OBJECTIVES OFSEBI

The main objectives of SEBI are concerning the security markets. According to the pre-amble of the Securities and Exchange Board of India Act, the objective of setting up SEBI is to protect the interests of investors in securities and to promote the development and to regulate the security market. Thus the SEBI has the following basic threeobjectives:

1. To protect the interests of Investor Insecurities

Investors are the backbone of the securities markets. After 1992 Harshad Mehta security scam, the faith of the general investor was shattered. The SEBI has taken aserious note of it and the objective set is to restore the faith of investors in the securities market. After even ten years, this objective could not be achieved in its real sense and even today primary markets have not recovered. Still there is need to make a lot of efforts by the SEBI to achievethis

Objective.

2. To promote the development of securitiesmarket

The stock exchanges in the country were also in bad shape. Some of the stock exchanges were not working as per the regulations. SEBI shall ensure the development of securities markets. The Mumbai Stock Exchange and the National Stock Exchange are now working properly under the supervision of SEBI guidelines. Previously there had been serious problems regarding functioning of these stock exchanges ego brokers were not following the stock exchange regulations. Now the Brokers are registered with SEBI and they are subject to capital adequacynorms.

3. To regulate the securities market:

There had been serious lapses in the regulations of securities markets Harshed Mehta andKetanPareekh hijackedthewholesecuritiesmarketsand thecountrywasdragged in security scam. Keeping in mind these circumstances, SEBI has another important objective to regulate the securities market, so that no such incident happens in future..

20.3 THE SECURITIES AND EXCHANGE BOARD OF INDIA (AMENDMENT) ACT,2002

Indian investors have been taken for a ride for a long time by several unscrupulous promoterswithoutmuchfearofthelaw.Asitiswellknown,severallistedcompanies,having collectedcoresofrupees,havejustvanishedwiththeinvestor'sfunds.Besides,thereare several other companies and their directors who have not been very particular about complying with serious capital market selectedrequirements.

Though the Government of India had created a specialized body called the securities and Exchange Board of India (SEBI) to deal with such offenders, not *much* could be achieved ostensibly due to limited powers enjoyed bySEBI.The recent amendments to SEBI Act, 1992, through SEBI (Amendment) 2002, have brought in: some radical changes for reaching consequences, that should enable SEBI to catch the offenders.

ESTABLISHMENT OF THE SECURITIES AND EXCHANGE BOARD OF INDIA

Section 3 of the SEBI Act empowers the Central Government to appoint, by notification, for the purposes of this Act, a Board by the name of the Securities and Exchange Boardof India. Accordingly SEBI was given a statutory status under section 3 of the SEBJ Act as on 30th January, I 992.

According to section 3(2) of the Act, the securities and the Exchange Board of India shall be a body corporate having perpetual succession and a common seal. It shall have the powertoacquire,holdanddisposeofftheproperty,bothmoveableandimmovable.Itwillhave the power to enter into a contract and may sue or be sued.

Self Check Exercise No 1

Q. lSEBI was given statutory powers from the beginning.

Q.2 The main objectives of SEBI include promoting unfair trade practices in securities markets.

Q.3 SEBI has the power to suspend trading of any security in a recognized stock exchange.

Q.4 The Securities and Exchange Board of India Act was last amended in 1992.

MANAGEMENT OF THE BOARD

SEBI is a statutory Body, i.e. a Board formed under a statute. The Board shall be headed by a chairman. In addition there will be eight members. (a) two members from amongst theofficials of the Ministers of the Central Government dealing with Finance and Law; (b) One

member from amongst the officials of the Reserve Bank of India; (c) five other members of whom at least three shall be the whole -time members (substituted by the SEBI(Amendment)

Act, 2002J. Thus there are nine members including chairman.

According to section 4(2) of the Act, this Board exercises general superintendence, direction and management of the affairs of the SEBI. The Chiarman, of the board can exercise all powers of the Board, except "those specified in the regulation framed under SEBIAct.

The Chairman and the members. are appointed by the Central Government except the member from Reserve Bank of India is appointed by the RBI.

The Chairman and other members shall be persons of ability, integrity and standing who have shown capacity in dealing with problems relating to securities market and have specialknowledgeorexperienceoflaw,finance,economics,accountancy,administrationetc.

TermofOfficeandConditionsofServiceofChairmanandmembersoftheBoard:-

According to section 5 of the SEBI Act, the term of office and other conditions of service of the chairman and other members shall be such as may be prescribed. However. the appointment of the chairman or other members can be terminated by giving three months notice with pay. Similarly, the chairman and any member can relinquish his office by giving three monthsnotice.

Removal of member from office

According to section 7, the Central Government can remove any member ifhe:

(a) is, or at any time has been, adjudicated asinsolvent.
(b) is of unsound mind as declared by competentcourt.
(c) hasbeen convicted of an offence involving moralturpitude,
(d) has, in the opinion of the central Government, so abused his position ll.S to render his continuation in office detrimental to the publicinterest.

Meetings of the Board

The Board shall meet periodically as may be required. Decisions will be by majority of theBoardandChairmanhasasecondorcastingvote(section7ofSEBIAct).Amembershould disclose his interest in a company if anymatter in connectionwiththat company comesin the Board and he should not take part in deliberation or decision of Board with respect to that matter (section 7 A). Act of SEBI are valid even if there is vacancy in the constitution of Board. Board will appoint officers and other employees as may be necessary. Their terms and conditions of service shall be such as determined by regulation (section9).

20.4 POWER AND FUNCTIONS OFSEBI

Section 11 of the SEBI Act provides that the basic function of SEBI is to (a) protect interests of investors in securities, and (bl regulate the securities market. In order to fulfill its objective, SEBI can take the following measures.

1. regulate business in stock exchanges and other securitiesmarkets,
2. registering and regulating working of stock brokers, share transfer agents, bankers to issue, trustees of trust deed, registr:3-'s of an issue, merchant bankers, under writers,portfoliomanagers,investmentadvisersandsuchotherintermediarieswho may be associated with securities markets in anymanner,
3. registering and regulating working of depositories, custodians of securities, Foreign Institutional Investors,credit rating agencies,and such other intermediaries as Board may by notificationspecify.
4. registering and regulating of venture capital funds and collective investment schemes, including mutualfunds.

S. promoting and regulating self-regulatory organizations.

6. prohibiting fraudulent and unfair trade practices relating to securitiesmarkets.
7. promoting investors education and training of intermediaries of securitiesmarkets.
8. prohibiting insider trading insecurities.
9. regulating substantial acquisition of shares and take-over ofcompanies.
10. Calling for information from undertaking inspection, conducting enquiries and audits of stock exchanges, mutual funds and intermediaries and self-regulatory organizations in the securitiesmarket.
11. Calling for information and record from any bank or any other authority or board or corporation established or constituted by or under any central, state or provincial Act in respect of any transaction in securities which are under investigation or inquiry by the Board. [Inserted by the SEBI (amendment) Act, 2002).
12. Performing such functions under securities contract (regulations) Act as may be delegated to SEBI by CentralGovernment.
13. LevyingfeesorotherchargesforcarryingoutpurposesofSEBlasstatedabove.
14. Conducting research for abovepurposes,
15. Calling information to agencies as may be specified byBoard,
16. Performing such other functions as may beprescribed.

20.S MEANING OFSECURITY

Section2(i)ofSEBIActdefinesthattheterm'securities'hassomemeaningasassi gned toitundersection2ofSecuritiesContract(Regulation)Act,1956.Section2(h)oftheSCR A states that 'securities' include (i) shares scrips, bonds, debentures stock or other marketable securities of like nature in or of any incorporated company or other bodycorporate (ii) Government securities (iii) other instruments as may be declared by Central Government as , - securities (iv) rights or interests in securities.

20.6 POWERS OFSEBI

Therehavebeenanumberofsecurityscamsinthecountryinvolvinglossofcrores of rupees to small and innocent investors. The Government of India constituted a Joint ParliamentaryCommitteetoprobethesescams.ThereisafeelinginmanyquartersthatS EBI enjoys, very limited powers and hence is unable to regulate the securitymarket.

To meet the long felt need of empowering SEBI, the Securities and Exchange Board of India Act was recently amended in year 2002. Sweeping changes have been made in the operative provisions contained in sections II, II A, II Band 12. The Amending Act has given several powers to SEBl such as power of investigation, inspection search and seizure.

SEBI cannot act on its own independently. The powers of SEBl can be exercised by way of regulations. The following powers have been given to SEBl with the enactment of the Securities and Exchange Board of India Act, 1992 and repeal of capital issues (control) Act, 1947 :

1. Power to control and regulate StockExchanges.
2. Power to compel listing of securities by publiccompanies.
3. Power to call for periodical returns from recognised stock exchanges in thecountry.
4. Power to call for any information or explanation from recognized stock exchanges or itsmembers.
5. Power to make or amend bye-laws of recognized stockexchanges.
6. Power to direct inquiries to be made in relation to affairs of stock

exchanges or its members.

7. Power to grant approval to bye-laws of recognised stockexchanges.
8. Power to grant registration to marketintermediaries.
9. Power to register and regulate working of collective investment schemes including mutualfunds.
10. Power to levy fees andfines.
11. Power to promote and regulate self regulatorybodies.
12. Power to prohibit fraudulent and unfair trade practices relating tosecurities
13. Power to prohibit insidertrading.
14. Power to promote investor's education of trading of intermediaries in capital market.
15. Power to seek information and records from any bank or any otherstatutory authority.
16. Power to conduct inspection of books, registers, documents and records of any listed company or a public company intending to get its securitieslisted.
17. Power to suspend anysecurity.
18. Power to conduct investigations in respect of transactions in securities which SEBI believes to be against the interests of investors or against marketintermediaries.
19. Power to prohibit employment .of manipulative or deceptive practices in connection with the issue, purchase or sale of anysecurity.
20. Power to regulate substantial acquisition of shares and takeover ofcompanies.
21. Power to conduct research and otherfunctions.

Some of these powers like imposing penalties etc. are quasi-judicial powers of the SEBI which are discussed as under:

20.6.1 Power to Seekinformation

Section11oftheSEBIAct,1992asamendedbytheAmendmentActof2002confersa very important power on SEBI to seek information and records from any bank or any other statutory authority or board or corporation established either by central, state or local government.Inotherwords,SEBIcannowseeksuchinformationthatwouldenableittoknow the route through which the funds have been siphonedoff.
Earlier, it was not possible for SEBI to do so, resulting in hampering of investigations against offenders.

20.6.2 Power ofInspection

The new section 11 (2) inserted by the securities and Exchange Board of India (Amendment)Act,2002enpowersSEBItoconductinspectionofbooks,registers.documents and records of any listed company or a public company intending to get its securities listed. Suchaninspectioncanbeconductedby SEBIwhenithasreasonablegroundstobelievethat the particular company has been indulging in insider trading or indulging in fraudulent unfair trade practices relating to the securities market. It is interesting to note that this is the first time that inspection powers have been given to SEBI and that should help the regulator in conducting speedy and effective investigations.

20.6.3 Power to suspend trading insecurities:-

Sub-section (4) which has been inserted in section II by the securities and Exchange Board of India (Amendment) Act, 2002 confers that following powers on SEBI either pending inestigation or inquiry or on completion of such investigation or inquiry namely :

(a} Restrain persons from accessing the securities market and prohibit anyperson

associated with securities market to buy, sell or deal in securities.

(b) Suspend the trading of any security in a recognized stockexchange.

(c) Suspend any office-bearer of anystock exchange or self-regulatory organization from holding suchposition..

(d) Impound and retain the proceeds or securities in respect of any transaction which is underinvestigation.

(e) Attach after passing of an order on an application made for approval; by the Judicial Magistrate of first class having jurisdiction, for a period not exceeding one month, oneormorebankaccountor accountsof any intermediaryorany person associated with the securities market in any manner involved in violation of any of the provisions of this Act, or the rules or the regulations madethereunder;

(1) Direct any intermediary or any person associated with the securities market in any mannernottodisposeoforalienateanassetformingpartofanytransaction which is underinvestigation.

However, the Board shall, either before or after passing such orders, give an opportunity of hearing to concerned intermediaries or persons. (Section 11(4)).

20.6.4PowertoregulateorprohibitIssueofprospectus,offerdocumentoradvertisement, soliciting money for Issueof securities

The securities and Exchange Board of India (Amendment) Act,2002 hasreplaced section 11 A of the Act by a new section. The newly introduced provision empowers SEBJ, to prohibit by general or special orders to any company from issuing prospectus, any offer or advertisementsolicitingmoney fromthepublicfor issueof securities or may impose conditions subject to which such material may be issued.

Further the Board may specify the requirements for listing and transfer of securities andother matters incidental thereto. [SectionllA].

20.6.5 Power of' search andseizures

A new section 11 C has been introduced in the principal Act by the secunt1es and ExchangeBoardofIndia(Amendment)Act,2002whichcoversthepowerofsearchandseizure. This arms SES! where it has reasonable grounds to believe that transactions in securities are being dealt with in the capital market in a manner detrimental to the interests of the securities market, to order investigation and also issuing directions for the productionof books and other relevant records (which may be kept in the custody of the investigating authority).

The detailed provisions of section 11 C and given below :-

Where the Board has reasonable ground to believe that

(a) The transactions in securities arc being dealt with in a manner detrimental to the investor's or the securities market,or

(b) Any intermediary or any person associated with the securities market has violatedany of the provisions of this Act or the rules or the regulations made or directions issued by Board thereunder,

It may, at any time by order in writing, direct person (hereafter in this section referred to as the Investigating Authority) specified in the order to investigate the affairs of such intermediary or person associated with the securities market and to report thereon to the Board (Section 11C(l)[.

It shall be the duty of every manager, managing director, officer and other employee of

the company and every intermediary referred to in section 12 or every person associated with the securities market to preserve and to produce to the investigating Authority or any person authorised by him on his behalf, all the books, registers, other documents and record relevant for investigation. [Section 1 I C(2)].

The investigating Authority may require any intermediary or any person associated with securities 'market in any manner to furnish such information to, or produce such books, or registers or other documents, or record before him or any person authorized by him in this behalf as he may consider necessary if the furnishing of such information or the production of such books, or registers, or other documents, or record is relevant or necessary for the purposes of its investigation.(Section 11C(3)].

The Investigating Authority may keep in its custody any books', registers, other documents and record for six months and thereafter shall return the Same to any intermediary or any person associated with securities market by whom or on whose behalf thebooks,registerotherdocumentsandrecordareproduced.HowevertheInvestingAuthority may call for any book, register, other document and record if they are neededagain.

Furtherifthepersononwhosebehalfthebooks,registers,otherdocumentsandrecord are produced requires certified copies of the books, registers, other documents and record produced before the Investigating Authority, it shall give certified copies of such books, registers, other documents and record to such person or on whose behalf the books, register, other documents and record were produced. (Section 11C (4)].

Any person directed to make an investigation examine on oath, any manager, managing director, officer and other employee of any intermediary or any person associated with securities market in any manner, in relation to the affairs of his business and may administer on oath accordingly and for that purpose may require any of those persons to appear before him personally. [Section 11 C(S)].

If any person fails without reasonable cause or refuses :

(a) To produce to an Investigating Authority or any person authorized by him in this behalf any book, register, other document and record which is his duty to produce; or
(b) To furnish any information which it is duty to furnishor
(c) To appear before the Investigating Authority personally when required to do so or to answer any question which is put to him by the Investigating Authority,or
(d) To sign the notes of any examination referred to insubsection(?).

He shall be punishable ,with imprisonment for a term which may extend to one year, or with fine which may extend to one crore rupees, or with both, and also with a further fine which may extend to five lakh rupees for everyday after the first day during which the failure or refusal continues. [Section 11 C(6)].

Notes of any examination under sub-section (2) shall be taken down in writing and shall be read over to or by, and signed by, the person examined, and may thereafter be used in evidence against him. [Section 11 C(7)].

Whereinthecourseofinvestigation,theInvestigatingAuthorityhasreasonableground to believe that the books, registers, other documents and record of, or relating to, any intermediary or any person associated with securities market in any manner may be destroyed, mutilated, altered, falsified or secreted, the Investigating Authority may make an applicationtotheJudicial Magistrateofthefirstclasshavingjurisdictionforanorderforthe seizure of such books, registers, other documents and record. [Section 11 C(8)].

After considering the application and hearing the Investigating Authority, if necessary, the Magistrate may, by order, authorise the Investigating Authority -

(a) To enter, with such assistance, as may be required, the place or places where such books, registers, other documents and records arekept,
(b) To search that place or those places in the manner specified in the order,and
(c) To seize books, registers. other documents and records it considers necessary for the purposes of theinvestigation.

However, the Magistrate shall not authorise seizure of books, registers, other documents and record, of listed company or a public company (not being the intermediaries specified under section 12) which intends to get its securities listed in any recognised stock exchange unless such company indulges in insider trading or market manipulation. [Section 11 C (9)].

The Investigating Authority shall keep in its custody the books, registers, other documentsandrecordseized under thissectionforsuchperiodnotlaterthantheconclusion of the investigation as it considers necessary and thereafter shall return the same to the companyortheotherbodycorporate, or,asthecasemaybe,tothemanagingdirectororthe manageroranyotherperson,fromwhosecustodyorpowertheywereseizedandinformthe Magistrate of suchreturn.

But the Investigating Authority may, before returning such books, registers, other documents and record as aforesaid, place identification marks on them or any part thereof [Section 11 C (10)].

Save as otherwise provided in this section, every search or seizure made under this section shall be carried out in accordance with the provisions of the code of Criminal procedure, 1973 relating to searches or seizures made under that code. [Section 11 C (11)].

To summarise section 11 C, SEBI now has powers to search and seize the documents, among other things, where it has reasonable grounds to believe that any of the provisions ofsecurities laws are contravened. The search has to be authorised by a JudicialMagistrate,the first class havingjurisdiction.

20.6.6 Power to order cease anddesist:-.

Section 11 D , a new Section inserted by the securities and Exchange Board of India (Amendment) Act, 2002 empowers, SEBI to issue a cease and desist order, where necessary. It provides that if the Board funds, after causing an enquiry to be made, that any person has violated, or is likely to violate, any provisions of this Act, or any rules or regulations made thereunder, the Board may pass an order requiring such person to cease and desist from committing or causing suchviolation.

However,theBoardshallnotpasssuchorderinrespectoflistedpubliccompanyora public company (other than the intermediaries specified under section 12) which intends to get its securities listed on any recognised stock exchange unless the Board hasreasonable grounds to believe that such company has indulged in insider trading or market manipulation. [Section 11D].

20.6.7Prohibition of manipulative and deceptive devices insider trading and substantial acquisition of securities orcontrol

Manipulative and deceptive practices have played a significant role in cheating the ordinary investors and that too without such hindrance from SEBI. A new section I2A has been introduced by the securities and Exchange Board of India (Amendment) Act,2002which

prohibits the use of. manipulative or deceptive practices in connection with theissue, Purchase or sale of any security listed on any stock exchange or proposed to be listed. Similarly, employing any device or scheme to debrand investors would attract the provisions of SEBl Act. So also, dealing by any person in possession of material information or unpublished information will be publishable.

The detailed provisions of section 12A are given below.

No person shall directly or indirectly

(a) Use or employ, in connection with the issue, purchase or sale of any securities listed or proposed to be listed in a recognised stock exchange, any manipulative or deceptive device in contravention of the provisions of this Act or the rules orthe regulations made thereunder,

(b) Employ any device, scheme or artifice to debrand in connection with issue or dealinginsecuritieswhicharelistedorproposedtobelistedinarecognizedstock exchange.

(c) Engage in any act, practice, course of business which operates or would as frand or deceit upon any person. in connection with the issue, dealing in securities which are listed or proposed to be listed in a recognised stock exchange, in contravention of the provisions of this Act or the rules or the regulations madethereunder,

(d) Engage in insidertrading,

(e) Deal in securities while in possession of material or non-public information or communicate such material or non-public information to any other person, in a manner which is in contravention of the provisions of this Act or the rules or the regulations madethereunder,

(f} Acquire control of any company or securities more than the percentage ofequity share capital of a company whose securities are listed or proposed to be listed in a recognised stock exchange in contravention of the regulations n lade underthisAct.

20.6.8 Power overintermediaries

According to section 12 of he SEBl Act, no broker, sub-broker, merchant banker etc. can buy, sell or deal in securities unless they are registered with SEBI. SEBI has been empowered to issue directions to them. They are bound by the conditions prescribed for registration and if these conditions are not followed, their registration can be suspended or even cancelled.

The detailed provisions of section 12 are discussed as under.

No stock-broker, sub-broker, share transfer agent, banker to an issue, trustee of trust deed, registrar to an issue, merchant banker, under writer, portfolio manager, investment adviser and such other intermediary who may be associated with securities market shall buy, sell or deal in securities except under, and in accordance with, the conditions of a certificate of registration obtained from the Board in accordance with theregulations made under Act. (Section 12 (1)].

No depository, participant, custodian of securities, foreign national investor, credit rating agency, or any other intermediary associated with" the securities market as the Board may by notification in this behalf specify, shall buy or sell or deal in securities except under and in accordance with the conditions of a certificate of registration obtained from the Board in accordance with the regulations made under this Act. [Section 12(A)].

No personshall sponsoror causeto be sponsoredor canyon or cause to be carried onany venture capital funded or collective investment scheme including mutual funds, unlessheobtainsacertificateofregistrationfromtheBoardinaccordance with the regulations[Section12(1B)].

Everyapplicationforregistrationshallbeinsuchmannerandonpaymentofsuchfees

asmaybedeterminedbyregulations[Section l2(2}].

TheBoardmaybyorder,or spendor cancela certificateofregistrationinsuchmanneraemaybedeterminedbyregulations|Section12(3)].

However,no order under this cub-section shall be made unless the person connectedhasbeengivenareasonableopportunityofbeingheard.[Section12(3}].

TO.6.9Powers of USBI under Securities Contracts {Regulation}, Act 1g56:-

The securities contracts (Regulation] Act, 1956 (SCRA} mainly deals with the formationand management of stock exchanges in India. SEBI has been giver almost all powers underSCRAasregardscontrolandsupervisionoverstockexchanges,Thesepowersarebrieflydiscussed.

(a) Section4ofthesecuritiescontracts(Regulation)ActempowersSEBItograntrecognition to a stock exchange such recognition can be withdrawn by SEBI if it isintheinterestofthetradeorinthepublicinterest.
(b) Section6 of SCRA providesthatevery recognized stock exchange shall furnish toSEBIsuchperiodicalreturnsrelatingtoitsaffairsasmaybeprescribed.
(c) Section 9 of SCRA provides that any recognized stock exchange may, subject to thepreviousapprovaloftheSEBI,makebye-lawsfortheregulationandcontrolofcontracts.
(d) TheSEBIisempoweredtomakeoramendthebye-lawofrecognizedstockexchanges.(Section10).
(e) Section11 confers powers on the Central Government as well ae SEBI to supersedethegoverningbodyofarecogni9edstockexchange.
(f) Section12 empowersthe SEBIto suspendthe business ofa recognizedstockexchangeforalimited period.Astockexchangemay establish additional trading floor with the prior approval oftheSEBI.

Theabove mentionedpowers conferred on the SEBI, it is hoped that the regulator willbeableto bringaboutbetterdisciplineinthesecuritiesmarket.

A very significant change that have been effected in the SEBI Act is the enhancementofpenalties prescribed under the 'Act. Earlier, for certain offences the penalties ranged from Rs.5000perdaytoRs.10,000perdayofthe.violationandthemaximum

wasRe. 1,50,000to Rs.5lakh.Now,thesepenalties. havebeensubstantiallyenhanced byprovidinga minimumpenaltyof Rs.1lakh per day for most of the violations under the Act,withthemaximumpenaltygoinguptorupeesonecrore.

However, in the case of insider trading, the penalty that can .be levied has been raisedfrom Rs. 5 lakh to Rs.25 crore or three times the amount of profit made out of insider trading,whicheverishigher.

The provisionsrelatingto penalties as amended by the Securities and Exchange BoardofIndia(amendment}Act,2002aregivenasunder:

lfanyperson,whois requiredunderthisAct or any rules or regulations madethereunder-

(a}To furnish any document, return or report to the Board, fails to furnish the same,heshallbe liableto a penalty of one lakh rupees for each day during which suchfailurecontinuedoronecrorerupees.Whicheverisless.[Substitutedby**SEBI**(AmendmentAct2002] .

(b} To file any return or furnish any information, book8 or other documents within thetimespecified in the regulation fails to file return or furnish the same, within thetimespecifiedtherefore in the regulations, he shall be liable to a penalty of onelakhrupees for each day during which such failure continues or one crore rupeeswhicheverisless.

(c) To maintain booze of accounts or records, fails to maintain the same, he shall beliabletoapenaltyofonelakhrupeesforeachday during which such failurecontinuesoronecrore rupees,whicheverisless.[Section15AJ.

TO.7.2Penaltyforfailurebyanypersontoenterintoagreementwith clients

If any person, who is registered as an intermediary and is required under this Act orany rules or regulations made thereunder, to enter into an agreement with his client, fails toenterinto8uchagreement,heshall be liable to a penalty of one lakh rupees for each dayduringwhichsuchfailurecontinuesoronecrorerupees,whicheverislese|section15B|.

20.7.3 Penalty for failure to redress investor's grievances

If any listed company or any person who is registered aa an intermediary, after havingbeencalleduponbytheBoardinwriting, to redress the grievance a of investors, fails toredresssuchgrievance swithinthetimespecifiedbytheBoard,suchcompanyorintermediaryshall be liable to a penalty of one lakh rupees for each day during which suchfailurecontinuesoronecrorerupees,whicheverisless.[Section15c].

20.7.4 Penalty for certain defaults in case of mutual funds

Ifanyperson,whois

(a)Requiredunderthis Actor any rules or regulationsmadethereunderto obtainacertificate of registration from the Board for sponsoring of carrying on any collectiveinvestmentscheme,includingmutualfunds,sponsoror carriersonany collectiveinvestmentscheme,includingmutualfunds,oronecrorerupees, whicheverisless,

(b) RegisteredwiththeBoardae a collective investmentscheme, including mutualfunds, for sponsoring or carrying on any investment scheme, fails to comply withthe items and conditions of certificate of registration, he shall be liable to a penaltyof one lakh rupeesfor each day duringwhichsuchfailurecontinuesor onecrorerupees,whicheverislese;

(c) RegisteredwiththeBoardaaa collective investment scheme, including mutualfunds,fails to make an applicationfor listing of itsscheme ae provided for in theregulation governing such listing, he shall be liable to a penalty of one lakh rupeesfor each day during which such failure continued or one crore rupees, whichever isless;[substitutedbytheSEBI(Amendment)Act,2002].

(d) RegisteredasacollectiveInvestmentscheme,includingmutual funds, fails todispatchunit certificatesofanyscheme inthe manner providedif; the regulationgoverningsuchdispatch,heshallbeliabletoapenaltyofonelakhrupeesforeach

day during which such failure continues or one crore rupees, whichever *is* less,

(d) Registered as a collective Investment scheme, including mutual funds, fails to refund the application money pa.id by the investors which the period specified in the regulation, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever isless;

(e) Registered as a collective Investment scheme, including mutual funds, fails to invest money collected by such collective investment schemes in the manner or within the period specified in the regulations, he shall be liable to a penalty ofone lakh rupees for each day during which such failure continues or one crore rupees, whichever is less (Section 15 DJ.

20.7.5 Penalty for failure to observe rules and regulations by an asset management company

Where any asset management company of a mutual fund registered under this Act, fails to comply with any of the regulations providing for restrictions on the activities of the asset management companies, such asset management company shall be liable to be penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less (Section 15E].

20. 7.6 Penalty for default in case of stockbrokers

If any person, who is registered as a stock broker under this Act-

(a) Fails to issue contract notes in the form and in the manner specified by the stock exchange of which such broker is a member, he shall be liable to a penaltynot exceeding five times the amount for which the contract note was required to be issued by thatbroker.

(b) Fails to deliver any security or fails to make payment of the amount due to the investor in the manner within the period specified in the regulations, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees which every isless.

(c) Charges an amount of brokerage which is excess of the amount due to the investor in the regulations, he shall be liable to a penalty of one lakh rupees. [Section 15F].

20. 7.7 Penalty for insidertrading

If any insider who

(i) either on his own behalf or on behalf of any other person, deals in securities ofa body corporate listed on any stock exchange on the basis of any unpublished price sensitive information, or

(ii) communicates any unpublished price sensitive information to any person, with or without his request for such information except as required in the ordinary course of business or under any law,or

(iii) counsels, or procure/'< for any other person to deal in any securities of anybody corporate on the basis of unpublished price sensitive information, Shall be liable to a penalty of twenty five crore rupees or three times the amount of profits made out of insider trading, whichever is higher [Section 15G].

20. 7.8 Penalty for non-disclosure of acquisition of shares and take overs:-

lf any person, who is required this Act or any rules or regulations made thereunder, fails to:-

..(i) disclose the aggregate of his share holding in the body corporate before he acquires

any shares of that body corporate; or

(ii) make a public announcement to acquire shares at a minimum price;or

(iii) make a public offer by sending letter of offer to the shareholders of the concerned company;or

(iv) make a payment of consideration to the shareholders who have sold their shares pursuant to letter of offer, he shall be liable to a penalty of twenty five crorerupees

or three times the amount of profits made out of such failure, whichever is higher(Section 15 H].

20. 7.9Penalty for fraudulent and unfair trade practice:-

lf any person indulges in fraudulent and unfair practices relating to securities, he shall beliableto a penalty not exceeding twenty five crore rupees or three times the amount of profits made out of such practices, whichever is higher. (Inserted by the_ SEBI (Amendment) Act 2002 [section 1.5HA).

20. 7.10 Penalty for contravention where no separate penalty has been provided:•

WhosoeverfailstocomplywithanyprovisionofthisAct,therulesortheregulationsmade or directions issued by the Board thereunder for which 110 separate penaltyhasbeenprovided,shallbeliabletoapenaltywhich mayextendtoonecrore,rupees.[Section15HB].

The ordinary investors have been victims of the greedy promoters fora long time and they certainly hope for some effective policing by the SEBI. Now, that SEBI has beenprovided with real teeth it should be able to effectively bite theviolators.

The huge penalties that can be imposed by SEBI would certainly create some fear in the minds of potential offenders, but the extent to which the unscrupulous .promoters and othermarketintermediarieswilldependuponthespeedofinvestigationsandculminationof penal proceedings bySEBI.

20.8 ROLE OF SEBI IN CONTROLLING THE SECURITIESMARKET

The main provisions of the Securities and Exchange Board of 'India Act, 1992 as amended upto date have been discussed in the earlier pages. The constitution, management, functions and powers of the Board have been discussed in detail. It may be notedthatSEBIhasspreaditsnetworkofcontroloveralltheplayersinthesecuritiesmarket SEBI has been delegated concurrent powers with the Central Government under many provisions of the Securities contracts (Regulations) Act. 1956 such as recognition and derecognition of stock exchanges. SEB'I has got more powers on companies, intermediaries andstockexchangesandtheirmembers.Theconceptofinsidertradinghasbeenmademore comprehensive, SEBI can now impose stringent penalties and file suits for insidertrading, violation of listing agreement and failure to redress the investor grievances and takeover bids and violations of itsguidelines.

20.9 SEBIGUIDELINES

SEBI has issued guidelines from time to time which run into volumes and have been published as handouts separately. Such guidelines are issued separately for New Issues market, Stock market, Mutual Funds, Merchant Banks, Registers and transfer agents, Underwriters, Brokers, Sub-Brokers, Portfolio Manager ,etc. Thus, the SEBJ guidelines encompass all the intermediaries in the Capital market, and a code of conduct is also laid downforeachcategoryseparately.Theguidelinesand thecodeofconductaretobeobserved and lapses are subject to penal points. In view of the voluminous material involved inthese

regulationsofSEBI,abriefoutlineisattemptedinrespectofmajorreformsinvolved.

1. ReformsIntheNewIssueMarket:-

Free entry and free pricing of new issues in the capital market subject to observance ofsomeguidelines.

2. FreePricing-SEBlGuidelines:-

Now there is a complete freedom for the public companies to raise funds to meet theirvarious type ofbusinessrequirements.They are no more limited to financing of the projectcost only. but they can also collect funds for cost oversums and working capital requirements.The companiescan also raisefunds for other purposeslike premating. payment of highdebtborrowings. There is no restriction on public companies for raising the funds for meeting suchrequirements. But there is only one condition that the offer document shall provide adequateinformationtosafeguardtheinterestofthepotentialinvestors.

SEBI has streamlinedthe process of free pricing of equity shares in the interest of theIndianCapitalMarketsononehandandinterestoftheinvestorsontheotherhand.

3. FirstPublicIssue:-

The very first public issue of the new companies shall be allowed only at par. It meansthat where a new company is coming for the first time in the Capital Market to raise funds itcannotissueitssharesatpremium.

But the first issue of existing private or closely held companies is allowed to be freelypricedin consultation with the head managers. The load managers are required to disclosethe justification on the premium being charged by the company on public or rights issues bysuchexistingcompanies.

4. FreePricingofPublicandRightsIssues:-

AccordingtoSEBIguidelinesonfreepricingofcapitalissuesonlythe following gcategoriesofpubliccompanieshavebeenpermittedtopricetheirequityissuesfreely:

5. Thosenewcompanieswhichareestablishedbyindividualpromotersandentrepreneurs, or which are setup by the existing public company with a five years trackrecordofconsistentprofitability.

6. Those existing private or closelyheld companies or other unlisted companies with orwithoutthreeyearstrackrecordofconsistentprofitabilityorthosepubliccompaniesestablished by companies which are having five years trackrecords whether or notseekingdisinvestmentsbyoffertopublicwithoutissuingfreshcapital.

7. Allthoseexisting publiccompanies which are listedcompanies.

8. **Hote**:- **SEBI**hasissuedGuidelinesforissueofsharestothepublicentitled.

SEBI (Disclosureand Investor Protection}Guide1inee,2000. Theseguidelineshavecomeintoforcew.e.f.27.1.2000

It is seen that false claims and misleading statements are made while offering sharesto the public.The. prospective investor is not an expert in this field and often gets misled bysuch advertisements or rumors about unofficial premium on a share, etc. SE81 has, therefore,issueddetailedguidelines in respect of securities issued to the public (IPO’s). Highlights oftheguidelinesissuedbySEBIaresummarizedbelow:

9. TheappointmentofC ate gory-IMerch an tBankertomanageanissueshallbecompulsory.

10. Registrartoissuemustbeappointed.

11. Partlypaidsharesmusteitherbemadefullypaidorforfeited.

IN. The‘companyshallnotmakepublicissuewhereithas beenprohibited bytheSEBI.

13. Draftofferdocument(prospectus)shallbefilledwiththeSEBIatleast2 ldaysbeforefilingoftheprospectsswithRegistrarofCompanies.

14. ThedraftofferdocumentfiledwiththeSEBIshallbemadepublicforaperiodof21 daysfromthedateoffilingthe*offer*documentwiththeSEBI.

15. Theheadmerchantbanker shall,

    I. Whilefiling the draft documentwiththe SEBI also filethe draft offer documentwiththestock**exchanges**wherethesecuritiesareproposedtobelisted;
    II. MakecopiesofdraftofferdocumentavailabletothePublic;
    III. Shall maketen copies of the draft offer document available to the dealing office ofthe SEBI, three copies to the Primary Market Department,SEBI, Head Office and 25copiestotheStockexchange(s)wheretheissueisproposedtothelisted;
    IV. Thelead merchantbankershallsubmitthedraftoffer document on a computerfloppytothe dealingofficeofthe Board and to the Primary Market Department,SEBIHeadOffice;
    V. Obtainandfurnish to the SEBI, an in-principle approval of the stock exchangesfor listing of the securities within 15 days of filing of the draft offer document withthestockexchange(s}.

16. The company shall carry out the changes suggested by SEBI before filing of prospectuswithRegistryofCompanies..

17. PublicissuebyUnlistedcompany:An unlistedcompanyshall be allowed to make apublicissuesubjecttothefollowingconditions.

    (a) Itmusthaveatrackrecordofdistribute tableprofitsintermsofsection205 ofthecompanies Act, 1956 (i.e., ability to pay dividends} for at least 3 out of immediatelyproceeding5years.
    (b) It must have a minimum pre-issue net worth of not less than Re.1 crore 3 out ofpreceding5yearsandalsoinimmediatelypreceding2years.
    (c) Theissuesizemustnotexceed5timeitspre-issuenetworthaa per the lastavailableaccounts either at the time, at filing offer document with SEBI or at thetimeofopeningofissue.

Incasethecompanydoesnotsatisfytheaforesaidrequirements or the issue size**exceeds** five times its pre-issue net worth as per last available audited accounts, it can makea publicissue only through book-building subject to at least 60% of the issue being allottedtoqualifiedInstitutionalBuyersfailingwhichfallsubscriptionmoneymustberefunded.

'QualifiedinstitutionalBuyer'shallmean-

(a) Publicfinancial institutionsaedefinedinsection 4Aofthe companiesAct, 1956;
(b) Scheduledcommercialbanks;
(c) Mutualfunds;
(d)Foreigninstitutionalinvestorsregisteredwith **SEBI.**
(e} Multilateraland bilateral development financial institutors;
(f) Venturecapital fundsregistered withSEBI.

18. The company shall enter into agreements with all the depositories for dematerializationofsecurities.However,theinvestorsshallhaveanoptionto receive allotment ofsecuritiesthroughanyofthedepositories.

19. Exemptionfrom EligibilityNorms;Theeligibilitynormsfor makinga public issue asnotedaboveshallnotbeapplicableincaseof

    I. AbankingcompanyincludingaLocalAreaBank(hereinafterreferredtoaPrivate

Sector Banks) set up under sub-section of section 5 of the Banking Regulation Act, 1949. and which has received licence from the Reserve Bank of India, or

II. a corresponding new bank set up under the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970, Banking companies(Acquisition and Transfer of Undertakings Act 1980, State Bank of India Act 1955, and State Bank of India (subsidiary Banks) Act 1959, hereinafter referred to as 'public sectorbanks'.

Ill. An infrastructure company:

(a) whose project has been appraised by a Public Financial Institution or Infrastructure leasing and finanacing services Ltd. (IL & FS)and

(b) not less than 5% of the project cost is financed by any of the institution referred to in sub-clause(a), jointly or severally, irrespective of whether they appraise the project or not, by way of loan or sub scription to equity or a combination ofboth.

20. Pricing of Issue: Free pricing has been allowed under SEBI Guidelines,2000.

Inotherwords,everycompanywhichisentitledtomakeapublicissue,shall befreetooffer its public issue either at par or at a premium. Issuer company can mention a price band of 20% (cap in **the** price band should not be more than 20% of the floor price) in "the offer documentfiledwiththeBoardandactualpricecanbedeterminedata laterdatebeforefiling of the offer document with the ROC. When the Board of Directors has been authorized to determine the offer price within a specified price band, such price shall be determined by a resolution to be passed by the Board ofDirectors.

Differential pricing :

I. any unlisted company or a listed company making a public issue of equity shares or securities convertible at a later date into equity shares, may issue such securities to applicants in the firm allotment category at a price different from the price at which the net offer to the public is made, provided that the price at which the security is being offered to the applicants in firm allotment category is higher than the price at which securities are offered topublic.

II. A listed company making a composite issue of capital may issue securities at differential prices in its public and rightsissue.

III. In the public issue which is part of a composite issue, differential pricing is also permissible.

IV. Justification for the price difference shall be given in the offerdocument.

21. A banking company shall be allowed to make a public issue at a price approved by the Reserve Bank ofIndia..

22. Public issue by listed companies: A listed company shall be free to make a public issue. However, if the net worth of the company becomes more than 5 times the net worth prior to the issue, it shall be allowed only through book building subject to at least 60% of the issue being allotted to Qualified Institutional Buyers (Q!Bs) failing with full subscription money must be refunded. A listed company shall be allowed free pricing of itsissue.

23. Denomination of shares: The companies, which have already issued shares in the denominationofRs.10orRs.100,maychargethestandarddenominationoftheshares by splitting or consolidating the existingshares.

The companies proposing to issue shares in any denomination or changing thestandard denomination shall comply with the following:

(a) the shares shall not be issued in the denomination of decimal of arupee;
(b} the denomination of the existing shares shall not be altered to a denomination of decimal of arupee;
(c} at any given time there shall be only one denomination for the shares of the company.
(d) The companies seeking to change the standard denomination may do so after amending the Memorandum and articles of Association, ifrequired;
(e) The company shall adhere to the disclosure and accounting norms specified by the SEBl from time totime.

24. Promoter'sContribution:
(a) Unlisted company: The promoter's contribution shall be at least 20% of the post issuecapital.
(b) Listed company: The promoter's contribution shallbe:
(i) at least 20% of the proposed public issue;or
(ii} shall not fall below 20% of the post issuecapital.
(c) In case of composite issues of listed companies, rights issue component of the composite issue shall be excluded while calculating the post issuecapital.
(d) Private placement of promoters through market Intermediaries shall not be allowed.
(e) Promoter's contribution shall be at the same price as applicable to theinvesting public.
(f) Minimum amount to be contributed by each promoter shall not be less than Rs.25,000 per application. This limit shall also apply to contribution made by business associates such as dealers and distributors. However, in case of contributions made byfirms or body corporates not being business associates, the minimum contribution shall be Rs.1,00,000.
(g) In case of listed as well as unlistedcompanies,
I. Promoters must bring in the full amount of their contribution (in eluding premium at least one day before the issue opens which shall be kept in an escrowaccountwithaScheduledcommercialbankandthesaidcontribution/ amount shall be released to the company along with the public issue proceeds).
II. Where Promoters contribution exceeds Rs. JOO crores, they shall bring Rs.100 crores before opening of the issue and the balance on prorata basis in advance before calls are made on public.
Ill. The company's Board shall pass a resolution allotting the shares to convertible instruments to promoters against the money received.
IV. A copy of the resolution with a 'Chartered Accountants' certificate . certifying that the promoter's contribution has been brought in shall be filed with the SEBI before opening of theissue.
V. Promoters shall not acquire share through private placements either directly or through any intermediary. Further, any allotment made to promoters / management within twelve months prior to public issue at a price less than the offer price, shall be subject to lock-in-period of sixmonths.
(h) Promoters Participation in Excess of the Required minimum contribution to be treated as preferential allotment. In case of listed company, participationby

promoters in the proposed public issue in excess of the required minimum provisions shall attract the pricing provisions of Guidelines on preferential allotment, if the issue price is lower than the price as determined on the basis of saidpreferentialallotmentguidelines,Further.thesameshallbesubjecttoalock- in-period of oneyear

(i) Exemption from requirement of promoter's contribution. The requirement of promoters contribution shall not be applicable in case of public issue of securities bya company which has been listed on a stock exchange for atleast three years and has a track record of dividend payment for at least 3 immediately preceding years.

25. Lock-in-Period-The promoter's contribution shall be subject to a Jock-in-period of 3 years.

26. Lock-in the excess contribution by promoters. In case the promoter's contribution in the proposed issue exceeds the required minimum contribution, such excess contribution shall be locked in for a period of one year (earlier threeyears).

The entire pre-issue share capital, other than that locked-in as promoter's contribution, shall be locked-in for a period of one year from the date of commencement of commercial production or the date of allotment in the public issue, whichever is later.

However, the aforesaid lock-in requirement shall not be applicable to the pre- issue share capital.

(i) held by venture capital funds registered with the Board though the same shall be locked-in as per the provisions of the SEBI (Venture capital funds) Regulations 1996 and any amendmentthereto.

(ii) held for a period of atleast one year at the time of filing draft offer document with the Board and being offered to the public through offer forsale.

27. Reservations and firmallotment

Reservations for allotment on firm / preferential basis for various categories together with promoter contribution must not exceed 75% of **the** total issue amount.

(a) Reservation on competitive basis can be made in a public issue to the following categories:

(i) Permanent employees (including working directors) of the company and in the case of a new company, the permanent employees of the promotingcompanies.

(ii) Shareholders of the promoting companies in the case of a new company and shareholders of group companies in the case of an existingcompany.

(iii) Indian MutualFunds.

(iv) Foreign institutional investors (including non-resident Indians and overseas corporate bodies).

(v) Indian and multilateral developmentinstitutions.

(vi) Scheduledbanks.

(c) Firm allotment in public issues can be made to thefollowing:

(i) Indian and multilateral development financialinstitutions.

(ii) Indian mutualfunds.

(iii) Foreign institutional investors (including non-resident Indians and overseas corporatebodies).

(iv) Permanent / regular employees of the issuercompany.

(v) ScheduledBanks.

(d) Reservation in favour of employees shall not exceed 10% of the issue. Reservations **is** favour of shareholders and lead merchant bankers must not exceed 10% and 5%respectively.

(e) In case promoting companies are designated financial institutions / State and Central Financial Institutions, the employees and the shareholders of such promoting.

(I) The allotments to the reservedcategory(ies) shall be subject to lock-in period of oneyear.

(g) In case of reservations / firm allotment in favour of any person, no further applicationforsubscriptiontothepublicissuefromsuchperson(s)exceptingfrom shall beentertained.

(h) Nobuy-backorstand-byorsimilararrangementsshallbeallowedwiththepersons for whom securities are reserved for allotment on a firmbasis.

(i) Any unsubscribed portion in any reserved category may be added to any other reservedcategory.

The unsubscribed portion, if any, after such inter se adjustments amongst the reserved categories shall be added back to the net offer to thepublic.

(j) If any person to whom firm allotment is proposed to be made withdraws partially or fully from the offer made to him after filing the prospectus with the ROC, the extent of shares proposed to be allotted to such persons shall be taken up by the promoters and the subscription amount shall be brought in at least one day prior to the issue opening date.

20,7 CONDITIONS FORPROMOTERS

The promoters who acquire such shares shall not be allowed to sell them or otherwise transfer them for a period of oneyear.

1. Minimum application:• The minimum number of shares for which application shall be allowed to be made has been fixed at 200 shares of the face value of Rs.10 each. In case of issue at a premium, the minimum amount payable (on application, allotment and cells) 'shall not be less thanRs.2000,
2. Minimum Application Money:- The minimum application money to be paid by an applicant along with the application shall not be less then 25% of the issue price. Further, the minimum number of instrument of which an application has to be made shall not be less than the tradeablelot.
3. Minimum Tradeable lot:- The minimum tradeable lot, in case of shares of face value of Rs.10 each, shall at the option of the issuer / offered, be fixed on the basis of offer price as givenbelow:

   Provided that the maximum tradeable lot in any case shall not exceed 100 shares.

Offer Pricepershare	MinimumtradeablelotUptoRs.100
100Shares	Rs.101toRs.400
50Shares	More than Rs.400
10 Shares	

4. Share application form to seek permanent account number in respect of applicationsforthevalueofRs.50,000ormore,theapplicant(s)shallmentionhis/ her/their permanent account number / GIR number and income tax circle/ward, district or the fact of non-allotment of PAN/GIR number, as the casemay be.

Applications not complying with these provisions are liable to berejected.

5. ClosureofIssue:-Issuemustbekeptopenforatleast3workingdaysandnotmore thantwoworkingdays.However,publicissuesmade byinfrastructurecompanies may be kept open up to 21 workingdays.
6. Minimum Subscription:- The following statements shall appear in theprospectus:
   (i) For non-underwritten Public Issues: •If the company does not receive the minimum subscription of 90% of the issued amount on the date of closure of theissue,orifthesubscriptionlevelfallsbelow90%aftertheclosureofissue on account of cheques having being returned unpaid or withdrawal of applications, the company shall forth with refund the entire subscription amount received. If there is a delay beyond days after the companybecomes
   liable to pay the amount, the company shall pay interest as per section 7"3 of companies Act 1956".
   (ii) For under written Public Issues:- "If the company does not received ,the minimumsubscriptionof90%ofthenetoffertopublicincludingdevelopment of underwriters within 60 days from the date of closure•- of the issue, the company shall forthwithre-
   (iii) For compositeIssues
      (a) The lead Merchant Bankers shall ensure that the requirementof •minimum subscription• is satisfied both jointly and severally, i.e., independently for both rights and public issues.
      (b) If the company does not receive the minimum subscription in either of the issues, the company shall refund the entire subscription received. The aforesaid requirement of 90% minimum subscription will not be relevantincaseofofferforsaleofsecurities(i.e.themanagementoffering their shareholdings through public offer with a view to convert a closely held company into a widely heldcompany).

      Again the requirement of 90% subscription for issue of capital by an infrastructure company shall not be mandatory if disclosures are made in the prospectus regarding the alternate sources of finding, The lead manager shall verify and confirm the same as part of his duediligence.
7. Over subscription:- No retention of over-subscription shall be allowed except to the extent of maximum 10% necessitated by approximation while making proportionate allotment.
8. Allotment to be on proportionate basis:- In case of over - subscription, the allotment shall be on proportionate basis subject 'to a minimum of 50% of the net public offer to be reserved for allotment to individuals applying for 1000 or less shares. SEBI in this regard has classified that reservation in favour of small investors has to be a minimum of 50%. It means that if the category of individual applicants upto 1000 shares would have got 70% of the public offer in accordance with proportionate formula, they would be given 50% of the net offer to thepublic.
9. Issue to be made fully paid up;- issue must be made fully paid up within 12 months except where the total issue size exceeds Rs. 500 crores. If the investor fails to pay call money within 12 months, as aforesaid, the sub, scription money already' paid may beforfeited.
10. Refund of over subscription:- All money in excess of the application moneyon

shares allotted must be repaid forthwith without interest.

Section 73 (2A) provides that if such money is not repaid within 8 days from the day the company becomes liable to pay, the company and every director or the company, who is an officer in default, shall be jointly and severally liable to repay the same with interest@ 15% p.a. There shall be no escape from payment of interest irrespective of circumstances (Raymond Synthetic Ltd. Vs. Union of India (1992) 73 Comp. Case 763(SC)].

11. Refund orders/shares or debentures certificates, Refund orders of the valueoverRs. 1500 and share/debentures certificates shall be sent by registered post only.
12. Safety net or buy back arrangement:- Where any safety net scheme or buyback arrangement is proposed, it must be ensured that:
    - I. The safety net scheme or buy-back arrangement has been finalized inadvance and disclosed in the prospectus.
    - II. The facility can be made available only to original allottees who are persons resident inIndia;
    - III. The facility is limited up to a maximum of 1000 shares perallottee..
    - IV. The offer must be kept open for a period of at least six months from the last date of dispatch ofsecurities.
    - V. The financial capacity of the person (Viz, promoters, directors ormerchant bankers) making available such facility must have been disclosed in the draft prospection, and
    - VI. Nobuy-backorstandbyorsimilararrangementsareallowedwiththepersons for whom securities are reserved for allotment on firm basis.

20.11 OTHERREQUIREMENTS

I. Updating of offer document: The lead merchant banker shall ensure that the particulars as per audited statements contained in the offer document· are not more than 6 months old from issue openingdate.

In respect of a Government company making a public issue, the report in the prospectus shall not be more than six months old as on the date of filing of the prospectuswiththeRegistrar-ofCompaniesortheStockExchangeasthecasemay be.

II. Compliance Officer to' be appointed by lead merchant banker: The leadmerchant bankershallappointa-seniorofficerascomplianceofficertoensurethatallrules, regulations, guidelines, notifications, etc. issued bythe Board, the Government of India,andotherregulatoryorganizationsarecompliedwithThecomplianceofficer shall coordinate with regulatory authorities in various matters and provide necessaryguidanceandalsoensurecomplianceinternally.Thecomplianceofficer shall also ensure that observations made/deficiencies pointed out by the Board do notsecure.

III. Incentivestoprospective shareholders.Theissuershallnotofferanyincentivesto theprospectiveinvestorsbywayofmedicalinsurancescheme,luckydraw,prizes etc.

IV. Requirement of monitoring agency: In case of issues exceeding Rs.500 Crores, the issuer shall make arrangements for the use of proceeds of the issue to be monitored by one of the financialinstitutions.

V. Option to receive securities in dematerialized form: The lead merchantbanker shall incorporate a statement in the offer document and in the application form to the effect that the investors have an option to either receive securities inthe-form

of physical certificates or hold them in a dematerializeform.

20.12 SUMMARY

The need for setting up independent Government agency to regulate and develop the stock and Capital Market in India as in many developed countries was recognised since the sixth five year plan was launched (1985) when some major industrial policy changes like opening up of the economy to outside world and greater role to the Private Sector were initiated. The rampant malpractices noticed in the Stock and Capital Market stood in the way of infusing confidence of investors which is necessary for mobilisation of larger quantity of funds from the public and help the growth of the industry.

The malpractices were noticed in the case of companies, merchant bankers and brokers who are all operating in the capital market. The need to curb these malpractices and to promote healthy capital market in India was felt. The security industry in India has to develop on the right, lines for which a competent Govt. agency as in U.K. (SIB) or in U.S.A (SEC) is needed.As referred to earlier, malpractices have been reported in both the primary market and secondary market. A few examples of malpractices in the primary market are as follows :-

(a) Too many self styled Investment Advisers andconsultants.
(b) Grey Market or unofficial premiums on thenew issues.
(c) Manipulationofmarketpricesbeforenewissuesarefloated.
{d) Delay in allotment letters or refund orders or in dispatchof share certificates.
(e) Delay in listing and commencement of trading inshares.

A few examples of malpractices in the secondary market are as follows:-

(a) Lack of transparency in the trading operations and prices charged toclients.
(b) Poor services due to delay in passing contract notes or not passing contractnotes, at all.
(c) Delay in making payments to clients or in giving delivery ofshares.
(d) Persistence of odd lots and refusal of companies to stop this practice of allotting shares in odd lots.
(e) Insider trading by agents of companies or brokers rigging and manipulatingprices.
(f) Take over bids to destabilizemanagement.

20.13 GLOSSARY

1. Malpractices - Using wrongmethods
2. Trading in Securities - Dealing/Sale or Purchaseof Securites
3. Soliciting Money - Makingmoney
4. Violation - Not tofollow
5. Deceptive - Tocheat

20.14 Keywords: SEBI, Guidelines, Securities

20.15 SUGGESTEDREADINGS

I. Securities Analysis & portfolio Management - By V.A.Avadhani
2. Business Environment - FrancisCherunilun
3. Financial Services & Markets - By G.S.Batra

20.16 PRACTICEEXERCISE

Q.1.What are the objectives of SEBI?

Q.2.What powers have been given to SEBI?

Q.3. What penalties can be imposed if guidelines of SEBI are notfollowed?

Q.4. What special conditions are meant for promoters underSEBI?

20.17 Answers to Self check activity

Q1 False ; Q2 False ; Q3 True ; Q4 False

Lesson No.21

AUTHOR : DR. RITULEHAL

CONSUMER PROTECTION ACT, 1986

STRUCTURE

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21.2 Extent and coverage of theAct
21.3 RedressalMachinery
21.4 The limit for DecidingComplaint/Appeal
21.5 Procedure for Filing theAppeal
21.6 Who is a Consumer ?
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21.7.1 Self Check Exercise I
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21.10 Coverage of Consumer Protection Act
21.11 Some cases
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21.13 Answer to Self Check Exercise
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21.16 Glossary
Suggested Readings

21.0 OBJECTIVESOFTHELESSON

ConsumerProtectionActisasteptakenbytheGovernmentinfavourofconsumerism. Our market was totally a seller's market, so the sellers tempted to follow diverse practices whichturnouttobeunfairtotheconsumers.Althoughsomanyother Actswereinexistence like MRTP Act, Essential Commodities Act, Sale of Goods Act, etc., but an individual consumer in India does not find his complaint worth perusing due to disproportionate costs involved in redressal, unduly long time consuming court process, yearsof embarrassment.
The Consumer Protection Act, 1986, marks the growth of the enlightened consumer movement in our country.

21.1 INTRODUCTION

ConsumerProtectionAct,1986:TheActprovidessimple,speedyandinexpensive redressal to consumer's grievances, particularly against unfair trade practices or exploitation ofconsumers.

21.2 EXTENT AND COVERAGE OF THEACT

The Act applies to all goods and services unless specially exempted by the Central Government. It covers all the sectors whether private, public or cooperative. The provisions of the Act are not preventive but compensatory in nature. The Act gives the following rights to the consumers:

(i) The right to be protected against the marketing of goods whichare hazardous to life andproperty.

(ii) The right to access to a variety of goods at competitive prices. It becomes the duty of the seller to make all the varieties available to theconsumer.

(iii) The right to be informed about the quality, potency, purity, standards andprices

of the goods. This right also protects the consumer against unfair trade practices.

(iv) The right to be heard and be assured that consumer's interest will receive due consideration at appropriateforums.

(v) The right to consumer education. It also includes the right of having proper information related to the product by thesupplier.

It provides consumer the protections at central and state levels whose main objective is to protect the rights ofconsumers.

:U.3 REDRESSAL MACHINERY

The Act envisages establishment of consumer Protection Council at the Central and State levels whose main object will be to promote and protect the right of the cons umers. The hierarchy of three redressal forums is given below:

21.3.1 District Forums

Each district should have at least one district forum or it can be more than one depending upon the number of cases brought to the notice by the consumers.

Each District Forum should consists of :-

(i) a person who is or qualified to be a District judge, as president, nominated by the StateGovernment.

(ii) a person of eminence in the area of education, tradeor commerce

(iii) a lady social worker every member of the District Forum shall hold the office for a term of 5 years or upto the age of 65 years which ever isearlier.

21.3.2 Statecommissions

Each State Commission shall consist of-

(i) a person who is or has been a judge of High court shall be appointed as president by StateGovernment.

(ii) two other members, who shall be person of ability, integrity and standing with having adequate knowledge and experience in dealing with the problems in the area of commerce, law, economics, accountancy, public affairs etc. and one of them shall bewoman.

The salary or honorarium and other allowances payable to the members of the S ta te Commission shall be such as may be prescribed by the state government.

21.3.3 National commissions

The National Commission shall consists of :-

(i) a person who is or has been judge of the supreme court shall be appointed as President by the centralgovernment.

(ii) fourothermemberswhoshallbepersonofability,integrityandstandingandhave adequate knowledge or experience of dealing with the problems of related areas like law, commerce, economics administration etc. and one of whom shall be a woman.

The salary or honorarium payable to the members of National Commission shall be such as may be prescribed by Central Government. A consumer is not satisfied with the decision givenbyDistrictForum,canappealtoStateCommissionandfurthertoNationalCommission within stipulated timeperiod.Any person aggrieved by an order made by National Commission can move to SupremeCourt within a period of 30 days from the date of the order.

According to the Amendment made in 2002 in the Act thecases for the claims upto Rs. 20 lakhs will be dealt by District Forums, from Rs. 20 lakhs to Rs. 1 crore will be dealt by the State Commission and the cases for more than Rs. 1 crore come under the per-view of NationalCommission.

21.4 THE LIMIT FOR DECIDINGCOMPLAINT/APPEAL

To ensure speedy disposal of consumer grievances, as far as possible, within a period of three months from the date of notice received, the decision should be taken by the district Forums. In case testing of commodities is also required, within 5 months the case should be decided. The National Commission and State Commission are required to decide the appeal, as far as possible, within 90 days from the first date ofhearing.

21.5 PROCEDURE FOR FILING THEAPPEAL

Appeal against the decision of a District Forum can be filed before the State Commission within a period of 30 days. Appeal against the decision of a State Commission can be filed against the order of the National Commission can be filed before the Supreme Court within 30days.

21.6 WHO IS A CONSUMER?

The producer of some goods and services is also consumer for various services produced byothers.Theword'consumer'underthisAct,hasbeendefinedseparatelyforthe purpose of goods andservices.

For the purpose of goods, a consumer means a person belonging to the following categories :

1. One who buys any goods for consideration which has been paid or promised or .partly paid and partly promised or under any system of deferred payment.
2. It includes any user of such goods other than the person who actually buys goods and such use is made with the approval of the purchaser.

For the purpose of services, a consumer mean• a person belon,1n, to the following categories :

1. One who hires any services or services for a consideration which has been paidor promised or partly paid and partly promised under any system of deferred payment.
2. It includes any beneficiary of such service other than the one who actually hire theservice for consideration and such services are availed with the approval of such person.

21.7 WHO CAN FILE A COMPLAINT?

A Consumer, any voluntary consumer organisation, registered under the Societies Registration Act, 1860, or the Companies Act, 1956 or under any other law for the time being in force. The Central Government, the State Government or Union TerritoryAdministration.

21.7.1 SELF CHECK EXERCISE NO.1 (True/False:)

1 The Consumer Protection Act, 1986, was introduced to create obstacles for consumers in pursuing complaints.
2 The Act applies only to goods and does not cover services.
3 The National Commission consists of a person who has been a judge of the High Court as its President.
4 According to the Amendment made in 2002, cases for claims above Rs. 1 crore are dealt with by District Forums.

21.8 HOW TO FILE A COMPLAINT?

The procedure is very simple. There is no fee for filing a complaint before the District Forum, the State Commission or the National Commission. The complaint can be sent by post. A complaint should contain the following information:

the name, description and address of the opposite party or parties;
the name, description and address of the complainant;
the facts relating to complaint and when and where it arose; document, if any, in support of the allegation contained the complaint; the relief which the complainant isseeking.

The complaint should be signed by the complainant or his authorized agent.

21.9 RELIEF AVAILABE TOCONSUMERS

Depending on the nature of relief sought by the consumer and facts, the Redressal Forum may give orders for one or more the following reliefs:

(i) removal of defects from thegoods,
(ii) replacement of thegoods.
(iii) Refund of the price-paidor
(iv) award of compensation for the loss or injurysuffered.

21.10 COVERAGE OF CONSUMER PROTECTIONACT

The range of consumer law is vast. There is remedy for defective goods, deficient services and excess prices of goods. The following are some complaints against companies selling goods and offering services.

Defective Goods : It will not only include private business but public utility services,

government departments and public sector undertaking. It may include impure blood, repressed oil tragedy, minor defect in brand new car, manufacturing defect in car, iodization of salt, defective edible oil, certified seeds, defective medicines, cement, textile, defective tea, footwear, defective bicycle, defective lathe machine, defective tailoring, washing machine with defect, defective electronic items like computers, television sets, etc. The above mentioned defective items are already brought to the notice of Consumer Protection Act and the people receive the appropriate reliefs for thesedefects.

Deficient Services : Deficiency means any fault, imperfection, shortcoming or

inadequacy in the quality, nature and manner of performance which is requiredtobemaintainedbyorunderanylawfortimebeinginpracticehasundertakentobeperformedby a person in pursuance of a contract or otherwise in relation to any services. It mayinclude.

Banking Services : Consumer forums are now a days hearing a number ofcomplaints

against banks, e.g., where a bank made the payment of a cheque, despite stop noticeofthe customer, bank was held liable for deficient service. State Commission directed the bank to compensate the customer by giving Rs. 500 as general damages plus Rs. 250 asexpenses.

InsuranceServices:Almosteverythingmaybeinsuredthesedays.Insuranceprovides pool of funds to which many contribute a certain sum called the premium and out of which the few who suffer losses are compensated. So many cases have been dealt by consumer forums in the context of life insurance, and general insurance both. These days so many insurance companies are working in private sector. So, a check on their working & dealing consumers ismust.

Medical Services : Doctor's help is indispensable in our lives. A doctor is supposed to

keep information about his patient confidential. Because of medical negligence so many people even have to lose their lives. Consumer forums have granted huge compensations for such negligence by pinpointing the person responsible forit.

Courier Services : In a case where the consignment was lost in transit , the National Commission held it was a deficient service and compensation was awarded to the complainant.

Telephone Services : It is the duty of the (telephone authority to serve bills to the subscribers and not of the subscriber's duty to keep collecting the bills. Where the subscriber was told to collect his bill and he refused to do so, he was subjected to disconnection and the service of a bill for Rs. 48,000, it was held that the bill had to be set aside. A compensation of Rs. 3500 was awarded to theplaintiff.

Electricity Services : Electricity authorities can also be held responsible for high voltage, loss due to fluctuation, illegal disconnection, excessive billing etc.

Postal and Railway Services ; Failure to deliver a registered letter,any

fraudulent or willful act of postal employees, non delivery of postal articles etc. are some issues which consumers can raise. In the same way, any kind of negligence on the railways can also be challenged. Along with the above mentioned services, some other services are Airlines services, cargo services, building and housing services, transport services, lawyers etc. are also included under the purview of the Consumers ProtectionAct.

21.11 SOME CASES OF CONSUMER PROTECTION:

1. In the case in Madras District Consumer Forum, the Crompton Greaves Ltd. had to pay the compensation of Rs. 69,420 with 12% interest to Amanullah. He had purchased a washing machine from R.S. enterprise Madras, which caused a major fire in his house. The forum held that dealer and manufacturer are jointly liable for thismishap.
2. The doctors also come under the preview of Consumer Protection Act. Two doctors had to pay a compensation of Rs. 9.7 lakhs for their negligence. The compensation was awarded for loss of marital happiness and for the pain and sufferings which Mrs. K. Ramalkshmi had borne. Two doctors of Christian Medical Centre, Pithapuram, had left a blade in the stomach of Mrs. Ramalakshmi during the operation.
3. A person was forced to make 16 visits to the tehsildar 's office in Khandapara from Cuttak to get the certified copies of an order. The Orissa State Commission directed Puri District Official to compensate the harassed consumer Rs. 1200 as compensation and Rs. 700 for travelcost.
4. In another case against Indian Airlines, Bihar State Commission awarded a compensation of Rs. 2000 to Mr. S.N. Sinha. He was served a piece of wire with dinner, when he was travelling by Indian Airline flight. He had an injury on his tongue for which Indian Airlines did not provide even firstaid.

21.12 SUMMARY

This lesson includes the following topics :

Introduction : It is a positive step taken by the Government in order to help the Consumer Protection Act. The Act was introduced in 1986 in order to have a simple and speedy redressal for consumers.

Extent and Coverage or the act

RedressalMachinery : There is a three tier redressal machinery for listening consumer's complaints.

District Forums, State Forums, and National Commission Procedure for Filing the Appeal

Who is Consumer ?

Who can file Complaint? How to file a Complaint?

Relief available to Consumers Coverage of Consumer Protection Act Some Cases of Consumer Protection

21.13 ANSWER TO SELF CHECKEXERCISE

(i) False
(ii) False
(iii) True
(iv) False

21.14 Key Words

Consumer Protection Act, Redressal machinery, Rights of consumers, Jurisdiction of forums

21.14 Glossary

Respondent	Against Whom the complaint has been field
Expensive	Costly
Hazardous	Harmful
Compensatory	Something in return
Allegation	Providing some relief as compensation Blame
Plaintiff	A person who files the complaint

21.15. Practice Exercise:

Short Questions:

- What are the main objectives of the Consumer Protection Act, 1986?
- Name three rights granted to consumers under the Act.
- Explain the hierarchy of redressal forums mentioned in the Act.

Long Questions:

- Discuss the significance of the Consumer Protection Act, 1986, in the context of the Indian market.
- Explain the rights granted to consumers under the Act. How do these rights protect consumers?
- Describe the three-tier redressal machinery established by the Consumer Protection Act and its functioning.

21.16. SUGGESTEDREADINGS

1. *Business Environment* by K.Aswathappa
2. Business *Environment* by FrancisCherunilam
3. *Consumer Protection in India* by NeerajKumar

LeasonNo.22 AUTHOR : TARANNUMMOHAN

NGOs : TYPES AND ROLE IN PROMOTING CONSUMER AWARENESS

STRUCTURE

22.0 Objectives
22.1 Introduction
22.2 History
22.3 Types ofNGOS
22 .3.1 Acronyms developed around the term 'NGO'
22.3.2 Classification of NGOs
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22.4.1 Publicrelations
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22.15 Keywords
22.16 Answers to Self Check Exercises
22.17 SuggestedReadings

22.0 OBJECTIVES

After reading this chapter, the student should be able to :

- Understand the role of NGOs in promoting consumerawareness.
- Understanding of various types of NGOs and theirfunctions.
- Define various methods through which NGOsoperate.

22.1 INTRODUCTION

A non-governmental organization (NGO) is a legally constituted organization created byprivatepersonsororganizationswithnoparticipationorrepresentationofanygovernment. InthecasesinwhichNGOsarefundedtotallyorpartiallybygovernments,theNGOmaintains its non-governmental status insofar as it excludes government representatives from membership in the organization. Although the definition can technically include for-profit corporations, the term is generally restricted to social, cultural, legal, and environmental advocacygroupshavinggoalsthatareprimarilynoncommercial.NGOsareusuallynon-profit organizations that gain at least a portion of their funding from private sources. Because the label "NGO" is considered too broad by some, as it might cover anything that is non-governmental,manyNGOsnowpreferthetermprivatevoluntaryorganization(PVO).The numberofinternationallyoperatingNGOsisestimatedat40,000.Indiaisestimatedtohave. between 1 million and 2 millionNGOs.

22.2 HISTORY

International on -governmental organizations have a history dating back to at least the mid-nineteenth century. They were important in the anti-slavery movement and the movement for women's suffrage, and reached a peak at the time of the World Disarmament Conference. However, the phrase "non-governmental organization" only came into popular use with the establishment of the United Nations Organization in 1945 with provisions in Article 71 of Chapter 10 of the United Nations Charter for a consultative role fororganizations which are neither governments nor member states.

The definition of "international NGO" (!NGO) is first given in resolution 288 (X) of ECOSOC on February 27, 1 9 50 : it is defined as "any international organization that is not founded by an international treaty".

The vital role of NGOs and other "major groups" in sustainable development was recognised in Chapter 27 of Agenda 21, leading to intensearrangementsfora consultative relationship between the United Nations and non-governmentalorganizations.

Globalization during the 20th century gave rise to the importance of NGOs.Many problems could not be solved within a nation. International treaties and international organizations such as the World Trade Organization were perceived as being too centered on the interests of capitalist enterprises. Some argued that in an attempt to counterbalance this trend, NGOs have developed to emphasise humanitarian issues, developmental aid and sustainable development. A prominent example of this is the World Social Forum which is a rival convention to the World Economic Forum held annually in January in Davos, Switzerland. The fifth World Social Forum in Porto Alegre, Brazil, in January 2005 was attended by representatives from more than 1,000 NGOs. Some have argued that in forums like these, NGOs take the place of what should belong to popular movements of the poor. OthersarguethatNGOsareoftenimperialistinnatureandthattheyfulfillssimilarfunction to that of the clergy during the high colonial era. Whatever the case, NGO transnational networking is now extensive.

22.3 TYPES OFNGOa

Apartfrom'NGO'oftenalternativetermsareusedasforexampleindependentsector, volunteer sector, civil society, grassroots organisations, transnational social movement organisations, private voluntary organisations, self-help organisations andnon-state actors (NSA's).

22,3.1 ACRONYMS DEVELOPED AROUND THE TERM 'NGO'

Non- governmental organizations are a heterogeneous group. A long list of acronyms has developed around theterm'NGO'.

These include :

(1) INGO stands for international NGO; An internationalnongovernmental organization (INGO) is a voluntary association of organizations or individuals for worldwide or regional action. The term nongovernmental organization or NGO is sometimes used to describe these groups, although it more correctly refers to an entity working domestically. Both terms, NGO and. !NGO, should be differentiated from intergovernmental organizations or IGOs, which describes groups such as the United Nations or the International Labour Organization

(2) BINGO is short for business-oriented international NGO, or big internationalNGO; BigInternationalNon-GovernmentOrganisation(BINGO)isabackronymapplied to large international non-governmental organizations. These aretypically

organizations with enough resources that they can be expected to act quickly in a global emergency. Some examples of BINGOS are: CARE, Red Cross, Greenpeace.

(3) ENGO, short for environmental NGO, such as Global 2000,Conservation international;

(4) GONGOs are government-operated NGOs, which may have been set upby governments to look like NGOs in order to qualify for outside aid or promote the interests of the government inquestion;

(5) QUANGOs are quasi-autonomous non-governmental organisations, such asthe International Organization for Standardization (ISO). (The ISO is actually not purely an NGO, since its membership is by nation, and each nation is represented by what the ISO Council determines to be the 'most broadly representative' standardization body of a nation. That body might itself be a nongovernmental organisation;forexample,theUnitedStatesisrepresentedinISObytheAmerican National Standards Institute, which is independent of the federal government. However, other countries can be represented by national governmentalagencies; this is the trend in Europe.)

(6) TANGO,shortfortechnicalassistanceNGO;TANGO existswiththegoaltoprovide support and assistance to associations and civic activism, as well as various forms of technicalsupport.

(7) CSO, short for civil society organization; The World Bank interacts withthousands ofCivilSocietyOrganizations(CSOs)throughouttheworldat theglobal,regional, and country levels. These CSOs include NGOs, trade unions, faith-based organizations,indigenouspeoplesmovements,foundationsandmanyother.These interactions range from CSOs who critically monitor the Bank's work and engage the Bank in policy discussions, to those which actively collaborate with the Bank in operational activities. There are many examples of active partnerships in the areas of forest conservation, AIDS vaccines, rural poverty, micro-credit,and internet development.

22.3.2 CLASSIFICATION OF NGOa

There are also numerous classifications of NGOs. The typology the World Bank uses divides them into Operational and Advocacy.

OPERATIONAL : The primary purpose of an operational NGO is the designand implementation of development-related projects. One frequently used categorization is the divisioninto'relief-oriented'or'development-oriented'organisations;theycanalsobe classified according to whether they stress service delivery or participation; or whetherthey are religious or secular; and whether they are more public or private-oriented.Operational NGOs can be community-based, national or international.

ADVOCACY : The primary purpose of an Advocacy NGO is to defend or promote a specific cause. As opposed to operational project management, these organisations typically try to raise awareness, acceptance and knowledge by lobbying, press work and activistevents.

USAIDreferstoNGOsasprivatevoluntaryorganisations.Howevermanyscholarshave arguedthatthisdefinitionishighlyproblematicasmanyNGOsareinfactstateandcorporate funded and managed projects with professional staff.

NGOs exist for a variety of reasons, usually to further the political or social goals of their members or funders. Examples include improving the state of the natural environment, encouraging the observance of human rights, improving the welfare of the disadvantaged, or representing a corporate agenda. However, there are a huge number of such organisations and

their goals cover a broad range of political and philosophical positions. This can also easily be applied to private schools and athleticorganisations.

22.4 METHODS

NGOs vary in their methods. Some act primarily as lobbyists, while others conduct programs and activities primarily. For instance, an NGO such as Oxfam, concerned with povertyalleviation,mightprovideneedypeoplewiththeequipmentandskillstofindfoodand clean drinkingwater.

22.4.1 PublicRelations

Non-governmental organizations need healthy relationships with the public to meet their goals. Foundations and charities use sophisticated public relations campaigns to raise funds and employ standard lobbying techniques with governments. Interest groups may be of political importance because of their ability to influence social and political outcomes. At timesNGOsseektomobilizepublicsupportsuchasthebytheNGOGlobalWarmingAlliance.

22.4.2 Consulting

Many international NGOs have a consultative status with United Nations agencies relevant to their area of work. As an example, the Third World Network has a consultative status with the UN Conference on Trade and Development (UNCTAD) and the UN Economic and Social Council (ECOSOC).

22.4.3 Projectmanagement

There is an increasing awareness that management techniques are crucial to project success in non-governmental organizations. Generally, non-governmental organizations that are private have either a community or environmental focus. They address varieties of issues such as religion, emergency aid, or humanitarian affairs. They mobilize public support and voluntary contributions for aid; they often have strong links with community groups in developing countries, and they often work in areas where government-to-government aid is not possible. NGOs are accepted as a part of the international relations landscape, and while they influence national and multilateral policy-making, increasingly they are more directly involved in localaction.

22.4.4 Self Check Exercise

1. INGO stands for _____________ NGO.
2. BINGO is short for _____________.
3. ENGO, short for environmental _____________, such as Global 2000, Conservation International.

22.5 MANAGEMENT

Two management trends are particularly relevant to NGOs: diversity management and participatory management.

Diversity management deals with different cultures in an organization. Intercultural problems are prevalent in Northern NGOs which are engaged in developmental activities in the South. Personnel coming from a rich country are faced with a completely different approach of doing things in the target country.

A participatory management style is said to be typical of NGOs. It is intricately tied to the concept of a learning organization: all people within the organization are perceived as sources for knowledge and skills. To develop the organization, individuals have to be able to contribute in the decision making process and they need to learn. The management is runby.

22.6 STAFFING

Not all people working for non-governmental organisations are volunteers. The reasons people volunteer are not necessarily purely altruistic, and can provide immediate benefits for themselves as well as those they serve, including skills, experience, andcontacts.

Thereissomedisputeastowhetherexpatriatesshouldbesenttodevelopingcountries. Frequently this type of personnel is employed to satisfy a donor who wants to see the supported project managed by someone from an industrialised country. However, the expertise these employees or volunteers may have can be counterbalanced by a number of factors: the cost of foreigners is typically higher, they have no grassroot connections in the country they are sent to, and local expertise is oftenundervalued.

TheNGOsectorisanimportantemployerintermsofnumbers.Forexample,bytheend of 1995, CONCERN worldwide, an international Northern NGO working against poverty, employed 174 expatriates and just over 5,000 national staff working in ten developing countries in Africa and Asia, and inHaiti.

22.7 FUNDING

Large NGOs may have annual budgets in the hundreds of millions or billions of dollars. For instance, the budget of the American Association of Retired Persons **(AARP)** was over US$540 million in 1999. Funding such large budgets demands significant fundraising efforts on the part of most NGOs. Major sources of NGO funding include membership dues, the sale of goods and services, grants from international institutions or national governments, and private donations. Several EU-grants provide funds accessible toNGOs.

Even though the term "non-governmental organisation" implies independence from governments, some NGOs depend heavily on governments for their funding. A quarter of the US$162 million income in 1998 of the famine-relief organisation Oxfam was donated by the British government and the EU. The Christian relief and development organisation World Vision collected US$55 million worth of goods in 1998 from the American government. Nobel Prize winner Medecins Sans Frontieres (MSF) (known in the USA as Doctors without Borders) gets 46% of its income from government sources.

22.8 Self check Exercise II

4. GONGOs are ______________,
5. QUANGOs are__________________,
6. TANGO, short for ______________;

22.9 MONITORING ANDCONTROL

InaMarch2000reportonUnitedNationsReformpriorities,U.N.SecretaryGeneralKofi Annan wrote in favor of international humanitarian intervention, arguing that the international community has a "right to protect" citizens of the world against ethnic cleansing, genocide, and crimes against humanity. On the heels of the report, the Canadian government launched the Responsibility to Protect R2P project, outlining the issue of humanitarian intervention. While the R2P doctrine has wide applications, among the more controversial has been the Canadian government's use of R2P to justify its intervention and support of the coup inHaiti.

Years after R2P, the World Federalist Movement, an organization which supports "the creation of democratic global structures accountable to the citizens of the world and call for the division of international authority among separate agencies·, has launched Responsibility to Protect - Engaging Civil Society (R2PCS). A collaboration between theWFMand the Canadian government, this project aims to bring NGOs into lockstep with the principles outlined under the original R2Pproject.

The governments of the countries an NGO works or is registered in may require reporting or other monitoring and oversight. Funders generally require reporting and assessment, such information is not necessarily publicly available. There may also be associations and watchdog organizations that research and publish details on the actions of NGOs working in particular geographic or program areas.

In recent years, many large corporations have increased their corporate social

responsibility departments in an attempt to preempt NGO campaigns against certain corporate practices. As the logic goes, if corporations work with NGOs, NGOs will not work against corporations.

22.10 LEGALSTATUS

NGOs are not subjects of international law, as states are. An exception is the InternationalCommitteeoftheRedCross,whichissubjecttocertainspecificmatters,mainly relating to the Geneva Convention.

The Council of Europe in Strasbourg drafted the European Convention on the Recognition of the Legal Personality of International Non-Governmental Organizations in 1986, which sets a common legal basis for the existence and work of NGOs in Europe. Article 11 of the European Convention on Human Rights protects the right to freedom ofassociation, which is also a fundamental norm for NGOs.

An NGO can be formed under various legal identities:

4. Society registered under Societies Registration Act,1860.
5. Trust (Formed under the Trust deed and registered with Income TaxAuthority.)
6. Limited company incorporated under section 25 of the Companies Act,1956

22.11 OLE OF NGOs JN CONSUMERAWARENESS

The need for empowerment of consumers as a class cannot be over emphasized and is already well recognized all over the world. The advancement of technology and advent of sophisticated gadgets in the market and aggressive marketing strategies in the era of globalizationhavenotonlythrownopenawidechoice,fortheconsumerbutallthesamealso rendered the consumer vulnerable to a plethora of problems concomitant to such rapid changes. There is an urgent and increasing necessity to educate and motivate the consumer tobewaryofthequalityoftheproducts,andalsothepossibledeficienciesintheservicesof the growing sector of public utilities. In short, the consumer should be empowered with respect to his rights as a consumer. He should be equipped to be vigilant with a discerning eyesoastobeabletoprotecthimselffromanywrongfulact onthepartofthetrader.Inorder to be able to position the consumer in such a state, there is every need not only to evolve legal remedies but also provide reliable and exhaustive information, which he can access withoutmucheffortandexpense.Recognizingtheimportanceoftheproblem,theGovernment ofIndiaandStateGovernmenthaveinitiatedstepstointroducedisputeredressalmechanism by way of Consumer Protection Act, but a lot more has to be done in the area of creating awareness on the part of the consumer to facilitate his seeking suitable remedy wherever _ there is a need. This becomes more important in the rural areas, where there is widespread illiteracy.

Aided by advances in information and communications technology, NGOs have helped to focus attention on the social and environmental externalities of business activity. Multinational brands have been acutely susceptible to pressure from activists and from NGOs eager to challenge a company's labour, environmental or human rights record. Even those businesses that do not specialize in highly visible branded goods are feeling the pressure, as campaigners develop techniquesto target downstream customers and shareholders.

Steps taken by NGOs to create a facilitative mechanism with the following objectives:

1. Promote General Awareness of the rights of the consumer by encouraging consumer education and supplyinginformation.
2. Publish periodical and product specific booklets, pamphlets, cassettes, CDs,slides,

documentary films and other devices of mass communication for promoting consumer awareness in English and regional languages, highlighting the problem in specified areas like real estate, public utilities, non-banking financial agencies etc.

3. Enlighten the business community on its ethical and legal obligations to maintain quality of the products or services and to be transparent in dealing withconsumers.
4. Encourage consumer activities to strengthen the existing institutional set up of consumer dispute redressal by acting as a facilitator between consumer and the institution.
5. Study the available legal remedies, analyze and suggest new measures for the effective and better consumerprotection.
6. Bring together the consumer, traders and policy makers to exchange information of mutual interest for better coordination. Work together with other NGO's/ Consumer activities operating in different areas and equip them with suitable and required information and knowledge to enable them to act as nodal agents of change in ruralareas.
7. Organize and conduct seminars, workshops and group discussions and thus provide a platform for threadbare discussion of the issues and evolve suitable remedialaction.Conductmotivationalcampaignsforgroupsofpotentialcustomers both in urban and ruralareas.
8. Periodic interaction with electronic and print media on success stories of consumers.
9. Establish links with educational institutions like universities, colleges,high schools to emphasize the need for improving consumer education in the curriculum. Consumer clubs which were started recently by the A.P. Consumer affairs, Food & Civil Supplies Dept. would go a long way in achieving this.

22.15 SUMMARY

The chapter focused on the role NGOs play in consumer awareness. NGOs can be classified as operational and advocacy. NGOs vary in their methods. Some act primarily as lobbyists, while others conduct programs and activities primarily.Consumer should be empoweredwithrespecttohisrightsasaconsumerandmuchofthecreditforcreatingthese trends can be taken byNGOs.

22.6 PRACTICEQUESTIONS

Short Questions:

- **What is the primary purpose of an operational NGO?**
- **Provide examples of acronyms developed around the term 'NGO.'**
- **How do NGOs vary in their methods?**

Long Questions:

1. What do you understand by the term NGOs? List various types of NGOsand them functions?
2. DoNGOshavealegalstatus?AlsoexplainvariousmethodsinwhichNGOsoperate?

22.7 GLOSSARY

World Disarmament Conference- The Disarmament Conference of 1932-34 (sometimes World Disarmament Conference or Geneva Disarmament Conference) was an effort by member states of the League of Nations , together with the U.S. and the Soviet Union, to actualize the ideology of disarmament. It took place in the Swiss city of Geneva, ostensibly between 1932 and 1934, but more correctly until May1937.

Chapter10oftheUnitedNationsCharter-ChapterXoftheUnitedNationsCharter deals with the Economic and Social Council. Article 62 empowers ECOSOC to "makeor

initiate studies and reports with respect to international economic, social, cultural, educational, health, and related matters" and to make recommendations "promoting respect for, and observance of, human rights and fundamental freedoms for all."

Agenda 21- it is a programme run by the United Nations (UN) related to sustainable development. It is a comprehensive blueprint of action to be taken globally, nationally and locally by organizations of the UN, governments, and major groups in every area in which humans' impact on the environment. The number 21 refers to the 21stcentury.

Sustainable development - it is a pattern of resource use that aims to meet human needs while preserving the environment so that these needs can be met not only in the present, but in the indefinitefuture.

22.8 Keywords

Non-Governmental Organizations (NGOs), Consumer Awareness, Advocacy NGOs, Funding Sources for NGOs

22.9 Answers to the Self Check Activities

1. International
2. big international NGO
3. NGO
4. government-operated non-governmental organisations
5. quasi-autonomous non-governmental organisations
6. technical assistance non-governmental organisations

22.10 SUGGESTEDREADINGS

Journals

- Chitra, A. "Role of NGOs in Promoting Environment and Health" in Martin J.Bunch, V.Madha
- Suresh and T. Vasantha Kumaran, eds., *Proceedings of the thirdInternational Conference on Environment and Health,* Chennai, India, 15-17 December, 2003. Chennai: Department of Geography, University of Madras and Faculty of Environmental Studies, York University. Pages 106-112.

MEANING, NATURE AND FEATURES OF A COMPANY

STRUCTURE

23.0. Objectives
23.1. Introduction
23.2. Meaning and Definitions of acompany
23.3. Features of acompany
23.3.1 SELF CHECK EXERCIS I
23.4. A Company is not acitizen
23.5. Lifting the corporateveil
23.5.1 StatutoryException
23.5.2 SELF CHECK EXERCISE II
23.6. Summary
23.7. KeyWords
23.8. Glossary
23.9. Practice Exercise
23.10. Suggested Readings
23.11. Answer to Self CheckExercises

23.0 ·OBJECTIVES

With the fast changes in the economic policies of Indian government, the company form of business has gained a special importance in the economy. The objectives of this lesson is to define clearly the meaning of the word 'company' and also giving main features of a company which differentiate it from other types of business. Some related issues have been discussedinthelessonlike.Citizenshipofacompany,liftingthecorporateveiletc.

23.1. INTRODUCTION

The present Companies Act came into force with effect from 1st April, 1956 but amendedfromtimetotimeaspertherequirementofthecircumstances.TheCompaniesAct abounds in restrictions, approvals, sanctions and punishments. The definition given in the Act is not exhaustive and does not clearly reveal the true characteristic of a company. On being incorporated, a company enjoys certain advantages over other associations. Such advantages which are termed as characteristics or features of a company have alsobeen

· discussed in detail in thislesson.

The Company is not a mere collection of individuals like a partnership firm, but at law it is a separate and different person from its subscribers to the memorandum ofassociation.

23.2. MEANING AND DEFINITIONS OF ACOMPANY

Indian Companies Act, 1956 does not define a company clearly. According to Section 3(11 (i) of Companies Act, a company mean, "A Company formed and registered under and this act or an existing company." An existing company means. "A Company formed and registered un de r any of previous companies Laws." This definition does not clearly reveal the true meaning and characteristicofacompany.Insimplewords,acompanyisanartificialperson, created by law, with a common seal and a permanentexistence.

According to Chief Justice Marshall of U.S . A., "A Company is a person artificial invisible, intangible and existing only in the contemplation of the law " So, o:im pan yexists in the eyes of law and it has no physical existence. Sometimes the term 'corporation' is used for acompany.Howeverthetermcorporationiswiderthanthecompany.A Corporation isanassociationofpersonsincorporatedaccordingtothelawoflandwith alegal personalitywhichis

separatedfromthepersonswhoconstituteit.Acompanyisandsociationofmanyreasons

who contributed money or money worth to a common stock and employed fora common purpose.

If we compare company form of business with other types, it has so many advantages over them. For example, in case of sole trading type of business only one person has to manage all the affairs of the business. Even in case of partnership it is also suitable for small scale business. But in case of a company huge financial resources are available along with having experts to manage the affairs of the company. In this way the company has become the most dominant form of business organisation.

23.3 FEATURES OF ACOMPANY

(11 Separate LegalEntity

A company is an artificial person having a distinct legal entity. A company iscreated by law being invisible and intangible person, but not a natural person. It has individuality. It has power to sue and be sued in its own name, has the right to own property and has theright to enter into a contract with third parties in its ownname.

It's personality is separate and distinct from the personality of those who promote it. This principle was established in the leading cases - **Saloman Va. Saloman& Co. Ltd.** Salomansoldhis businessandformedacompany.Thereweresevenmembers,hiswife,one daughter and four sons, who took 1 share each. S himself took 20,000 shares. He also took debenturesworth10,000pounds.Aftersometime,thecompanywaswound up.Theassetsof thecompanywere6,000poundsonly.Theunsecuredcreditorsweretoreceive7,000pounds and 10,000 pounds were due to S himself. The unsecured creditorsclaimedthat S and his companywerenotdifferententities.So,theyshouldbepaidbackfirst.Itwasheldthat Swas entitled to get 6,000 pounds as the company as an entirely separate fromSaloman.

(2) SeparateProperty

A Company is capable to own, enjoy and dispose off the property. The property of the company will not be considered as joint property of the members, although the capital and assets of the company are contributed by members.

(3) PerpetualSuccession

A Company never dies. It has a permanent tenure. A company is an immortal person. Members may come members may go, company goes on forever . A Company is created by the process of law and can be put to an end only by a legal process. The existence of company is not affected by the death of shareholders. So, even if all members of a company were killed by a bomb, the company will be deemed tosurvive.

(4) LimitedLiability

The liability of members of a company is limited upto the value of shares held bythem. In case of a company limited by guarantee, the liability of the members is limited to such amount as **the** member may undertake to contribute to the assets of the company in the event of winding up of the company. It is this reason why a great many people invest theirmoney in company form of business.

(5) CommonSeal

A company being an artificial person can not sign its name on any document. So, a common seal is a substitute of signatures for a company. Every companymusthave a seal with company's name embossed on it. This seal should be present on each and every document related to the company and on every contract entered in on behalf of the company. A document not bearing the name of the company can not put any bindingonthe company.

(6) Transferability orShares

If a shareholder of a company is no more interested in continuing as a shareholders hecantransferhissharesinsharemarket.Thesharesofa companyarefreelytransferablein the market provided the manner is same which is provided in the articles. But this is an absoluterightofashareholder.Inthecaseofaprivatecompany,transferofsharesisgenera lly notpermitted.

SELF CHECK EXERCISE NO. I

Fill in the Blanks:

1. A company is created by law, with a ________ and a permanent existence.
2. The doctrine of lifting the corporate veil may be applied in cases of fraud or ________________ conduct.
3. If the number of members of a company falls below the statutory requirement and the company carries on business for more than 6 months, the members will be liable for the payment of the whole __________ of the company.

23.4 A COMPANY IS NOT ACITIZEN

Acompanybeinganartificialpersoncanbesuedanditcanholdpropertyalso.Butn o provision of Company's Act expressly confers citizenship. A company does not enjoy the fundamental rights of an Indian citizen. Although company has no citizenship, it has domicile, nationality andresidence.

A Company can have only one nationality and one domicile but may have several residences at the same time.

23.5 LIFTING THE CORPORATE VEIL

A company has a different identity and members have different. This principle is regarded as a curtain, a veil or shield between the company and its member, thus protecting the latter from the liability of the former.

Example: Where the business of lady was in the name of the company, Lady's attempt to regain tenanted area for self business could not succeed. The courts have also given the decision which are strongly in favour of the principle of Separate Legal Entity.

The rule of separate legal entity cannot be pushed to unnatural limits. Circumstances may occur which compel the courts to identify a company with its members. When the notion of legal entity is used to defeat public convenience or to protect fraud, the law will not regard the company as a separate entity.

SC also observed that lifting of the corporate veil is permitted in the expanding horizon of modern jurisprudence. But it must depend primarily on the realities of the situation. The corporate veil has been lifted in the following case:

(1) **Determination orCharacter**

A company is not a natural person with any mind/conscience. But it may assume when persons who have effective control over affairs of the company, are residents in any enemycountry.Intimesofwar,thecourtwillliftheveiltosee whetherthecompany'saffairs are controlled by alien enemy. A company being an artificial person, cannot be loyal or disloyal,friendorenemybutitmayassumethecharacterofanenemyifpersonsindefector control of its affairs, are residents in any enemycountry.

(2) **Where Company la aSham**

If the Company is a mere cloak or sham, court can lift the veil e.g. if the company is formed for some illegal or improper purposes.

In P.N.B. Finance Vs. Shital Prashad, when a person borrowed money from a company

and invested it in3different companies in which he and his son were the only members the lending company was permitted to attach the assets of all 3 companies as they were created to hood wink the lendingcompany.

(3) Fraud or ImproperConduct

If the company is formed for some fraudulent purpose or to avoid legal obligations, the court veil.

In Gilford Motor Co. Ltd. Vs. Home, when even being appointed as ManagingDirector oi the company with the condition that Home will not solicit the customers of the company. He formed a new company to carry on same business. An injunction was granted against Home and his company both because the court held that the company was a mere cloakfor defendant to commit a breach of agreement.

(4) Where the Company is acting as the Agent of the Shareholders

Ifa company is acting as an agent of its shareholders or another company e.g. A government company is not an agent of the state unless it is performing subsistence governmental or sovereign functions.

(5) Protection or Revenue

The court may lift the corporate veil if corporate entity is used for tax evasion.Supreme Court held that the income tax authorities are entitled to pierce the veil of corporateentityand to look at the reality of the transaction.

In Sir DinashawMancekjee Petit case, D was a man getting huge dividendsand incomes. In orders to avoid tax, he formed four private companies. Dividends received were credited in the account of **the** company and amount was handed back to him as loan. The Court held that as the companies did no business, the 4 companies were noting more than he himself.

(6) Avoidance of WelfareLegalization

Avoidanceofwelfarelegislationisascommonasavoidanceoftaxation.Itistheduty of the court in such a case to go behind the screen and discover the true state of affairs. In such a case the Supreme Court disregarded the existence of a separate company for the purpose of working out bonus of itsemployees.

23.S.1 STATUTORY EXCEPTIONS

(1) Numbers of Member• below StatutoryRequirement

If the number of members of a company is reduced below two in case of a private· company or below seven in case of a Public Company and the company carries on business formorethan6months,thenthememberstowhomthisfactwasknownwillbeliableforthe paymentofthewholedebtofthecompanycontractedduringthattime.Thegeneralruleunder normal circumstances is that the company's debts cannot be enforced against the members.

(2) Failure to Refund ApplicationMoney

If such amount is not returned within 130 days the directors shall be jointly and severally liable to repay that money with interest at the rate 6% per annum.

(3) Name of the Company not mentioned on BW orExchange

lf any concerned person/officer of the company signs a bill of exchange, cheque or promissory note etc. on behalf of the company, and company's name is not properly mentioned on it, he is personally liable e.g. The real name of a company was "L and R Agencies Ltd." and it was written as "L.R. Agencies Ltd." by the directors. The directors were held personally liable for a cheque signed them as mentionedabove.

(4) GroupAccounts

The principle of separate legal entity may be disregarded where a company has subsidiaries and group accounts must be laid before the company in general meeting when the company's own profit and loss account and balance sheet is so laid.

SELF CHECK EXERCISE NO. II

4. True or False: A company, as described by Chief Justice Marshall, has a physical existence.
5. True or False: The corporate veil can be lifted in cases where a company is formed for fraudulent purposes or to avoid legal obligations.

(5) FraudulentTrading

Ifduringthecourseofwindingupofacompanythebusinessofcompanyiscarriedon with an intention of defrauding the creditors, the court may declare that any persons who wereknowinglypartiestothecarryingonofsuchbusinessaretobepersonallyliableforthe debts and other liabilities of thecompany.

(6) Inve1tlgatlon Into relatedCompanie•

An inspector appointed by Central Government may lift the veil of incorporation if he thinks it necessary specially in case of investigating the affairs of holding and subsidiary company.

The doctrine of lifting the corporate veil does not extend to statutory corporations and their members cannot claim any benefit which is not legally available to such corporations, unless there is any specific provisions in the statute in this regard. Further, the corporate veilcannotbeliftedincaseofGovernmentcompaniessoastoenabletheemployeesofsuch companies to claim the statute of Governmentemployees.

23.6 SUMMARY

Meaning and Definition for a Company

The Indian Companies Act, 1956, Sec 3(1) (i), defines a company as a company formed and registered under this Act or an existing company. In general, a company is an artificial person created by law, with a common seal and perpetual succession. A company has no physical existence and sometimes it is confused with a corporation. But corporation is a wider term than company.

Features or a Company

The main features of a company are as under:

1. Separate LegalEntity
2. SeparateProperty
3. PerpetualSuccession
4. LimitedLiability
5. CommonSeal
6. Transferability ofShares

A Company Is not a Citizen

No provision of Companies Act expressly confer citizenship to a company. But a company has a nationality, domicile andresidence.

Lifting the Corporate Veil

The company has a different entity and members and directors have different entities.

But certain circumstances give'! the court a pow r to lift the corporate veil to go through the matter properly. The corporate veil has been lifted in following cases:

1. Determination ofcharacter
2. Where company is asham
3. Fraud or improperconduct
4. Where the Company is acting as an agent of theShareholders
5. Protecting theRevenue
6. Avoidance of WelfareLegislation.

Along with the above mentioned cases, there are some statutory exceptions also when the court can lift the corporate veil.

23.7 KEYWORDS

Company, Corporate Veil, Limited Liability, Perpetual Succession

23.8 Glossary

Word	**Meanings**
Perpetual Succession	Permanent Existence
Embossed	Design or word sticks up slightly from the surface Period
Tenure	of Time
Seal	An Official mark which confirms the legality of documents Something
Alien	that belongs to a different country
Veil	Something that hides an activity or situation

23.9 Practice Exercise

Short Questions:

- Define a company according to the Indian Companies Act, 1956.
- What is the significance of the principle of "Separate Legal Entity" for a company?
- Explain the role of a common seal for a company.

Long Questions:

- Discuss the main objectives of the lesson on "Meaning, Nature, and Features of a Company." How has the economic environment influenced the importance of the company form of business?
- Examine the challenges in defining a company as per the Indian Companies Act, 1956. How does the Act's definition fall short in capturing the true characteristics of a company?
- Elaborate on the features that make a company a separate legal entity. Use relevant examples to illustrate the practical implications of this principle.

23.10 SUGGESTED READINGS

1. Business Environment by K. Aswathappa
2. Business Environment by Francis Cherunilam
3. Consumer Protection in India by Neeraj Kumar

23.11 ANSWERS TO SELF CHECKEXERCISES

1. common seal
2. improper
3. debt
4. False
5. True

KINDS OF COMPANIES

STRUCTURE

24.1 Objectives
24.2 Introduction
24.3 Kinds ofCompanies
24.3.1 On the basis ofIncorporation
24.3.2 On the basis ofLiability
24.3.3 On the basis ofMembership
24.3.3.1 Difference between a public and a privatecompany
24.3.3.2 Conversion of a private company into a public company
24.3.3.2.1 SELF CHECK EXERCISE-I
24.3.4 On the basis ofControl
24.3.5 On the basis ofOwnership
24.3.6 On the basis ofNationality
24.4 One Man Company and IllegalAssociations
24.4.1.1 SELF CHECK EXERCISE- II
24.5 Summary
24.6 KeyWords
24.7 Glossary
24.8 Suggested Readings
24.9 Answers to Self CheckExercise

24.1 OBJECTIVES

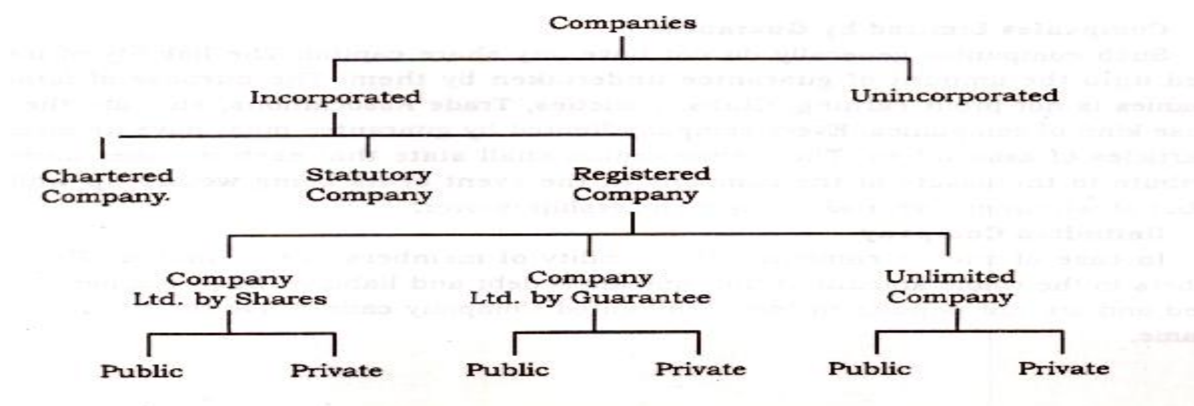
A joint stock company which is an artificial person created by law has so many kinds. A company can be divided in so many kinds on the basis of some points which have been given in the following lesson.

24.2 INTRODUCTION

A company is different from other forms of business organisation like sole trading, partnership and HUF, etc. A Joint Stock Company has to follow the provisions laid down in the Companies Act 1956. A company may be of a different type in comparison with a company also. For, different types of companies, different provisions are to be followed at formation stage or even for day to day working.

24.3 KINDS OFCOMPANIES

A joint stock company has following which can be clearly understood with the help of achart.



24.3.1 ON THE BASIS OFINCORPORATION

(I) **CharteredCompanies**

In earlier days, trading companies were often created by royal charter. The 'crown'in the exercise of the ro'al prerogative had power to create a corporation by the grant of a character to persons assenting to be incorporated. These type· of companies are known as charteredcompanies.EastIndiaCompanyandBankofEnglandaretheexamplesofsuchtype of companies.

(II) **StatutoryCompanies**

The company which is formed by passing a special Act of the parliament or anyState Legislature are known as statutory companies. Generally the purpose or formation of such companies is to create special public undertaking e.g. Railways, Electricity Generation, Reserve Bank of India, Life Insurance Corporation, State Trading Corporations, Unit Trust of India, Food Corporation of India, State Financial Corporations, etc. These companies have to follow the provisions of Companies Act 1956, if no other provisions are given in the Act creating them. Even changes in their structure are possible only by Amendment in the Act crating them. A statutory company although owned by Government, but has a separateentity.

(iii) **Registered Companies**

A company formed and registered under Companies Act 1956, or any of the earlier Companies Act are registered companies. A registered company may be limited by Shares or limited by guarantee.

24.3.2 ON THE BASIS OFLIABILITY

(i) **Company Limited byShares**

Thistypeofcompanyisverycommonandpopularalso.Iftheword'Company' is pronouncedthefirstthingcomesintomindisacompanylimitedbysharesIncaseofsuch companies,theliabilityofthemembersislimiteduptothevalueofsharesheldbytheme.g.Ifa person has purchased 1000 shares of value of Rs. 10 each, it means during thelifetimeofthecompanyliabilityofthismemberislimitedupto Rs.10,000only.Eveninextraordinarycircumstances, a company cannot ask any shareholders to contribute more than thevalueofshares (unpaid) held by them. The personal property of a member is entirelyhispersonalaffairscompanyinwhichhehasinvestedhismoneyinformsofshares,hasnorightoverhispersonal property.

(HI **Companies Limited byGuarantee**

Such companies generally do not have any share capital. The liability of members is limited upto the amount of guarantee undertaken by them. The purpose of forming such companies is not profit earning. Clubs, Societies, Trade Associations, etc., are the examples of these kind of companies. Every company limited by guarantee must have its memorandum and articles of association. The memorandum shall state that each member undertakes to contribute to the assets of the company in the event of its being wound up while he isa member or within one year after his membership isover.

(HI) UnlimitedCompany

In case of such a company, the liability of members is not limited. The liabilityof members to the whole amount of the company's debt and liability. Such companies are rarely formedandarenotpopularinIndia.UnlimitedCompanycannotusetheword 'Limited' with its name.

24.4 ON THEBASIS OF MEMBERSHIP

(I) PrivateCompany

This type of companies are suitable for carrying on, family business or small scale business. The Companies (Amendment) Act, 2000, explains it as a company which has a minimumpaid-upcapitalofonelakhrupeesorsuchhigherpaidupcapitalandbyitsarticles:

(a) restricts the right of transfer ofshares'
(b) should have minimum 2 member and maximum number of members can not exceedfifty;
(c) prohibitsanyinvitationtopublictosubscriberforanysharesordebenturesofthe company;
(d) prohibits any invitation or acceptance of deposits from person other than its members, directors and theirrelatives.

If 2 or more members are jointly. holding shares/shares in the company, they will be treated as a single member. A private company can not even public to pay shares, oral or written.Asper theCompanies(Amendment)Act2000,aprivate-Company(existing)withapaid up capital of less than one lakh rupees, shall within 2 years, enhance its paid up capital to one lakhrupees.

(II) Public Company

Indian Companies Act defines a Public Company as a company which is not a private company. Minimum there should be 7 members to form a public company but there is no limit of maximum number of members. A public company have a minimum paid up capital of five lakh rupee!! or such higher paid up capital as may be prescribed. A private company which is a subsidiary of a Public Company is a publiccompany.

24.3.3.1 DIFFERENCE BETWEEN A PUBLIC AND A PRIVATECOMPANY

1. **A** private company can start the business with minimum 2 members and a public company can start business with minimum 7members.
2. The maximum limit of members in case of private company is 50, but there is no such limit prescribed for a publiccompany.
3. A private company can start business immediately on incorporation. A public company can not start business before getting a certification of commencement ofbusiness.
4. A private company must add the word 'Private Limited' at the end of its name but a public company can end its name with the word 'Limited'only.
5. , A private company can not issue the prospectus. But there is no such restriction for a publiccompany.
6. There is no restriction on the transfer of shares of a Public Company whereas a private company by its articles must restrict the right of members to transferthe shares.
7. A public company can issue share warrants but such a right is not given to a private company.
8. A public company must have a least 3 directors whereas a private company mayhave at least 2 directors.
9. A public company must hold statutory meeting, but this is not necessary for a private company.
10. In case of a public company, 5 members should be personally present in themeetings and in the case of a private company at least 2 members should be personally present to complete theQuorum.

11. In case of a public company, 2/3rd of the directors of the company must retire by rotation. These restrictions do not apply to a privatecompany.
12. Apubliccompanyisrequiredtofileastatementinlieuofprospectuswiththe Registrar of companies, if it does not issue a prospectus. A private company is exempted form this requirement.
13. Directors of a private company may be appointed by a single resolution, but it is not so incaseofapublic company. In a public company, each director is to be appointedby a separate resolution.
14. Ina private company, there is no restriction on exceeding the number ofdirectors beyond twelve. But in case of a public company if number of directors is to be increased beyond twelve, approval of Central Govt. is necessary.
15. A private company must have a minimum paid-up capital of Rs. Onelakhbut a public company must have a minimum paid-up capital of Rs. Five lakhs.

24.3.3.2 CONVERSION OF PRIVATE COMPANY INTO A PUBLIC COMPANY

A private company may become a public company by any mode like-conversion by default, or conversion by choice.

On the conversion of a private company into a public company, no new company comes into existence. As such conversion does not affect the identity of the company. The power u/s 43, for making default in complying with conditions, has been vested withCentralGovernment.

24.3.3.2.1 SELF CHECKEXERCISE-I

1. On the basis of Incorporation, which type of company is created by a royal charter?
   - A. Statutory Companies
   - B. Registered Companies
   - C. Chartered Companies
   - D. Limited Companies
2. What type of company does not have any share capital, and its members' liability is limited by guarantee?
   - A. Private Company
   - B. Public Company
   - C. Unlimited Company
   - D. Companies Limited by Guarantee
3. According to the Companies Act 1956, what is the minimum number of members required to form a public company?
   - A. 2 members
   - B. 5 members
   - C. 7 members
   - D. 10 members
4. What type of company is suitable for family businesses or small-scale businesses?
   - A. Public Company
   - B. Private Company
   - C. Government Company

- D. Chartered Company

5. In the context of a public company, what is the minimum paid-up capital required as per the Indian Companies Act?
   - A. Rs. 50,000
   - B. Rs. 1 lakh
   - C. Rs. 2 lakhs
   - D. Rs. 5 lakhs

24.4.2 ON THE BASIS OFCONTROL

Holding Company and Subsidary Company

A company which controls another company is known as the 'holding' Company.

According to Section 4 of Companies Act 1956, a holding Company is that which

(a) controls thecomposition of Board of Directors of another Companyor
(b) holds more than half of the nominal value of equity share capital ofanother company or
(c) isa subsidiary of any company which is in tum a subsidiary of anotherCompany.

For Example:

If X is Holding Company and Y is a Subsidiary Company. The Co. X should fulfil the conditions related to Holding Company. If Co. X controls composition of Board of Directors of Co. Y or if Co. X holds than half of Y's Equity share capital or if there is a company Z which is a Subsidiary Co. of Company Y then, automatically Co. Z is also a subsidiary ofCo. X.

24.3.S ON THE BASIS OF OWNERSHIP

(l) Government Company

Section 617 of Companies Act defines a Government Company as a Company inwhich notless51% ofpaidupsharecapitalisheldbyCentralGovernmentorbyStateGovernments or partly by the Central Government and partly by one or State Government or Governments. It also includes a Company which is asubsidiary of a Government Company. The Actlays

down certain special provisions for government companies like • appointment of auditor, submission of audit report to the Comptroller and Auditor-General of India, presentation of annual reports before both the house of parliament, etc. But a Government company also has a separate legal entity. In a related case, the Chief Justice of India, 1982 observed that even though the entire share capital of a company has been subscribed by the Government of India, it can not be predicted that the companies themselves are owned by the Government of India. The companies incorporated under Companies Act, have a corporate personality of their own, distinct form Government of India. The Govt. can only owns the sharecapital.

(U) Non-Government Companies

Those companies in which Govt. is not the Controlling Authority but private hands have the control over the functioning of the Company are known as Non-governmentcompanies.

24.3.6 ON THE BASIS OF NATIONALITY

(I) **IndianCompanies**

The Companies which are formed and registered under Indian Companies Act or any of the Companies'Act.

(U) **ForeignCompanies**

Foreign Company is a Company which is incorporated outside India and establishes a place of business in India Section 591, defines a foreign company as a Company incorporated outside India

(a) and has established a place of business within India after the commencement of this Act

(b) which had a place of business within India before the commencement of this Act and continues to have the same at the commencement of thisAct.

A foreign Company must have a place of business in India. A foreign controlled company is different from a foreign company. A company will be established a place of business in India if it has a specific place at which it carries on business such as an office, store house, godown, etc. The word 'establish' means more than occasional connection. A foreign Company has to follow certain rules of the Companies Act.

Every foreign Company shall, within, 30 days of the establishment of the business in India and will also furnish certain documents with the registers. Once in every Calendar Year, a foreign Company has to get prepared its balance sheet and profit and loss account. Every foreign Company shall exhibit on the outside of every office or place of business its name and the country of incorporation in English and in one of the local languages. Any process, notice or other documents may be served on a foreign Company by addressing the same to the authorised person of the Company and .either left at his address or sent to the address by post. The Act also imposes certain penalties also in case of noncompliance with any of the provisions.

24.4 ONE MAN COMPANY AND ILLEGALASSOCIATIONS

In such companies, one man virtually holds the whole of share capital with a few extra members holding the remainder. Being the large holder, such person enjoys complete control over the company. He is, thus, in a position to enjoy the profits of the business with limited liability. Example of this is Saloman V/s. Saloman & Co. Ltd. Case. Like any other Company it has a legal entity different from its members.

IllegalAssociations: Section11providesthatnocompany,associationorpartnership consisting of more than 10 persons in case of banking business or more than 20 persons in case of any other business has for its objects the acquisition of gain can be legallyformed

unless it is registered under the Companies Act or is formed in pursuance of some other India law. An illegal association under this section is not an association for illegal purpose. The illegality of an association cannot be cured by subsequent reduction of the number ofitsmembers.

CONSEQUENCES OF ILLEGAL ASSOCIATIONS

i. Every member of such an association shall be personally liable for all liabilities incurred in such business and shall also be liable to a fine which may extend upto Rs 1,000.

ii. Anillegalassociationcan not,seetorecoveranydebtorotherproperty.Butsuch an association may get itself registered and after becoming legal may enforceits claims.

iii. Such an association cannot be dissolved under the act either at the instance of a creditor, member or the association itself. Such an association cannot be wound up even under the provisions relating to winding up of unregistered companies.

Every person who is a member of a company, association or partnership formed in contravention of Section II shall be punishable with fine which may extend to ten thousandrupees.

24.4.1.1 SELF CHECK EXERCISE- II

6. A private company can issue share warrants.
   - True / False
7. A public company must have at least 3 directors.
   - True / False
8. A company incorporated outside India and establishing a place of business in India is considered a foreign company.
   - True / False
9. The Companies Act requires a private company to file a statement in lieu of prospectus with the Registrar of Companies if it does not issue a prospectus.
   - True / False
10. In the context of illegal associations, an association formed in contravention of Section 11 can be dissolved under the Act.
    - True / False

SUMMARY

The lesson includes different kinds of companies, on the basis of some factors:

1. On the basis of Incorporation, a Company can be divided in three types, viz. Chartered companies, Statutory companies and Registeredcompanies.
2. On the basis of Liability of Company may be limited by share or limitedby guarantee or even unlimited Company.
3. On the basis of Membership a Company may be a PublicCompanyor a Private Company. A Private Company can also beconverted into a Public Company.
4. On the basis of Control, Companies can be divided in holding andsubsidiary companies. .
5. On the basis of Ownership, a Company may be a Government Companyor a Non-Government Company.
6. On the basis of Nationality, Companies may be Indian or ForeignCompanies. A foreign company has to follow the special provisions meant under the Act, for such companies. In the end, one more type of companies has been discussed which is one man Company.

24.6 KEYWORDS

Company Types, Incorporation Criteria, Liability in Companies, Government vs. Private Entities

24.7 Glossary

Word	Meaning
Non-compliance	Not fulfilling any provision
Conversion	Tochange
Extraordinary	Notcommon
Prohibit	Tostop

24.8 Practice Exercise:

- **Short Questions:**
- Define Chartered Companies. Give an example of a Chartered Company.
- What is the key characteristic of a company limited by shares? Explain briefly.
- What are the criteria for a company to be classified as a Private Company?
- Differentiate between a Public Company and a Private Company.
- Explain the concept of a Holding Company and its criteria under the Companies Act 1956.

- **Long Questions:**
- Describe the different types of companies based on their incorporation, focusing on Chartered Companies, Statutory Companies, and Registered Companies. Provide examples for each.
- Discuss the characteristics and criteria that define a Private Company. How can a Private Company be converted into a Public Company?
- Explore the differences between a Public Company and a Private Company, considering factors such as the number of members, business commencement, and share transfer restrictions.
- Provide an overview of Government Companies, including the criteria for their classification and the special provisions outlined for them under the Companies Act.
- Differentiate between Indian Companies and Foreign Companies, detailing the rules and regulations that foreign companies must adhere to when establishing business in India.

24.9 SUGGESTED READINGS

- Business Environment by K. Aswathappa
- Business Environment by Francis Cherunilam
- Consumer Protection in India by Neeraj Kumar

24.10 ANSWER TO SELF CHECKEXERCISE

1. C. Chartered Companies
2. D. Companies Limited by Guarantee
3. C. 7 members
4. B. Private Company
5. D. Rs. 5 lakhs
6. False
7. True
8. True
9. True
10. False

Lesson No. 25 **AUTHOR: LOVELEEN VEENA**

PROMOTION AND REGISTRATION OF A COMPANY (FORMATION OF A COMPANY)

STRUCTURE

25.1 Objectives
25.2 Introduction
25.3 Promotion Stage
25.4 Self Check exercise 1
25.5 Registration Stage
25.6 Commencement of Business
25.7 Preliminary Contracts
25.8 Self check exercise II
25.9 Answers to Self-check questions
25.10 Keywords
25.11 Suggested Reading
25.12 Suggested Questions

25.1. OBJECTIVE

When a company is to be formed by a group of individuals, certain basic steps are necessary. What should be the capital of a Company, whether the money will be raised by the issue of shares or by shares and debentures and the source from which it is to be raised. All this is to be decided by certain persons known as Promoters. There are several stages in the formation of a company which we will discuss in this chapter.

25.2. INTRODUCTION

When a group of persons desires to form a Company for the purpose of carrying on a business, certain steps are to be taken before the work of formation of a company which are taken by promoters. In order to form a company a number of documents are filed with the Registrar of Companies. The formation of a company is a lengthy process. These are four stages of formation of a company.

1. Promotion Stage
2, Incorporation Stage
3. Subscription Stage
4. Commencement Stage

25.3. Promotion Stage

In this stage, the idea for the formation of a company is conceived by the individuals. To give practical shape to the idea conceived they have to take the help of several experts. The persons who conceive the idea are called promoters and the process by which a company is incorporated is known as promotion. Promotion may be defined, according toGestenberg as, "The discovery of business opportunities and the subsequent organization of funds property and managerial ability into a business concern for the purpose of making profits there form". The promotion of company involves

(a) Discovery of an Opportunity
(b) Detailed investigation of the Idea
(c) Estimation of Capital
(d) Acquisition of Assets
(e) Recruitment of Staff and
(f) Incorporation of a Company

Promoter

To form a company, some persons must conceive the idea that they act as the pioneers of the Company. The persons who act as pioneers of the Company are known as the promoters. It is difficult to give statutory definition of the word promoter because it is nowhere explained in Company Law, The promoters carry considerable risk because if the idea sometimes goes wrong the time and money spent by them are in vain.

Legal Position of Promoters

A promoter is neither trustee nor an agent of the company because neither the trust nor the principal exists at the time of his efforts. The promoters stand in fiduciary capacity to thecompany. The principles of agency and trusteeship, however are applicable to the promoters because the promoter is bound to disclose the material facts including the profit made if any, to the company. `

The Promoters

(i) Must not make any secret profit in the transaction made by him on behalf of the company.

(ii) Must not use his position unreasonably or undue influence of the position must not be made.

(iii) Must disclose all the material facts to the company.

PROMOTER'S DUTIES

The following are the duties of promoters:

(1) **To disclose the Secret Profits**

The promoters of a company must disclose all the money secretly obtained by way of profit, no doubt he is empowered to deduct the reasonable expenses incurred by him,

(2) To disclose all the Material Facts

The promoters should actively disclose all material facts. Now, the question arises as to when the material facts be disclosed. It is quite clear with the case of Salomon Vs. Salomon &Co, The disclosure must be made to the shareholders as a body and not to a selected circle of the promoter's nominees.

(3) He must make good to the damages to the Company what he has obtained as a Trustee

A promoter stands in a fiduciary position to the Company. It is his duty to make good to the Company what he has obtained as trustee and not what he may get at any time.

(4) Duty of Promoter against the Future

When it is said that promoters stand in a fiduciary position to the company then it does not mean that they stand in such relation only to the company or for the signatories of memorandum but they stand in this relation to the future allottees of shares also.

(5) Duty to Disclose the Private Arrangements

It becomes the duty of the promoters to disclose all the private arrangements resulting his profit by the promotion of the company.

PROMOTER'S LIABILITIES

The following are the liabilities of the promoters:

(1) Liability to account for Profit

The promoters stand in a fiduciary position to a company. Any profit made by the promoter after the existence of the company must be fully disclosed to the company. He cannot retain any profit made out of the transaction to which he is party without account of it

to company. The company may adopt any one of the following two courses if the promoter fails to disclose the profits.

(i) It may sue the promoter for an amount of profit and recover the same with interest.

(ii) It may rescind the contract and can recover the money paid. •

(2) Liability towards Misstatement in the Prospectus

If promoters make any default on the issue of prospectus then they are liableto the shareholders for the misstatement therein. They may be held liable for breach of trust also.

(3) Personal Liability

A promoter is personally liable for all contracts made by him on behalf of the company until the contracts have been discharged by the company **or** the company takes over the liability of the promoter.

The death of a promoter does not relieve him from his liabilities.

RIGHTS OF PROMOTERS

(1) Right to receive the Legitimate Expenses

A promoter is entitled to receive the legitimate expenses incurred in forming to company such as cost of advertisement, fee of solicitor, etc. The right to receive his expenses is not a **contracted** right. It depends upon the discretion of the directors. The claim of such expenses must be supported by valid vouchers,

(2) Right to receive the Remuneration

A promoter is empowered to receive the remuneration against the services rendered to the company i.e. Commission profit,lumpsum or he may be paid in cash, or the payments any be made partly by shares or partly in cash,

(3) Right of Indemnity

Where more than oneperson acts as the promoter of a company, one promoter can claim against another promoter for thecompensation and damages paid by him. Promoters are jointly and severally liable for the untrue statements in the prospectus and for secret profits.

25.4 SELF-CHECK EXERCISE- I

Q1. Who is a promoter?

Q2. Describe the relationship of promoters with the company?

25.5. REGISTRATION STAGE

The Second step is formation after promotion or incorporation stage. When promotional work is completed by the promoters they come together and take decisions regarding the following:

(I) Availability of Name

A Company may adopt any name it likes provided the name does not closely resemble with name of any other company and is not identical. To take approval **of** the name an application is filed with the department of the Law Administration, Govt. of India through the Registrar of Companies of the State concerned. The application should be filed with the Registrar prescribed fee of Rs. 10/- and as many names as possible should be given in it.

(2) Documents to be filed with the Registrar

An application of Registration should be given to the Registrar of Companies of the State, along with the following documents:

(i) The Memorandum of Association.

'(ii) The Articles of Association (Duly signed by the subscribers to Memorandum)

(iii) Any Agreement about the Appointment of Managing Director/whole time Director/ Manager.

(iv) A statement of nominal capital.

(v) Address of the Registered Office of the Company.

(vi) A list of Directors.

(vii) An undertaking by Directors for taking qualification shares.

(viii) A declaration that all the requirements of the Act have been complied with.

If the Registrar is satisfied with all the documents delivered, he shall retain and register the memorandum and the articles. He will register the company and place its name of the Register of the Companies.

For the approval of name of the company, to whom the application is filed?

(3) Certificate of Incorporation

The Registrar will issue a certificate of incorporation that the company incorporated. The legal effects of incorporation is as under:

(i) A company gets a separate entity from its members and it becomes a legal person.

(ii) A company has a perpetual succession and common seal.

(iii) The company becomes an immortal being. It remains an existence until it is dissolved by liquidation.

(iv) Company's debts and liabilities are only its own obligations and individual shareholders are not concerned with it.

The issue of certificate is the conclusive evidence of the fact that is incorporated and the requirements of the Companies Act have been complied under section 35. If once the certificate is issued the court cannot go behind it and the existence of a company cannot be questioned. There is nothing to be inquired regarding the prior proceedings.

25.6 COMMENCEMENT OF BUSINESS

A private company may commence its business immediately on incorporation but a public company cannot commence business immediately after incorporation unless it has obtained a certificate of commencement from the Registrar.

If the company has a share capital and had issued a prospectus inviting the public to subscribe for its share or debentures, it cannot commence business until:

(a) shares payable in cash have been allotted to the extent of the minimum Subscription

(b) Every director has paid in cash the application and allotment money on the shares taken by him:

(c) No money is liable to be repaid to the applicants for failure to apply or obtain permission for the ***shares*** of debentures to be dealt in on any recognised stock exchange;

(d) A statutory declaration duly verified by one of the directors or secretary or where the company has not appointed a secretary, a secretary in the whole time practice In the prescribed form that the above conditions have been complied with has been filed with the Registrar (Section 149(1)).

If the company has a share capital but has not issued a prospectus to the public, it shall not commence the business unless:

(a) Statement in lieu of prospectus has been filed with the Registrar;

(b) Every director has paid in cash the application and allotment money in the shares taken by him;

(c) A statutory declaration duly verified by one of the directors or the secretary or where the company has not appointed a secretary, a secretary in whole-time practice in the prescribed form that the above conditions have been complied with has been filed with the Registrar (Section 149 (2)).

On the above requirements being duly fulfilled the Registrar shall certify that the

Company is entitled to commence business. This certificate is a conclusive evidence that the company is so entitled (Section 149

Any contract made by the company before it has obtained the certificate of commencement is provisional only and does not become binding on the company until it has become entitled to commence business (Section 149 (4)).

A company is bound to commence business within a year of its incorporation or else it is liable to be wound up by the National Company Law Tribunal (Section 433 (C).

25.7. PRELIMINARY CONTRACTS

Preliminary contracts are those which are made by the promoters with different parties on behalf of the company, which is yet to be formed. The promoters act as agents or trustees of the company which is not existence so far. Hence, the contract made by the promoters are the personal liabilities of the promoters. Company can neither sue nor it can be sued by the other party. Company cannot ratify such contracts even after its incorporation, the reason being that existence of principal on the date of contract is necessary and which is not the only way to save the promoters is to take contract by the company with the party on the same line and the pattern on which the contracts were made by the promoters.

POSITION OF PROMOTERS AS REGARD TO THE PRELIMINARY CONTRACTS

1. Company not bound by Preliminary Contracts

A company when it comes into existence, is not bound by a preliminary contract even where it takes benefit of the contract entered into on its own behalf.

Example

A solicitor prepares the memorandum and articles of Association and paid the necessary registration fees and other incidental expenses to obtain the registration of a company. He did it on the instructions of certain persons who later became directors. He claimed his fees and expenses on the liquidation of the company. The court of Appeal held that the company was not liable to pay the solicitor's costs though it had taken the benefit of his work (Re-English and Colonial Produce Co, Ltd. (1906) 2 ch. 435 (CA)).

2. Company cannot enforce Preliminary Contract

The company cannot, after incorporation, enforce the contract made before its corporation. A company cannot sue a person who before its incorporation had contracted to buy its shares.

Example

A company agreed with Mrs. C, an agent of syndicate before its incorporation that N company would grant a mining lease to the syndicate. The Syndicate was incorporated as P Company. P Company discovered coal where upon N Company refused to grant the lease. The Privy Council held that there was no binding contract between N company and the P Company latter was not in existence when the contract was signed (Natal land and Colonisation Company V. Pauline Colliery and Development Syndicate Ltd. (1904)A.C.120).

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3. Promoters Personally Liable

The promoters remain personally liable on a contract made on behalf of the company not yet in existence. Such a contract is deemed to have been entered into personally by the promoters and they are liable to pay damages for failure to perform the promises made in the company's name, even though the contract expressly provides that only the company shall be answerable for performance.

Example

Kelner V. Baxter, (1866) LR. 2CP, 174. A hotel company was about to be formed, and persons responsible for the new company signed an agreement on 27th January, 1966, for

the purchase of stock on Behalf of the proposed company, payment to be made on 28th January 1866. The company was incorporated on 20th February, 1996. The goods were consumed in the business and the company went into liquidation before the debt was paid. The persons signing the agreement were sued in contract. Held, the persons signing were promoters and personally liable on their signatures.

RATIFICATION OF PRELIMINARY CONTRACT

A company cannot ratify a contract entered into by the promoters on its behalf before its incorporation. Therefore, it cannot by ratification obtain the benefit of the contract purported to have been made on its behalf before it came into existence as a ratification by the company when formed is legally impossible. The doctrine of ratification applies only if an agent contract at the time the contract is made by the agent.

Where a contract is made on the behalf of company known to both the parties to be non-existent, the contract is deemed to have been entered into personally by the actual maker, i.e. the promoters. The company can, if it desires, enter into a new contract, after its incorporation, with the other party. The contract may be on the same basis and terms as given in the preliminary contract made by the promoters. But the adoption of the preliminary contract by the company will not create a contract between the companies and other parties even though the adoption of the contract is made as one of the objects of the company in its Memorandum or Article. In such a case it is safer for the promoters acting on behalf of the company about the information to be provided in the contract that:

(a) If a company makes a fresh contract in the terms of the preliminary contract, the liability of the promoters shall come to an end, and

(b) If the company does not make a fresh contract within a limited time either of the parties may rescind the contract.

SPECIFIC PERFORMANCE OF PRELIMINARY CONTRACT

Section 15 and 16 Specific Relief Act, 1963 deal with this point. When the promoters of a company have, before its incorporation, entered into a contract for the purpose of the company and such contract is warranted by *the* terms of the incorporation, specific performance may be obtained by, or enforced against the company; provided that the company has accepted the contract and has communicated such acceptance to other party to the contract.

Example

The promoters of a manufacturing company entered into a contract with M for purchase of the manufacturing for the company. The company after its incorporation adopted the contract sent the communication of acceptance of M. It was held that the contract was for the purpose of the company and as such the company could sue or be used upon it (Imperial Ice Manufacturing Co. Ltd. V. Manchershaw I.L.R. (1889) Bombay 415).

25.8 SELF-CHECK EXERCISE- II

Q3. Does private and public company can both commence business immediately after incorporation? Discuss.

Q4. What are Preliminary Contracts?

Q5. With whom the application is filed for the approval of name of the company?

Q6. Describe the importance of issue of certificate of incorporation of company?

25.9 ANSWERS TO SELF-CHECK QUESTIONS

Exercise 1

ANS1. A promoter is one who works for the formation of the company.

Ans 2. A promoter is in fiduciary relationship with the company. He is neither an agent nor the trustee of the company because there is no company yet in existence.

Exercise 2

Ans 3. A private company can commence business immediately after incorporation but the public company cannot unless it has obtained a certificate of commencement from the Registrar.

Ans 4. Preliminary contracts are the contracts signed by the promoters of the company with the third parties during the promotion of the company.

Ans 5. To take approval ofthe name an application is filed with the department of the Law Administration, Govt. of India through the Registrar of Companies of the State concerned.

Ans 6. It is conclusive evidence of incorporation under section 35 of companies act. If once the certificate is issued the court cannot go behind it and the existence of a company cannot be questioned.

25.10 KEYWORDS

Promoter	pioneer of the company
Preliminary contract	contract made by promoters on behalf of the company before formation
Second stage after promotion	incorporation stage

25.11 SUGGESTED READINGS

1. Elements of Company Law by N.D. Kapoor
2. Company Law by Garg, Chawla, Gupta
3. Fundamental of Company Law by Sikka, Bhalla,

25.12. SUGGESTED QUESTIONS

1. Discuss the position of Promoters with regard to Preliminary Contracts.

2. Describe the role of promoter in the formation of a company.

3. Discuss the procedure with regard to the promotion and registration of a company.

4. Can preliminary contract be ratified? Discuss and explain specific performance of preliminary contract by stating any case related.

Lesion No. 26 **AUTHOR LOVELEEN VEENA**

MEMORANDUM OF ASSOCIATION

STRUCTURE

26.1 Objectives
26.2 Introduction
26.3 Contents of Memorandum of Association
  26.3.1 Name Clause
  26.3.2 Registered Office Clause
  26.3.3 Object Clause
  26.3.4 Liability Clause
  26.3,5 Capital Clause
  26.3.6 Association Clause
26.4 Self-check exercise I
26.4 Doctrine of ultra vires
26.6 Exceptions to doctrine of ultra vires
26.7 Self check exercise II
26.8 Answers to Self-check questions
26.9 Keywords
26.10 Suggested Reading
26.11 Suggested Questions

26.1. OBJECTIVES

An important step in the formation of a company is to prepare a document called Memorandum of Association. As observed by Palmer: It is a document of great importance in relation to the proposed company. Itsimportance lies in the fact that it contains some fundamental clauses which havebeen discussed in the chapter.

26.2. INTRODUCTION

There are different documents which are to be filed with the Registrar of Companies and the most important document out of them is memorandum of Association. A company cannot be registered without memorandum of Association and that is why it is called life giving documents. It is called Charter of the Company and it is the foundation stone on which the building of the Company is to be constructed. If defines and confines the powers of the Company. It creates relations between company and outside world. It fixesthe field of work of company beyond which the company cannot go.

Under section 2 (28) of the Companies Act, "Memorandum of Association of a Company as originally framed or as altered form time-to-time in pursuance of any previous company law or of this Act".

26.3. CONTENTS OF MEMORANDUM OF ASSOCIATION

According to Sec. 13, the memorandum of a company must contain the following clauses:

26.3.1 Name Clause

The memorandum of Company must state the name of the company. The company can choose any name it likes **subject** to the following conditions:

1. The word 'Ltd.' or 'Private Ltd.' must be used as the last word of the name in case of Public Limited Company and Private Ltd, Company respectively. The Central Government, Under licence may permit to drop the word 'Private Ltd.' or 'Ltd.' in case of companies established for the promotion of commerce, art, science and

Charity (Section 25).

2. The name chosen by the promoters of the company must not be undesirable in The opinion of the Central Government. The name is considered undesirable when it closely resembles with the name of any other existing company. The Government does not allow the use of word like 'Government', 'State' and 'Municipality' unless permission has been obtained.

The name of the company must be printed on signboards and should be displayed outside the business premises. The name of the company must be engraved on the seal of the company, bills of exchange invoices and receipts, etc. If the name of the company is not displayed outside the business premises of the Company then every officer, who is at fault, shall be punishable with fine which may extend to Rs. 50 per day of every day of default.

ALTERATION IN NAME CLAUSE

The Company may alter its name by passing special resolution and with the approval of Central Government according to Sec. 21 of Companies Act. But if the Company is registered with the similar name of existing company, the name can be altered with the passing of an ordinary resolution and with the approval of the Central Government (Sec. 22). If the Government issues order for the alteration. The Central Government may also, within twelve months of registration of company, direct the company to change its name. Within three months of such direction, the company must change its name by passing an ordinary resolution and with the previous approval of the Central Government. Default in complying with the directions is punishable with fine up to Rs. 1000 for every day during which the default continues.

ALTERATION IN DOMICILE CLAUSE

The alteration in domicile clause can be better understood if studied under different parts:

26.3.2 Shifting of Registered Office from one State to another

According to Section 17, a company may alter the provisions of its memorandum so as to change the place of its registered office from one State to another for certain purposes referred to in Section 17 (1) of the Act. These purpose are discussed under the heading 'Change or Object Clause'. In addition the following steps will be taken.

Special Resolution: For effecting this change a special resolution must be passed by the company and a copy thereof must be filed with the Registrar within 30 days.

Confirmation by *Central Government:* The alteration of the provisions of memorandum relating to the change of the registered office from one state to another state shall take effect only when it is confirmed by Central Government on petition. The Companies (Second Amendment) 2002, has amended section 17 (2) of the Companies Act under which the power to confirm the change in theregistered office of a company from one State to another state has been transferred from Company Law Board to the Central Government.

Before confirming the resolution, the Central Government will give an opportunity to members, creditors and other persons such as State and Registrar. The employees' union of the company may also object- The Central Government before confirming or refusing to confirm the change will consider primarily the interest of the company and its shareholders and also whether the change is bonafide and not against the public interest. The Central Government may then issue the confirmation order on such terms and conditions as it may think fit.

The company shall file with the Registrar a certified copy of the order of the Central Government confirming the alterations, within 3 months from the date of order together with a printed copy of the memorandum as altered and the Registrar shall register the same and certify the registration under his hand within one month from the date of filing of such documents (Section 18 (1) (b)).

(2) If Office is to be shifted from one place to another within the same State

The change can be made by special resolution, notice of the same must be given to Registrar within 30 days of transfer. If the office is to be shifted from one locality to another within the same city, it can be done only by way of passing resolution of the Board of Directors. A public notice is given thereafter.

26.3.3 The Object Clause

It is most important clause in memorandum of association because it determines the scope of work of a company. The company cannot do anything other than as specified in the memorandum, The object clause, of the company must be drafted with utmost care. The general rules for the objects clause are as follows:

(1) According to the Companies (Amendment Act, 1965), the objects clause of the Company must be divided into part i.e. main object and other objects. In case of non-trading companies the object clause should specify the name of the states where the objects of the company can be extended.

(2) The objects of a company must be lawful and should not be against the provisions Of the Companies Act or opposed to public policy. The object of the business must not be to carry out the lottery business, payment of dividend out of capital and to trade with the enemy country (Sec, 77).

(3) The object, should be clear and expressed. If the object clause says that any other business which the company thinks is profitable and defines nothing is meaningless. Anything done beyond the purview of memorandum is ultravires and is absolutely void.

(4) The memorandum should state the object of company not the powers. The power To borrow money in case of trading company is implied but in case of other than the trading companies or banking companies, the power to borrow money must be specified.

Alteration in Object. Clause

The object clause of the memorandum can be altered only in the following conditions:

(1) To carry on business more economically or more efficiently.

(2) To attain the main purpose by new and unproved means.

(3) To change or enlarge the local area of its operations.

(4) To carry on some business which can be suitably combined with present business Of the company.

(5) To restrict or abandon any of its existing objects.

(6) To sell or dispose off the whole or any part of the undertaking of the company,

(7) To amalgamate with any other company.

To alter the objects clause of the memorandum, a special resolution has to be passed and filed with the Registrar of Companies. The confirmation of the Central Government is not at all required!.

26.3.4 Liability Clause

The liability clause of the memorandum specifies the liability of members. A limited

Liability clause means that the liability of members is limited to the face value of shares held by them. If the number of members fall below 7 and 2 in public and private company respectively and company carries on business for more than 6 months then the members are severally liable for the debts of the company incurred in that period. If the memorandum so provides, the liability of directors, managers or managing directors may be unlimited (Sec. 322),

Alteration if Liability Clause

Ordinarily liability clause cannot be altered so as to make the liability of members unlimited. Any alteration in the memorandum will be void if the effect of the alteration is the enhancement of the liability of members. This provision, however, will not apply to a case where the members agree in writing to be bound by the alteration (Sec. 38).

26.3.5 Capital Clause

The capital clause of the memorandum of association indicates the amount of share capital with the company is to be registered and the division thereof into a fixed amount (Sec. 13 (4)), The Capital with which a company is registered, is called registered or authorised capital. Each subscriber of the memorandum must take one share at least. A limited company having share capital must have only two kind of share capital i.e. Equity share and preference share capital.

Alteration in Capital Clause

The procedure for the alteration in share capital is generally given in Articles of Association of a company. If the alteration is authorised by the articles of association the following change in capital may take place.

(l) It may increase its share capital.

(ii) Consolidate and divide its share capital into shares of larger amount. (iii) Cancel the unissued share capital.

(iv) Subdivide the shares into shares of smaller amount.

(v) Convert its fully paid-up shares into stock and stock into shares.

The alteration in share capital can be made either by way of passing of ordinary or special resolution, as the case may be if there is reduction of share capital in the company the special resolution is passed. A copy of same is sent to Registrar within 30 days of the alteration of share capital. The Registrar then notes the necessary change in the share capital (Sec. 95).

Reduction of Share Capital

If authorised by the articles the share capital of the company may be reduced in the following manner:

(i) By way of reducing the liability on shares which are not paid up or,

(ii) Cancel the paid up capital which is not represented by assets or.

(iii) By paying off the capital which is in excess.

A special resolution is passed and confirmation from Tribunal is obtained. The Tribunal confirms only in case when the notice has been served to the creditors and their consent in this regard has been obtained. The copy of confirmation of Tribunal and copy of resolution are submitted to the Registrar. The Registrar then records the necessary changes and issue a Certificate of Registration (Sec, 103).

26.3.6 Association Clause

Under this clause, a sort of declaration is made by subscribers of thememorandum that they desire to form a company and are ready to purchase the number of shares shown against their respective names. The signatures of thesubscribers should be duly attested by some witnesses.

THE STATEMENT IS AS FOLLOWS

"We the several persons whose names and addresses are subscribed, are desirous of being formed into a company in pursuanceof the memorandum of Association and agree to taken thenumber of shares in the capital of the company shown against our names'.

26.4 Self check exercise I

Q1. How the name of the company can be altered if it is registered with the similar name of existing company?

Q2. Define object clause.

26.5 DOCTRINE OF ULTRA VIRES

A company has the power to do all such things as are

(1) Authorised to be done by the Companies Act, 1956.

(21 essential to the attainment of its objects specified in the memorandum. It is the Function of the memorandum to delimit and identify the objects in such plain and unambiguous manner as that the reader can identify the field of industry within which the corporate activities are to be confined.

(3) Reasonably and fairly incidental to its objects,

PURPOSE

(1) These restrictions are meant to protect investors in the company so that they may know the objects in which their money is to be employed.

(2) And to protect creditors by ensuring that the company's funds, to which they must look for payment, are not dissipated in unauthorised activities.

The objects clause requires that the company should devote itself only to the objects set out in the memorandum and to no others. The memorandum is thus the *area*beyond which a company cannot travel. Any activities not expressly or impliedly authorised by the memorandum are ultra *vires* the company,

'Ultra means beyond, 'vires' means powers. An action outside the memorandum is *ultra vires* the company. An act is said to the ultra *vires* when it is performed which, though legal in itself, is not authorised by the objects clause in the memorandum of association or the statute. Such an act is void and cannot be ratified even by unanimous resolution of all the shareholders,

Case **Ashbury Rly,,** Carriage &**Iron** Co, Ltd. V. Riche. A company was incorporated with the following objects

(a) to make and sell, or lend or hire, railway carriages and wagons,

(b) to carry on the business of mechanical engineers and general contractors.

(c) to purchase, lease work and sell mines minerals, lands and buildings.

The directors contracted to purchase a concession for making a railway in Belgium. Articles gave express power to the company to extend its business beyond the memorandum by a special resolution. The company passed a special resolution to ratify the purchase. Later, the company repudiated the agreement and was sued for the breach of the contract.

Court held that the contract was ultra vires the company and void so that not even the subsequent assent of the whole body of shareholders could ratify it.

An ultra vires contract can never be made binding on the company. It cannot becomes intra vires by reasons of estoppel, lapse of time, ratification or delay. The rule is meant to

protect future shareholders and thepublic at large who deal with the company.

The main fact and features of ultra vires is that a company being a corporate person should not be fined or punished for its own acts or its agent, if it is beyond its powers and privileges. When a contract is ultra vires a company it is wholly void and of no legal effect, so:

(1) An act is performed or a transaction is carried out which, though legal in itself, is not authorised by the objects clause in the memorandum or by statute, it is said to be ultra vires the company.

(2) If an act is ultra vires the company, it cannot be ratified even by the whole body of shareholders.

(3) If an act is ultra vires the directors (i.e. beyond the scope and powers of the Directors but within powers of company, it can be ratified by the whole body of shareholders.

(4) If an act is ultra vires the Articles, it can be ratified by altering the Articles by a special resolutions at a general meeting,

EFFECTS OF ULTRA VIRES TRANSACTIONS

(1) Injunction

A great mischief public or private, might ensure a company is not bound strictly by the terms of its incorporations. The members of the company are, therefore, entitled to hold it to the objectives given in its memorandum. Hence, whenever a company goes beyond the scope of its activities or objects laid down in the memorandum, any of its members can get **an** injunction from the court restraining the company from proceeding with the ultra vires.

If an act is not ultra vires the company and it is capable of being ratified or being approved by the company, it is not open to a minority of shareholders to object to any transaction unless it is a fraud or the majority have abused their powers and are depriving the minority of their rights.

(2) Personal Liability of Directors

Any member of a company may maintain an action against the Directors of the company to compel then to restore to the company the funds of the company which have been employed by them in ultra vires transactions. This is because it is one of the duties of the directors of the company to ensure that funds ofthe company are used for the achievement of the objects of the company for which it is incorporated. If any fund of the company is misapplied (spent on ultra vires transactions), the directors will be personally liable for the breach of trust even when the misapplication of funds does not consist of actual misappropriation by the directors **or** even when it is not fraudulent.

(3) Breach of Warranty

If an agent of a company exceeds its authority, he is personally liable for breach of warranty of authority ina suit by the third party. The directors of a company are its agents and as such they must act within the limits of the company's powers. Ifthey induce, however, innocently, an outsider to enter into a contract which is ultra vires the company, they will be personally liable to third party for his loss for breach of warranty of authority, unless the fact of the contract being ultra vires would have been apparent to the third party if he had referred to the memorandum of the company.

(4) Ultra Vireo Contracts

A contract of a company which is ultra vires is void-ab-initio and of no legal effects, neither the company nor the other contracting party can enforce the ultra vires contracts. Further, no performance on either side can give ultra vires contract any validity or the

Foundation of any right or action upon it (Ashbury Rly. Carriage and Iron Co. Ltd. Riche). The company may, however, alter the objects clause for the future, but such alteration will not validate the past ultra vires act done.

(51 **Ultra Vireo Acquired Property**

Ultra vires transactions as already observed are void. If a company acquired some property under an ultra vires transaction it has a right to hold that property and protect it against damage by the other persons. The property which is legally and by formal transfer, transferred to the company is in law duly vested in such company even though the company was not empowered to acquire such property.

(6) Ultra Vireo Torte

A company is not liable for torts committed by its agents or servants during the course of Ultra vires transactions. This may result in injustice to third party who has been the victim of an ultra vires tort. A company is, however, liable for a tort if it can be shown that the activity in the course of which tort within the scope of memorandum and the agent or servant committed the tort within the course of his employment.

26.6. EXCEPTIONS TO THE DOCTRINE OF ULTRA VIRES

1. **If** an act is ultra vires the powers of the directors of a company but intra vires the company, the company may ratify it.
2. If an act is ultra vires the Articles of a company, the Articles may be altered to include the act within the powers of the company.
3. If an act is intra vires a company, but is irregularly done, the whole body of shareholders may ratify it.
4. If a person borrows money from a company under a contract which is ultra vires the company, the company can sue him for the recovery of the money.
5. If a company has purchased some property from a third party under an ultra vires loan, the third party has the right to follow his property or money it exists in specie. They may also obtain an injunction form the court restraining the company from parting with property money. But he must act before the identify or the property is lost or the money is spent.
6. If a company takes an ultra vires loan and uses it to pay- off intra vires debts, the lender who has lent under the ultra vires contract is substituted in place of the creditor who has been paid off and as such he can recover the money,
7. If a company has taken an ultra vires loan through some misrepresentation of act by the directors, the lender has the right to make the directors personally liable on the ground of breach of implied warranty and authority.

26.7 SELF CHECK EXERCISE II

Q3. Define ultra vires.

Q4. If an act is ultra vires the company, can it be ratified?

26.8 ANSWERS TO SELF CHECK QUESTIONS.

Exercise I

Ans1 : By passing the ordinary resolution and with the approval of the Central Government (Sec. 22).

Ans 2: Object clause determines the scope of work of the company.

Exercise II

Ans3: ultra means beyond and vires means power. Any action outside the memorandum is ultra vires.

Ans4: it cannot be ratified even by the whole body of shareholders.

26.9 KEYWORDS

M.O.A	memorandum of association
Name clause	Clause in M.O.A stating name of the company
Liability clause	memorandum stating liability of the company
Object clause	defines the scope of work of company

Association clause	declaration made by subscribers of company to be a member
Capital clause	amount of share capital to be raised and division thereof
Ultra vires	action outside the memorandum

26.10. SUGGESTED READINGS

1. Fundamental, of Company Law — By Gupta 8r, Sikka
2. Element of Company Law — By N. D. Kapoor
3. Company Law — By Kauslaal
4. Company Law — Garg, Chawla 84 Gupta

26.11. SUGGESTED QUESTIONS

1. "Memorandum of Association is a charter of Company". Comment upon the statement ? and explain the various clauses of M.O.A.

2. Explain fully the "Doctrine of Ultra vires." Mention the effects of Ultra vires Transactions.

3. Explain the procedure of alteration in name clause and object clause.

4. Define memorandum of association and explain exception to doctrine of ultra vires.

Lesson No. 27 **AUTHOR- LOVELEEN VEENA**

ARTICLES OF ASSOCIATION

STRUCTURE

27.1 Objectives
27.2 Introduction
27.3 Scope, Form and Necessity of Articles
27.4 Contents of Articles
27.5 Alterations of Articles
  27.5.1 Statutory restrictions
  27.5.2 Judicial restrictions
27.6 Effects of Memorandum and Articles
27.7 Distinction between Memorandum and Articles
27.8 Self check Exercise I
27.9 Doctrine of Indoor Management
  27.9.1 Exceptions to the doctrine of Indoor Management
27.10 Answers to self-check questions
27.11 Keywords
27.12 Suggested Readings
27.13 Suggested Questions

27.1. OBJECTIVES

Articles of association is the second document which has, in the case of same companies, to be registered along with the memorandum, which companies must have articles of association has been discussed in this chapter.

27.2. INTRODUCTION

The articles of Association are the rules, regulations and bye-laws for the internal management of the affairs of a company. They are framed with the objects of carrying out the aims and objects as set-out in the memorandum of Association.

Sec. 2(2) defines, "Articles as, The Articles of Association of a company as originally framed or as altered from time to time in pursuance of this Act, including so far they apply to the Company, the regulations contained in Table A in Schedule-I annexed to this Act."

Memorandum is the charter of a company and is accepted as a primary document of a company. The Articles comes next in the importance.

"The articles play subsidiary to the memorandum of association. They accept the memorandum as the charter of incorporation of the company and so accepting it, the articles proceed to define the duties, the rights and the powers of the governing body as between themselves and the Company at large and the mode and form in which changes in the internal regulations of the Company may from time to time be made." (Ashbury Railway Carriage Co. V. Riche)

27.3. SCOPE, FORM AND NECESSITY OF ARTICLES

It is compulsory, to file articles with the Registrar by an unlimited company, company limited by guarantee or a private company limited by shares. A Company limited by shares need not register articles of association and in that case, according to Sec. 28 (2), Table "A" shall apply to that company as given in companies Act.

The articles of association of a company must be printed, divided into paragraphs consecutively and signed by each subscriber of the memorandum. The signatures of the subscribers must be attested by one witness at least. It must be properly stamped and dated, (Sec. 30) The articles of association must not be in inconsistent with the provisions of the companies Act,, [Sec, 29].

27.4. CONTENTS OF ARTICLES

Articles of Association usually contain the rules regarding following:

1. The limit to which Table A is applicable.
2. Adoption of preliminary agreements.
3. Different classes of shares, rights of shareholders regarding dividends, bonus and voting.
4. Allotment of shares.
5. Fixation of minimum subscription,
6. Procedure for making calls on shares, issue of shares certification and shares warranties.
7. Forfeiture and surrender of shares,
8. Procedure for transfer and transmission of shares,
9. Rules regarding alteration of share capital.
10. Rules as to general meetings proceedings, and pools.
11. Rules as to directors, their qualifications, remuneration and retirement by way or rotation.
12. Accounts and Audit.
13. Rules regarding reserves.
14. Common seal,
15. Special provisions for winding-up
16. Rules regarding auditor's appointment and remuneration.

Provisions for such powers can be exercised by the Company only if authorised by its articles i.e issue of redeemable, preference shares, share warrant, payment of interest out of Capital, in certain cases (Sec. 208), reducing the share capital of the company. (Sec. 100) and fixing limit of the number of directors (Sec. 258)

Articles of Association should not in any way provide for anything which is against the companies Act, memorandum of Association and public policy. Any such thing will be void.

27.5 ALTERATION OF ARTICLES

The articles of association of a company is alterable under Section (31) of the companies Act, by passing special resolution. This is the statutory right of **a** company and it cannot **be** deprived of it. If alteration in articles has taken place by special resolution, a copy of the same must be filed with the Registrar with 30 days of the resolution. The following are the restrictions for alteration of articles of a company.

(1) Statutory restrictions.

(2) Judicial restrictions,

27.5.1 STATUTORY RESTRICTIONS.

Alteration must not be against the Provisions **of the Companies Act**

Alteration of articles can be made by wayof passing special resolution but for that, notice to the members must be given, otherwise it will make the alteration invalid. The

alteration to increase the liability of the shareholders without their written consent shall be in contravention of provision of Sec (38) of the Act. Any such alteration is Void, (Section 9).

(ii) Alteration must not be Inconsistent with Memorandum of Association

Any alteration made against the memorandum shall be void i.e. to purchase its shares, to extend the objects beyond the memorandum and to issue of shares at discount.

(ill) Alteration against the Provisions of Sec. 31 (I)

Any alteration made in articles to convert the public company into private company shall have no effect unless permission from the central government has been obtained.

(iv) Alteration regarding appointment of Directors

Any alteration in articles of association regarding appointment, reappointment or remuneration of a managing or whole time director is void without the approval of the Central Government.

27.5,2 JUDICIAL RESTRICTIONS

(i) Alteration should be for the Benefit of the Company as a Whole:

Any alteration in articles must be for the benefit of a company as a whole. The alteration made in articles in such a way that it empowered the directors to take all the shares of a member who was running business competitive of that of companies. The mem ber was running the business voted against the resolution. Then it was held that the alteration was valid, because it was for the benefit of the company as a whole.

(ii) Alteration should not be fraud on the minority

A majority of the shareholders will be not allowed to commit fraud on the minority shareholders. The alteration must be for the benefit of all.

(iii) No alteration to carry out illegal business

Any alteration in articles made to carry out illegal business shall be void such as lottery business etc.

(iv) Alteration must be in Good faith

Alteration in articles is not valid if it has been made only for the benefit of majority shareholders.

(v) Alteration cannot be made which enables a company to Commit Breach of Contract with Third Party. A company cannot snatch away the right already accrued from any person by way of alteration in articles. Thus a person appointed in accordance with the provisions of the articles as a director on a fixed remuneration under an independent contract of service, cannot be made to accept a lesser amount by altering the articles.

27.6. EFFECTS OF MEMORANDUM AND ARTICLES

Sec 36 (1) of the act provides that, "Subject to the provisions of the Act, the memorandum and articles shall, when registered, bind the company and the members thereof to the same extent as if they respectively had been signed by the company and by each members, and contained on it and this part to observe all the provisions of the memorandum and of the articles." This means that the articles bind the company to its members and vice versa, the members to each other but do not bind the company and its members for the outsiders. However it can be better understood under the following heads:

(I) Company Bound to Members

The articles is a contract between the members and the company and as a result of that, company is bound to comply with the provisions of articles. A member of the company can sue the company, for his right to receive the share certificate, right to receive dividend

and right to receive the notice meetings.

111) Members Bound to Company

All the members of the company are bound to comply with the provisions of memorandum and articles of the company. Any amount payable by the members to the Company is a debt under the memorandum and articles, (Sec. 36) A company can sue its members for the enforcement of the provisions of articles.

lill) Member Bound to Member

The articles or memorandum not only create contract between the members and the company but also between each members of the company. The member is not allowed to sue any other member directly. It can only be doneby company itself. The only exception where one member can sue any other member when relief is sought from a person who controls the majority of shares and the act performed by him was ultravires.

(iv) Company or Members are not Bound to the Outsiders

Neither the memorandum not the articles give any contractual right to the outsiders against the company or its members. These documents give right for the membership, not the contractual rights. In an articles of association the name of Eley was given as solicitor of the company and was to be removed only in case of misconduct. But after some time the company dismissed him without any cause. Eley then sued the company of breach of contract. It was held that the articles did not constitute any contract between Vey and the company.

[Eley Vs Positive Life Assurance Co. Ltd. 1876] Articles is not a contract between Company and the outsiders i.e, vendor.

(v) Articles are Binding upon Directors

The provisions of articles of association of a company must be followed by the director because they are bound with the articles. If they beyond the purview of powers given to them, they are personally liable for that.

27.7. DISTINCTION BETWEEN MEMORANDUM AND ARTICLES

Both thedocuments of the company are important. Yet following are the fundamental differences between the two.

(1) The memorandum is charter of a company and creates relations between the company and the outsiders. The articles is a subsidiary document of a company, defines relationship between the company and the members.

(2) The memorandum defines and confines the object of a company. While the articles regulate the internal arrangement of a company.

(3) The memorandum being a primary document cannot be altered easily while the articles subordinate document and can be altered easily by passing special resolution.

(4) The submission of memorandum is compulsory for all companies but articles are optional for some public companies.

(5) Acts done beyond the memorandum are ultravires and are void but acts done by a company ultravires the articles but intravires the memorandum can be ratified.

(6) If a contract is made by a person with the company ultravires the memorandum then company cannot be sued for the contract.

27.8 SELF CHECK EXERCISE I

Q1. For which companies, it is mandatory to file articles with the registrar?

Q2. On which company, table ‘A’ is applied. And why?

Q3. State any one difference between memorandum of association and article of association.

27.9 DOCTRINE OF INDOOR MANAGEMENT

Introduction

The Memorandum and the Articles are open and accessible to all. Every person dealing

with a company is deemed to have notice of the contents of the memorandum and the articles of association, which on registration with the registrar, assume the character of public documents. This is known as constructive notice of the Memorandum and Articles.

But there is a limitation to the doctrine of constructive notice of the Memorandum and the Articles of the Company. The outsider dealing with the company is entitled to assume that as far as internal proceedings of the company are concerned everything must have been done. They are bound to read the registered documents but they are not bound to do more, they need not enquire into the regularity of the internal proceedings as required by the memorandum and the articles. This limitation of doctrine of constructive notice is known as the doctrine of indoor management. Thus where the doctrine of constructive notice protects the Company against outsiders, the doctrine of indoor management seeks to protect outsiders against the company.

Royal British Bank V. Turquand (1856) E 84 B 327. The directors of a bank had issued a bond to T. They had the power under the Articles to issue such bonds provided they were authorised by a resolution which was passed by the company. Held, T could recover the amount of the bond from the Company on the ground that he was entitled to assume that resolution had been passed.

The gist of the rule is that persons dealing with limited liability companies are not bound to inquire into their indoor management and will not be affected irregularities of which they had no choice. The rule is based on public convenience and justice.

27.9.1. EXCEPTIONS TO THE DOCTRINE OF INDOOR MANAGEMENT

(1) Knowledge of Irregularity

Where a person dealing with a company has actual or constructive notice of the irregularity as regards internal management, he cannot claim the benefits under the rule of indoor management. He may in some cases be himself a part of the internal procedure. The rule is based on common sense and any other rule would "encourage ignorance and condone dereliction of duty,"

Example

A transfer of shares in a contract was approved by two director. One of the directors was not validly appointed. The other was disqualified by reason of being the transferee himself. These facts were known to the transferor. Held, the transfer was ineffective. [Devi Ditta Mal V. The Standard Bank of India A.1.R. (1927)1

(2) Negligence

Where a person dealing with a company could discover theirregularity if he had made proper enquiries, he cannot claim the benefit of the fuel of indoor management. The protection of the rule is also not available where the circumstances surrounding the contract are so suspicious as to invite inquiry.

Example

The sole director of a company in this case paid into his own account cheque, drawn in a favour of the company. Held, the bank was liable as it ought to have made inquiries before crediting the account of the directors. [Underwood V. Bank of Liverpool 1924)
K. B. 775)

Further the rule cannot be invoked in favour of a person who did not in fit lead the company memorandum and the Articles and consequently did not act in reliance of those documents.

(3) Acts Void ability and Forgery

Where the acts done in the name of a company are void abilities the doctrine of indoor management, does not apply. The doctrine applies only to irregularities that otherwise might affect a genuine transaction. It does not apply to a forgery. A company can never be held bound for forgeries committed by its officers.

(4) Acts outside the Scope of Apparent authority

If an officer of a company enters into a contract with a third party and if the act of the officer is beyond the scope of his authority, the company is not bound. In such a case, the plaintiff cannot claim the protection of the rule of indoor management simply because under the articles the power to do the act could have been delegated to him. The plaintiff can see the company if the power to act has in fact been delegated to the officer with whom he entered into the contract.

(5) No Knowledge of the Contents of the Article

A person who has not actually read the memorandum and articles of a company and whowas not at the time of entering into the contract, aware of their contents, cannot seek to rely on the statement contained therein. The rule of constructive notice operates against the person who fails to enquire but does not operate in his favour.

Effect of alteration is the memorandum or articles (Sec. 38): Any alteration in the memorandum or articles will be void and inoperative if the effect is the enhancement of the liability of a member, however, this provision will not be applicable where;

(i) The member agrees in writing either before or after a particular alteration is made, to be bound by the alteration; or

(ii) The company is a club or association and the alteration requires the member to pay security or periodical subscription or charges at a higher rate although he does not agree in writing to be bound by the alteration.

Copies of the memorandum, articles etc. to be gives to member (Sec 39) on payment of Re. 1 a member is entitled to have a copy of each of the following documents, within seven days from the company:

(a) the memorandum
(b) the article
(c) every agreement and resolution under Section 192.

If default is made in complying with this provisions, the company and every officer in default is punishable with a fine which may extend upto Rs. 500.

27.10 Answers to self check questions

Ans1. An unlimited company, company limited by guarantee or a private company limited by shares.

Ans2. A Company limited by shares need not register articles of association and in that case, according to Sec. 28 (2), Table "A" shall apply to that company as given in companies Act.

Ans3. The memorandum defines and confines the object of a company. While the articles regulate the internal arrangement of a company.

27.11 KEYWORDS

Article of association — stating rules, regulations and bye laws of the company

Doctrine of constructive notice — provides protection to company against third parties

Doctrine of indoor management — provides protection to third parties against company procedures

27.12. SUGGESTED READINGS

1. Element of Company Law : By N.D, Kapoor
2. Company Law : By Garg, Chawla et, Gupta
3. Fundamentals of Company Law : By Gupta 65 Sikka

27.13. SUGGESTED QUESTIONS

I. Define the term "Doctrine of Indoor Management!' and discuss the exceptions to this rule.

2. Discuss how and to what extent Articles of Association of a Company can be altered.

Lesson No. 28 AUTHOR: DR. SUMAN KUMAR JAIN

MEMBERS & MEETINGS

STRUCTURE

28.0 Objectives
28.1 Introduction
28.2 Persons Eligible to be a member
28.3 How to become a member
28.4 Rights of members
28.5 Self check exercise I
28.6 Procedure and requisites of a valid meeting
28.7 Chairman of meeting
28.8 Minutes of the meeting
28.9 Voting
28.10 Resolutions
28.11 Self check exercise II
28.12 Answers to self check exercise
28.13 Keywords
28.14 Suggested Readings
28.15 Suggested Questions

28.0 OBJECTIVES

The objective of this lesson is to introduce the student with the:

(i) Various types of meetings.

(ii) Procedure and requisites of a valid meeting.

(iii) Various types of resolutions.

28.1 INTRODUCTION

A company is composed of members, though it has its own entity distinct from members. Section 41 of the companies Act defines a member as:

1. The subscribers of the memorandum of a company shall be deemed to have agreed to become members of the company, and on its registration shall be entered as Members in its register of members,
2. Every other person who agrees in writing to become a member of the company and whose name is entered in its register of members shall be member of the company.
3. Every person holding equity share capital of the company and whose name is entered as beneficial owner in the records of that depository shall be deemed to be a member of the concerned company.

28.2 PERSONS ELIGIBLE TO BE A MEMBER

(1) Minor : A Minor cannot be a member as a contract with a minor is void.

(2) Company : A company is a legal person and is competent to contract and can become member of another company.

(3) Partnership firm A partnership firm is not a person is the eyes of law **and** cannot be a member of a company.

(4) Foreigners : Foreigners can become members of companies registered in India with the prior permission of RBI under FEMA, 1999,

(5) Insolvent : An insolvent cannot become a member but if a member has become **an** insolvent, he remains a member as long as his name appears is the register. According to section 12 of the companies Act, seven or more persons in case of public company

Or Two or more persons in case of private company can form an incorporated company, by subscribing to the memorandum.

When a public company carries on business with less than seven members (two in case of private company) every member who knows of this fact will become liable to an unlimited extent for all the debts contracted by the company in so carrying on business beyond six months after the number has so fallen.

Can a minor be a member of the company? No

Discuss the ways of getting membership to the company?

1. by subscription
2. by qualification shares
3. by transfer of shares
4. by transmission of shares

28.3 HOW TO BECOME A MEMBER

A person may become a member of the company in any of the following ways:

(1} Membership by subscription: Every subscriber to the memorandum is seemed to have agreed to become its member and on its registration must be put on the register of members.

(2) Membership by qualification shares : Directors of the company on delivering to the Registers, written undertaking to take their qualification shares and to pay for them to become members of the company, and they are in the same position as if they were subscribers to the memorandum,

(3) Membership by transfer: A person can become a member by acquiring shares from an existing member and by having the transfer of shares registered in the books of the company,

(4) Membership by transmission: On the death of a member his shares vest in his legal representative, who can sell the shares without being registered, but subject to the provisions of the articles. This process of transmission takes place on death or insolvency of a member or the liquidation of a company.

(5) Termination of membership: A person may cease to be a member of the company by any of the following acts:

1, When a person transfers his shares, the transferor ceases to be a member.
2. When his shares are validly forfeited by the company.
3. When a person surrenders his shares to the company.
4. When a company sells the shares in exercise of its right of lies over them.
5. When he repudiates the contract on the ground of false or misleading statement in the prospectus of the company,
6. When he is holding redeemable preference shares and such shares are redeemed.
7. When share warrants are issued is exchange of the fully paid up shares and the articles do not recognise holders of share warrants as members,

28.4 RIGHTS OF MEMBERS

When a person becomes a member of a company, he is entitled to exercise all the rights of a member, viz

(1) To have the certificate of shares delivered to him within the prescribed time (sec 113)

(2) To attend meetings of shareholders, receive proper notices and vote at the meetings,

(3) To transfer shares subject to the articles. (Sec. 82)

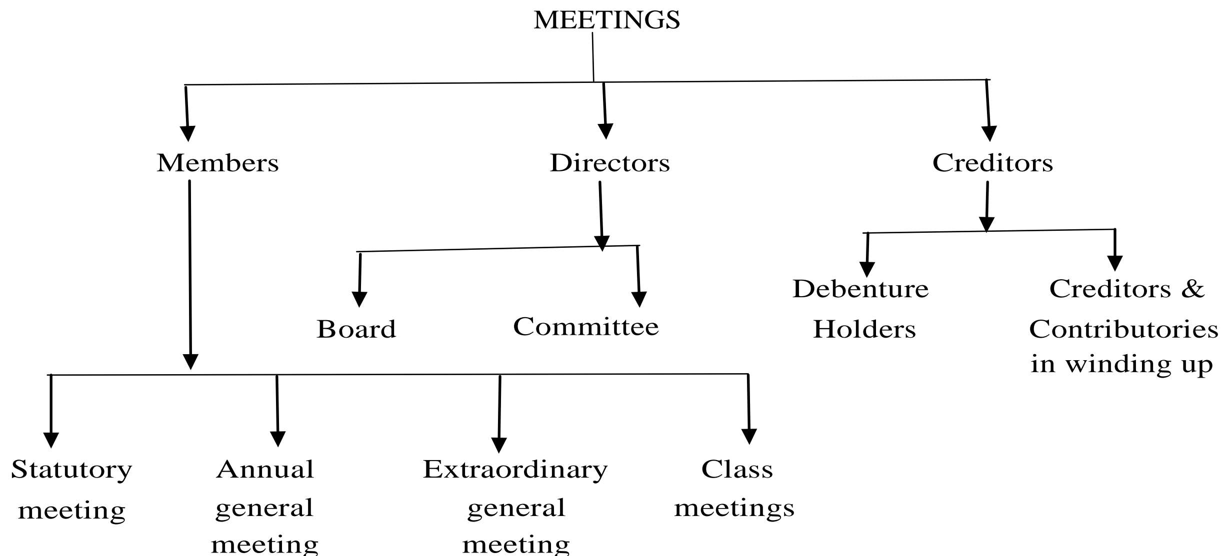
(4) To receive a copy of the statutory report,

(5) To apply to the court to have any variation in his rights set aside by the court (Sec 107.)

(6) To participate in the appointment of an auditor at the annual general meeting (Sec .224)

(7) To obtain copies of memorandum and articles on request and payment of the prescribed fees (Sec 39)

(8) To participate in passing of a special resolution that the company may be wound up compulsorily or voluntarily.



The ultimate control of the company rests with the general meeting. It is, therefore, imperative to understand how such meetings are summoned and conducted.

The general meetings of shareholders of a company are of three types

1, The Statutory Meeting
2. Annual General Meeting
3. Extraordinary General Meeting

(1) The Statutory Meeting

This is the first meeting of the members of a public company. A private company is not required to hold a statutory meeting. A statutory meeting has to be called within 6 months from the date at which the company is entitled to commence business, However, such a meeting cannot be held within one month from the date at which the company is entitled to commence business. During the whole of life of the company such a meeting is held only once.

The Board of Directors is required to prepare a report which is known as the "statutory report" and must send this report to the members at least 21 days before the day on which the meeting is to be held. If the report is sent later than the required time, it will be deemed to have been duly forwarded if it is so agreed to by all the members entitled to attend and vote at the meeting. Thus, the delay in sending the report can be condoned by unanimous consent of all the members present at the meeting. The statutory report is required to be certified as correct by at least two directors of the company one of whom must be a managing director, if there is any. Therefore, the auditor must certify that the report to be correct in as far as it relates to the shares allotted by the company, the cash received in respect of such shares and the receipts and payments of the company. A copy of the report must be sent to the Registrar also.

The purpose of the statutory meeting is to put the shareholders of the company as

early a date as possible in possession of all the important facts relating to the new company. A statutory general meeting is intended to have before it, a list of the members of the company with their names, descriptions and addresses and the number of shares held by them respectively and to have an opportunity of discussing any matter relating to the formation of the company. Members are given liberties to discuss any matter relating to or arising out of the statutory report.

At this meeting, the board of directors have to comply with several formalities. The board has to forward a report to every member of the company known asthe statutory report. The statutory report contains the fullest information on important matters and thus enables the members to make the best use of this opportunity. This statutory report has to set out the total consideration otherwise than in case, the total amount of cash received by the company in respect of shares, addresses and occupations of the directors and auditors of the company, particulars of contracts to the submitted to the meeting for approval and its modifications done or proposed detail of underwriting contract, areas of call due from directors, managing agents etc., particulars of commission or brokerage paid in connection with issue for sale of shares or debentures to the directors etc.

A copy of this report should be sent to the Registrar of companies also. Default in delivering the statutory report to the Registrar or in holding the statutory meeting of a company is a ground for winding up of a company (section 433 (b). In addition, every director or other officer of the company who is in default shall be punishable with fine which may extend to 5,000 rupees.

(2) Annual General Meeting

Every company is required to call at least one meeting of its shareholders each year. The meeting is known as annual general meeting. The meeting is to be held in addition to any other meeting held by the company. The first annual general meeting must be held within eighteen months from the date of its incorporation and then one meeting will be necessary in the year of incorporation and the following year. Therefore, one annual general meeting must be held in every year. The gap between one meeting and the next should not be more than fifteen months. The annual general meeting cannot be held on a public holiday. The meeting must be called during business hours and held either at the registered office of the company or some other place within the city, town or village in which the registered office of the company is situated.

The annual general meeting is a tool for protection of the interests of the members, because itis the one occasion when they can be sure of having an opportunity of meeting the directors and of questioning them on the affairs of the company. It is at this meeting that, normally, a proportion of the directors will retire and come up for re-election and at which the members will be able to try to exercise their only real power over the board of directors. Moreover, it affords members an opportunity of moving resolutions on their own account.

At the annual general meeting, the following items have to be taken up on the agenda :

(i) Consideration of the accounts, balance sheet and report of the directors and auditors;

(ii) Declaration of dividend;

(iii) Appointment of Directors in the place of those who are retiring;

(iv) The appointment and fixing up the remuneration of the auditors. Other business

may also be transacted at the annual general meeting, but such business shall deemed to be special.

If a company fails to hold this meeting the consequences will follow. Firstly, any member can apply to the Central Government and the latter will order the calling of the meeting. Secondly, the failure to call this meeting either generally or in pursuance of order of the Central Government is an offence, punishable with fine. The penalty is imposed upon the company as well as officer who is in default. The Central Government may order that one person present in person or by a proxy shall constitute a meeting.

The Registrar has been given the power, for any special reason to extend the time for holding an annual general meeting for a period of only three months. But the time for holding the first annual general meeting is never extended.

13) Extraordinary General Meeting

Extraordinary general meeting can be broadly divided into the following groups :

(i) Extraordinary general meeting convened by Directors.

(ii) Extraordinary general meeting convened by shareholders (popularly known as requisition meetings); and

(iii) Extraordinary general meetings convened by tribunal.

(i) Extraordinary General Meeting Convened by Directors : It there is some business which must or ought to be transacted before the general meeting, the directors may call an extraordinary general meeting. All business transacted at such meeting is to be deemed special business and the special notice provided by the Act has to be given for that purpose. As has already been pointed out, the extraordinary general meeting cannot encroach upon the function of the annual general meeting. Passing of the balance sheet, declaration of dividend, appointment of directors in place of those retiring and appointment and fixing up remuneration of auditors cannot be done at the extraordinary general meeting.

(ii) Requisition of Meetings : Under most forms of articles, a special percentage of the shareholders is to be given the right to call upon the directors to convene an extraordinary general meeting and on the failure the directors to call it themselves. Such meetings are called requisition meetings. It must be noted that all general meetings other than annual general meeting shall be called extraordinary general meetings. When a requisition is made by members, section 169 of the Companies Act, 1956 requires that the requisition must be signed by holder of at least one-tenth paid up capital having the right to vote on the matter of requisition. If the company has no share capital, the requisition must be signed by as many members as have one-tenth of the total voting power.

The requisition must set out the matters for the consideration of which the meeting is to be called. Only such matters can be taken up to the meeting in respect of which the requisitionists possess the above voting strength.

When requisition is deposited at the registered office of a company the director should within twenty one days, move to call a meeting and it should actually be held within forty five days, from the date of the requisition. If the directors fail to do so, the requisitionists may themselves proceed to call the meeting and claim the necessary expenses from the company. The company in turn can identify itself out of the remuneration due to the directors in default.

The power of calling a requisition meeting is one of the great emergency powers of

the shareholders. If the directors fail to perform their duties properly very often the shareholders make use of these powers.

Meeting Convened by Tribunal : Where for any reason, it is impracticable to call a meeting of the company in a manner in which meeting of the company may be called or to hold or conducted, the tribunal may either of its own or on the application of any director of the company or any member of the company who is entitled to vote, order a meeting to be called, held and conducted in such a manner as he is thinks fit. (Sec. 186). The tribunal has very wide powers under the section including powers to modify or supplement the provisions of the company's articles or even of the Companies Act. It may even direct that one member present either in person or by proxy shall constitute a meeting. The Companies Act, 1956, has, however, taken away from court the power to call annual general meeting and that power is now given to the Central Government. The tribunal therefore, have no power to call the annual general meeting of a company.

28.5 Self check exercise I

Q1. Define purpose of statutory meeting.

Q2. What is statutory report?

Q3. How annual general meeting is tool of protection of interest of members?

Q4. Who can extend the time of annual general meeting for any reason?

Q5. For how many months annual general meeting can be extended?

28.6 PROCEDURE AND REQUISITES OF A VALID MEETING

1. Proper Authority

The first requisite of .a valid meeting is that it should be called by proper authority. Obviously, the only proper authority is the board of directors, except when the meeting has, in the event of default by the directors been called by the requisitionist or by the Court or by the Central Government.

2. Notice

The second requirement for a valid meeting is that a proper notice of the meeting should be given to members. The notice of the meetings is to be given to every member of the company. Deliberate omission to give notice to a single member may invalidate the meeting although accidental omission to a member will not be fatal. Notice must be in writing and given twenty-one days before the date of the meeting. In computing the interval of twenty one days the date of posting and the date of meeting should be excluded to. Where a member does not have any registered address in India or has not supplied to the company address for the giving of notice to him, the company may advertise the notice in a newspaper circulating in the neighbourhood of the company's registered office and will be deemed to have been served on the members on the date of advertisement (Sec. 53).

3. **Contents of Notice**

Notice should specify the place, day and hour of the meeting and a meeting to be valid must be held at the place and time specified, except under exceptional circumstances.

Again, the notice must contain a statement of the business to the transacted at the meeting. Notice must give a sufficient, full and frank disclosure of the shareholders of facts upon which they are asked to vote.

4. Quorum

Another requirement of a valid meeting is the presence of quorum. Quorum means the minimum number of members that must be present at the meeting. It is generally for the articles to provide what numbers of members will constitute a quorum. If no provision is made in the articles, Sec. 174 of the Act will apply. Under this section, five members personally present in the case of a public and two in the case of a private company shall make the quorum for the meeting. If within half an hour from the time of a meeting, **a quorum** is not present the meeting will stand dissolved if it was called upon requisition,

But in other cases, the meeting is automatically adjourned to reassemble on the same day in the next week. And if at the reassembled meeting also a quorum is not present within half an hour as many members as are actually present shall constitute the quorum. The **crucial** problem in such a case is that suppose only one member turns up, will the meeting be valid ? In other words a meeting attended by one member can be called a meeting at all. It appears from the language of section 174 that the presence of one member only at reassembled meeting will not be enough. But exceptions will have to be admitted. In case, if all the preference shares in a company were held by one shareholder, meeting attended by him only was valid. Secondly, when the Central Government or the court calls a meeting, it may be directed that one member of the company present in person or by proxy shall be deemed to constitute a meeting. It is sufficient that quorum is present in the beginning of the meeting when it proceeds to business, and the subsequent departure of a member reducing the meeting below the number required for a quorum does not invalidate the proceedings at the meeting on his departure.

28.7 CHAIRMAN OF MEETING

For the proper conduct of the business at a meeting, chairman is necessary. His appointment is usually regulated by the articles of association. But if nothing is mentioned in the articles, the members personally present at the meeting shall elect one the themselves to be chairman.

If the chairman unjustly and without the consent of the shareholders stops the meeting, it is perfectly within the powers of the meeting to elect another chairman and to conduct the business remaining unfinished.

The court also has the power to appoint an independent chairman to preside over a meeting of a company. Such a chairman is practically necessary where there are differences among the shareholders and peaceful meeting under the chairmanship of a person appointed by either faction is improbable.

It is to be noted that the decision of the Chairman on points of order is taken to be prima facie correct. His decision as to the validity of a vote is also treated as conclusive provided (a) the articles of the company so provide and (b) there is no fraud on his part (i.e. he has acted banailde). Besides where a Chairman acting bonafide according to the best of his judgement and without malice erroneously excludes a member from voting and declares him ineligible as a director of the company, he will not be held liable in damages for this act. But in such a case he must act bonafide and without malice.

28.8 MINUTES OF THE MEETING

Every company is required to keep a record of all proceedings of every general meeting and of all proceedings of every meeting of its Board of Directors and of every committee of the Board. Within 30 days of every such meeting, entries of the proceeding must be made in the books kept for that purpose. These records are known as minutes and the books in which these records are kept is called the minute book. Each page of minute book which records proceedings of a Board meeting must be initialled or signed by the Chairman of the same meeting. The minutes of each meeting must contain a fair and correct summary of the proceedings at the meeting. All the appointments of officers made at any of the meetings aforesaid must be included in the minutes. In the case of meeting of the Board

of Director or of a committee of Board, the minutes must contain the name of the directors present of the meeting and the names of the directors dissenting from or not concurring with the resolutions passed at the meeting. The chairman may exclude from the minutes the matters which are defamatory of any person, irrelevant or immaterial to the proceedings or which are detrimental to the interests of **the** company. The Chairman has an absolute discretion in regard to the inclusion or non-inclusion of any matter in the **minutes.** Minutes of meeting kept in accordance with the above provision are evidence of the proceedings recorded therein. The minute books must be kept at the registered office of the company and open during business hours to the inspection by any member without charge subject to reasonable restrictions but at least two hours in each day must be allowed for inspection.

28.9 VOTING

The business of a meeting is done in the form of resolution passed at the meeting. After a resolution has been discussed it is put to vote. Every holder of equity shares has the right to vote. The only ground on which the right to vote may be excluded is non-payment of call by a member or other sums against a member or where the company has exercised the right of lien on shares.

The voting rights of preference shareholders are restricted by Section 87(2) of Act. A preference shareholder has right to vote only on resolution which directly effects the right attached to his preference shares.

In the first instance voting on a resolution takes place by show of hands. A declaration by the chairman of a show of hands that resolution has or has not been carried is conclusive, except when a poll is demanded.

If there is a dissatisfaction about the result of voting by show of hands a poll can be demanded. Taking a polI means recording the number of votes cast for or against a resolution. The voting right of a member on a poll shall be in proportion to his share of the paid equity capital of the company. Shares with disproportion to voting right are not allowed to be issued but private companies are exempted from the operation of this rule. Section 179(1) of theAct sets out cases when the Chairman will be bound to order a poll on being demanded. When a poll is taken, member is free to split votes for as well as against the same resolution. He has right to distribute his votes in any manner he chooses.

A member may vote either in person or by proxy. Articles may allow voting by proxy even on show of hands. A proxy is a person or representative or shareholder at meeting of the company, who may be described as his agent to carry out a course which the shareholder has himself decided upon. A proxy is not entitled to act contrary to the inspection of the shareholder in the matter. It is the relationship of principal and the agent. A proxy does not have the right to speak. The instrument appointing a proxy must be in writing and signed by the shareholder, and should be deposited withthe company forty eight hours before the meeting. A proxy is always revocable but it must be received at the office of the company before the commencement of the meeting. Where a company, Central Government or a State Government is a member of another company, it may attend the meeting of the other through a representative.

28.10 RESOLUTIONS

Under the present Companies Act the resolution may be of two kinds—GI Ordinary

resolution and (2) Special resolution.

1. Ordinary Resolution

It means a resolution passed at a general meeting of the company by a simple majority of members entitled to vote and also in person or by proxy (where proxies are allowed). Thus if out of 100 members entitled to vote 50 members attended the meeting and out of 50, 25 members vote in favour of the resolution and 10 against it and 15 members abstain from meeting the resolution will be taken to have been passed as an ordinary resolution. Thus a resolution will be treated as an ordinary resolution if the vote cast in favour of the resolution (including the casting of the Chairman) and more than the votes casted against the resolution by members so entitled and voting. It is to be noted that the required notice of the meeting must have been duly given to the members. The important items of business of a company which can be transacted with ordinary resolutions are :

1. Approval of statutory report.
2. Adoption of director's reports balance sheet profit & loss account & auditor's report on the accounts.
3. Election of directors.
4. Declaration of dividend.
5. Appointment of auditors and fixing **their** remuneration.
6. Appointment of sole-selling agents.
7. Removal of director before the expiry of his tenure.
8. Appointment of another director is place of the one removed.
9. Alterations of share capital such as increase, sub-divisions, consolidation.
10. Issue of shares at a discount.

2. Special Resolution

It is a resolution which is passed at a general meeting of a company by a majority of three-fourth of the members present and entitled to vote, As Sec. 189 provides that a resolution will be treated as a special resolution when (a) the intention to propose the resolution as a special resolution has been duly specified in the notice calling the general meeting and the notice has been given to the members in accordance with the provision of this Act and (b) the votes cast in favour of the resolution by members entitled to vote and voting are less than three times the number of the votes against the resolution by members so entitled and voting.

A copy of every special resolution is required to be registered with the Registrar within 30 days after passing of marking thereof.

Some of the purposes for which special resolution are necessary are as follows :

(1) to change the name of the company with the consent of the Central Government;
(2) to alter the object clause of the memorandum;
(3) Alter the company's articles;
(4) to reduce share capital;
(5) to introduce variation in shareholders right;
(6) to demand the Central Government to appoint as inspector to investigate the affairs of the company;
(7) to allow the director to hold an office of profit under the company;
(8) to alter the memorandum for making the liability of the directors unlimited;
(9) to wind up a company voluntarily.

Thus, the important matters relating to the affairs of the company require special resolution. Its objects appear to protect the minority interest at least is important matters of the company.

Resolution Requiring Special Notice

Sometimes a special notice of the intention to move the resolution is required to be given by the company. Where such a notice is required by this Act or the company's articles, the notice must be given not less than 14 days before the meeting at which the resolution is to be moved exclusive of the day on which the notice the company must give its members notice of the resolution in the same manner as it gives notice of the meeting or if this is not practicable the company must give notice to the members by advertisement in a newspaper having an appropriate circulation or in and other allowed by the articles. The Companies Act provides that a special notice will be necessary for a resolution which seeks to appoint an auditor other than the retiring auditors or to remove a director or to appoint a person as a director, or to appoint a person as a director in place of the director which is removed etc.

Circulation of Members Resolution

Where some members desire to move a resolution at a meeting they must before it serve a requisition on the company. The requisition must be signed by (a) the holders of one twentieth of the total voting power of all the members having a right to vote on the resolution or (b) one hundred members having the right to vote and holding shares in the company on which at least one lakh rupees have been paid up. A company is not bound to give notice of any resolution or circulate any statements unless : (a) a copy of the requisition signed by the requisitionists is deposited at the registered office of the company (i) in the case of a requisition requiring a notice of resolution to be given to the members not less than 6 weeks before the meeting and (ii) in the case of any other requisition not less than 2 weeks before the meeting and (b) there is deposited or tendered with the requisition a sum reasonably sufficient to meet the company's expenses in giving effect thereto.

The company is not bound to circulate any statement if on the application of the company or any aggrieved person, the court is satisfied that the right of circulating of statement is being abused to secure needless publicity for a defaulting matter. A banking company can also refuse to circulate any resolutionif in the opinion of the Board of Directors the circulation will injure the interests of the company.

Registration of Resolution and Agreements

The following resolutions and agreements have to be registered with the Registrar of the companies : (a) Special resolutions, (b) resolutions which have been agreed to by all the members of a company but which in the absence of such an agreement, would not have been effective unless they had been passed as special resolution, (c) any resolution of the Board of Directors of a company on agreement executed by a company relating to the appointment, re-appointment or renewal of the appointment or variation of the terms of appointment of a managing agent or secretaries for a company on varying the terms of appointment of a managing director, (e) any agreement relating to the appointment, reappointment or renewal of the appointment of a managing agent or secretaries for a company on varying the terms of any such agreement executed by the company (f) resolution or agreements which have been agreed to by all the members of a class of shareholders but which, in the absence of such agreement, would not have been effective unless they had been passed by particular

majority and all resolutions or agreements which have been agreed to by all themembers of a class of shareholders but which, in the absence of such agreement, would not have been effective unless they had been passed by particular majority and all resolutions or agreements which bind all the members of a class of shareholders though not agreed to by all these members, (g) resolution passed by a company conferring powers on the company's undertaking or to borrow money beyond the limit of the paid-up capital and free reserves of the company or to contribute to charities beyond 50,000 rupees or 5 percent of the average net profits, (h) resolution approving the appointment of sole setting agent under Section 294 and (i) resolution requiring a company to be wound up voluntarily. A copy of such resolution or agreement must be registered with the Registrar within 30 days after the passing of the resolution or making of the agreement.

Resolutions or agreements to be printed or typewritten and certified by an officer of the company shall be filed within 30 days of the passing of the resolution or making of the agreement.

In case of non-compliance, the company and every officer if default shall be fined upto Rs. 200 for every day during which the default continues.

28.11 SELF CHECK EXERCISE II

Q6. When section 174 is applied of quoram?

Q7. Define ordinary resolution.

28.12 ANSWERS TO SELF CHECK QUESTIONS

EXERCISE I

Ans1. To make shareholders or members familiar with all the important facts relating to the new company

Ans2. A report prepared by Board of Directors before the statutory meeting to be held is statutory report.

Ans3. Because in this meeting, they can be sure of having an opportunity of meeting the directors and of questioning them on the affairs of the company.

Ans4. Registrar

Ans5. 3 months

Exercise II

Ans 6. If no provision is made in the articles, Sec. 174 of the Act will apply. Under this section, five members personally present in the case of a public and two in the case of a private company shall make the quorum for the meeting.

Ans 7. It means a resolution passed at a general meeting of the company by a simple majority of members entitled to vote and also in person or by proxy (where proxies are allowed).

28.13 KEYWORDS

Statutory meeting — Meeting within 6 months of commencement of business

Annual general meeting — atleast 1 Meeting of shareholders every year

Requisition meeting — extraordinary meeting convened by shareholders

Quoram — minimum numbers of members to be present at the

meeting	
Resolution	Agreement made in meetings by members of the company
Minutes	written record of proceedings of all meetings

28.14 SUGGESTED READINGS

(1) Elements of Company Law — N.D. Kapoor

(2) Company Law — Garg. Chawla & Gupta

28.15 SUGGESTED QUESTIONS

(1) Discuss the various types of meetings **in one** company.

(2) What are **the** various requisites of a valid meeting?

Semester-I BUSINESS ENVIRONMENT

Lesson No. 29 AUTHOR : RAJINDER KAUR

MANAGEMENT OF COMPANIES — DIRECTORS

STRUCTURE

29.0 Objectives
29.1 Introduction
29.2 Who is a Director
29.3 Number of directors
29,4 Appointment of directors
29.5 Share Qualification
29.6 Penalty
29.7 Disqualifications of directors
29.8 Restriction on appointment of directors
29.9 Removal of director by Central Government
29,10 Position of directors
29,11 Powers of directors
29,12 Duties of directors
29.13 Director's liabilities
29.14 Suggested readings
29.15 Questions for practise

29.0 OBJECTIVES

The objective of this lesson is to introduce the student with the

(i) Procedure of appointment of a director,

(ii) Disqualifications of directors. (iii)

Powers and duties of directors,

29.1 INTRODUCTION

A company being an artificial person cannot act by itself, It has neither a mind nor a body of its own. It must act through some human agency. The persons by whom the business of the company is carried on, are termed as directors.

29.2 WHO IS A DIRECTOR

According to section 2 (13) of the Companies Act, 1956, "director includes any person occupying the position of director by whatever name called. Director may be defined as the Individual who directs, controls, manages or superintends the affairs of a company. The directors of a company collectively are referred to as the "Board of Directors". No body corporate, association or firm shall be appointed director of a company and only an individual shall be so appointed (Section 253). It is because the office of a director is to some extent an office of trust. Somebody should be personally present to see the day-to-day functioning of a company,

29.3 NUMBER OF DIRECTORS

Every public company shall have at least three directors. Provided that a public company having

(a) a paid-up capital of Rs. 5 crore or more,

(b) one thousand or more small shareholders, may have a director elected by such small shareholders in the manner as may be prescribed. Small shareholder means a shareholder holding shares of nominal value Rs. 20,000 or less is such public company [Section 252(1)1. Every other company shall have at least two directors [Section 252(211 Section 252 provides that every public company must have at least 3 directors and every private company must have at least 2 directors. Subject to this statutory minimum number of directors, the articles of a company may prescribe the maximum and minimum number of directors for its Board. **A** company in a general meeting may by ordinary resolution increase or reduce the number within the limits fixed in that behalf by its articles (Section 258). Beyond such limits the variations can be made by passing a special resolution. Where a minimum number of directors is fixed the directors cannot function if the number falls below the same unless the articles otherwise provide. Any increase beyond the limit fixed by the articles must be approved by the central government except where the increase in the number of directors does not make the total number of directors more than twelve.

29.4 APPOINTMENT OF DIRECTORS

Directors may be appointed

1. By subscribing to the memorandum - First directors - Section - 2.54, Regulation 64 of Table A.
2. By shareholders in general meeting - Section 255, 256, 257, 265.
3. By board of directors - Section 260, 262, 313.
4, By central government - Section 408., 409.
5. By third parties - Section 255.
6. **By** principle of proportional representation - Section 265.

1. Appointment of First Directors

The first directors are usually named in the articles. If not so named in the articles, the articles may authorise the subscribers to the memorandum to appoint the first directors. In that event the subscribers or majority of them may appoint first directors. If articles are silent on the matter, section 254 states that all the subscribers to the memorandum who are individuals are deemed to be the first directors who will hold office, tillthe first annual general meeting of the company. If the articles provide *for any* qualification shares, only such individuals who fulfil that requirement shall only be deemed to be the directors.

2. Appointment of directors by members at general meeting

According to section 255 of the Companies act, 1956, in the case of public company or a private company which is a subsidiary of a public company, unless the articles provide for the retirement of all directors not less than two thirds of total number of directors must be appointed in general meeting. These directors must be subject to retirement by rotation. One-third of the total number of directors can act as non-retiring directors, e.g if there are six directors, four will retire by rotation, two directors will be permanent. There is no provision for retirement of any director periodically of a company which is neither a public company nor a private company which is subsidiary of public company. According to section 256 of the Act only one third of the directors are liable to retire by rotation and they shall retire at every annual general meeting if their number is not three or multiple of three then the number nearest to one-third shall retire from office. Rotational directors **do** not include additional,

alternate, debenture holder or central government's nominee directors. Similarly, directors appointed by financial institutions in pursuance of the agreement entered into by these institutions with the company are not liable to retire by rotation. Where annual general meeting is not held, rotational directors would automatically retire from the officer on expiry of the maximum permissible period within which such meetings ought **to** have been held. Section 256 provides that vacancies created by retirement of directors are to be filled at the same annual general meeting. The retiring directors may be reappointed, if eligible and offer themselves for reappointment. If the place of retiring director is not so filled and the meeting has not been expressly resolved to fill the vacancy the meeting shall stand adjourned. If at the adjourned meeting also the vacancy is not filled and the meeting has been not expressly resolved to fill the vacancy, the retiring director shall be deemed to have been re-appointed at the adjourned meeting unless:

(i) The re solution for reappointment was put to the meeting and lost.

(ii) The retiring director has in writing addressed to the company or its Board Of directors expressing his unwillingness to be so re-appointed,

(iii) He is not qualified for appointment,

(iv) A special or ordinary resolution is necessary for his appointment or reappointment.

A person other than a retiring director is also eligible for appointment to the office of director subject to his necessary qualification. A notice in writing signifying his candidature must be sent to the office of the company at least fourteen days before the date of meeting along with a deposit of Rs. 500 which shall be refunded to such person or as the case may be to such member, if the person succeeds in getting elected as director. Appointment of directors of a Public Company must be voted individually by separate ordinary resolution unless company has in general meeting unanimously so resolved.

3. Appointment of directors by Board

The directors are empowered to appoint :

(i) Additional director : The Board of directors may if authorized by articles to appoint additional directors. Such additional directors together with the existing directors should not exceed the maximum number fixed by the articles and hold office only up to the date of the next annual general meeting of the company (section 260). If the annual general meeting of the company is not held or cannot be held, the person appointed as additional director vacates his office on the last day on which the annual general meeting should have been held in terms of section 166 of the Act.

(ii) Alternate directors : Section 313 of the Companies Act 1956, empowers the Board of directors of a company to appoint, if the articles or a resolution passed by the company in general meeting so authorise an alternate director to act in place of a director during his absence for not less than three months from the state in which the Board meetings are ordinarily held. The alternate director holds office for the period the original director is away from the state and vythen original director returns, the alternate director ceases to be director.

(iii)Appointment of directors to fill casual vacancies : Section 262 of the Act empowers the Board of directors of a company to fill casual vacancies. It states that if office of any director, appointed by the company in genera/ meeting, is vacated before his term of office expires in the normal course, the resulting vacancy may be filled by Board of directors at a Board meeting in accordance with the procedure laid down in articles.

(iv) Appointment of directors by Central Government: Section 408 of the Companies Act 1956 vests over-riding powers in central government to nominate directors. Sub-section

(i) of the section provides that the central government may appoint such number of persons as the National Company Law Tribunal (NCLT) may, by order in writing specify as being necessary to effectively safeguard the interests of the company or its shareholders or the public interests to hold office as directors thereof or such period, not exceeding three years on any one occasion, as it may think fit, if the National Company Law Tribunal (NCLT) on a reference made to it by the central government or on an application of not less than one hundred members of the company or of the members of the company holding not less than one-tenth of the total voting power therein is satisfied after such inquiry as it deems fit to make, that it is necessary to make the appointment or appointments in order to prevent the affairs of the company being conducted either in a manner which is oppressive to any members of the company or in a manner which is prejudicial to the interests of the company or to the public interest.

(v) Appointment of directors by third parties : The articles sometimes give a right to financial institutions and debenture holders to nominate directors on the Board with a view to ensure that the funds lent by them are used for the purpose for which they were borrowed. Normally such nominee directors are non-retiring.

(vi) Appointment by proportional representation : Normally directors are appointed on a straight voting of the members of the company by an ordinary resolution or by simple majority. As a result of this method of simple majority, a substantial minority may not succeed in placing even a single director on the Board. Section 265 affords an opportunity to the minority shareholders to have their representative on the Board of directors. The section provides that notwithstanding anything contained in the act a public company or a private company which is a subsidiary of a public company may in its articles for the appointment of two-thirds of the directors by the principle of proportional representation, by the single transferable vote or by a system of cumulative voting or otherwise such appointments are made once in every three years.

29.5 SHARE QUALIFICATION

Under the Companies Act, no specified academic qualification for appointment as a company director has been mentioned, not even qualification share. The articles of association generally require that the qualification of director shall be the holding of a specified number of shares. Known as qualification shares, so that directors may have personal interest in the company. If a director is not qualified, he must obtain the qualification shares within two months after his appointment as a director. The nominal value of one share NV here it exceeds Rs. 5,000. The holding of share current shall not be deemed to be the holding of qualification shares [Sec 270].

29.6 PENALTY

If a person acts as **a** director of a company without holding the qualification shares, he will be punishable with fine which may extend **to** Rs. 500 per day between such expiry and the last day on which he acted as a director [Sec 272]. These provisions do not apply to a private company unless it is a subsidiary of a public company [Sec 273], nor do they apply to directors appointed by the Central Government under Section 408.

29.7 DISQUALIFICATIONS OF DIRECTORS

A person cannot be appointed as a director of a company, if

(al he has been found to be unsound mind by a competent court and the finding is in force.

(b) he is an undischarged insolvent;

(c) he has applied to be adjudicated as an insolvent and his application is pending;

(d) he has been convicted of an offence involving moral turpitude and sentence to imprisonment for not less than 6 months and a period of 5 years has not elapsed since the expiry of his sentence;

(e) he has not paid any call is respect of shares of the company held by him for a period of six months from the last day fixed for the payment;

(f) he has been disqualified by an order of the court under section 203 of an offence in relation to promotion, formation or management of the company of fraud or misfeasance in relation to the company,

(g) A private company which is not a subsidiary of a public company may by its articles provide for additional grounds for disqualification.

29.8 RESTRICTION ON APPOINTMENT OF DIRECTORS

Section 266 provides that a person cannot be appointed a director by the articles or named as a director in a prospectus or statement in lieu of prospectus unless, before registration of the articles, publication of the prospectus, or filing of the statement in lieu of prospectus. as the case may be, he has:

(a) signed and filed with the Registrar a consent in writing to act as such director

(b) and has

(i)signed the memorandum for his qualification shares, if any, or

(ii)taken his qualification shares, if any, from the company and paid or agree to pay for them or

(iii) signed and filed with the Registrar a written undertaking to take from the company his qualification shares, if any, and pay for them or

(iv) made and filed with the Registrar an affidavit to the effect that his qualification shares are registered in his name.

This section however shall not apply to: -

(i) a company not having share capital,

(ii) a private company,

(iii) a public company which was originally formed as a private company.

(iv) prospectus issued by a company after the expiry of one year from the date on which the company was entitled to commence business.

Restriction on number of directorships: Section 275 of companies Act limits the member of directorships to 15 which a person can hold at a time. Removal of Directors

A director may be removed from his office :

(i) by the shareholders

(ii) by central government

(iii) By NCLT

(1) Removal of directors by the Shareholders

Section 284 of the Act provides that a company may by an ordinary resolution passed in general meeting after special notice, remove a director before the expiry of the period of his office. But the following exceptions to the section are note worthy :

(a) The section does not apply to a director appointed by the Central Government in pursuance of section 408.

(b) In the case of a private company, the section does not authorise the removal of a director holding office for life on April 1, 1952.

(c) It does not apply to a company which has adopted the system of appointing two-thirds of its directors by principle of proportional representation.

(d) Directors appointed by financial institutions pursuant to stipulation under the loan agreement,

(e) Directors appointed by Board for Industrial and financial reconstruction. A special notice of the intention to move the resolution should be given to the company not less than 14 days before the meeting. As soon as the company receives the notice, it must furnish a copy of it to the directors concerned who will have right to make a representation and to be heard on the resolution at the meeting. If the director submits a representation in writing not exceeding a reasonable length to the company and requests its notification to be circulated among the members, the company should, where there is enough time to do so, send a copy of the representation to every member of the company to whom notice of the meeting is sent. If this is not possible, the representation may be read out to the members at the meeting.

29.9 REMOVAL OF DIRECTOR BY CENTRAL GOVERNMENT

The Companies Amendment) Act, 1963, introduced a new chapter in the Act consisting of section 388-B to 388-E which empower the central government to remove managerial personnel including a director of a company from office on the recommendation of the NCLT. The procedure prescribed for removal of such person is that the central government will state a case against such a person and refer the same to the NCLT with a request that NCLT may enquire into it and record a decision as to whether such a person is fit and proper person to hold the office of director or any other office connected with the conduct and management of a company. Before making such an application to the NCLT, the Central Government must be of the opinion that there are circumstances suggesting;

(a) that the person is guilty of fraud, misfeasance, persistent negligence or default in carrying out his obligations and functions under the law or breach of trust; or

(b) that the business of the company has not been conducted and managed by him in accordance with the sound business principles or prudent commercial practices; or

(c) that the management and conduct by the person has been such which is injurious or damaging to the interests of the trade, industry or business in which the company is engaged ; or

(d) that such person has conducted or managed the business of the company fraudulently or in a manner prejudicial to public interest. The person removed by central government is disabled from holding a managerial office for five years, unless the period is remitted by central government with the previous concurrence of the NCLT. No compensation for loss or termination of office is payable to him. The company may with the previous approval of central government appoint another person to office.

Removal By NCLT

When the National Company Law Tribunal (NCLT) finds on an application to it for prevention of oppressions and mismanagement that a relief ought to be granted, it may terminate or set aside any agreement of the company with a director or managing director or other managerial personnel. When the appointment of a director is so terminated, he cannot except with the leave of the National Company Law Tribunal (NCLT) serve any company in a managerial capacity for a period of five years. Nor can he sue the company for damages for compensation for loss of office.

Check Your Progress:

1. In a public company ____ is the minimum number of directors.

2. The first director of a company is appointed by _______.

3. The appointment of the subsequent directors of a company is made in the ________________.

29.10 POSITION OF DIRECTORS

Companies Act 1956, is silent about position of directors. Bowers L.J. said, "Directors are described sometimes as agents, sometimes as trustees and sometimes as managing partners."

The directors are both trustees and agents of the company. The dual character of directors is best expressed by Lord Se'borne in G.E. Railway V. Turner where he said The directors are mere trustees or agents of the company, trustees of the company's money and property and agents in the transaction with which they enter into on behalf of the company."

(1) Directors as Agents

Directors are correctly described as agents of the company and the ordinary laws of agency govern their relationship with the company. The company is not a physical person and therefore cannot act in its own person. A company is an artificial being having neither a body nor mind of its own. **It** has to think and act through the agency of human beings. It is the directors who as agents act on behalf of the company. They are the agents of the company with powers and duties of carrying on the business subject to the restrictions imposed by the articles and the act. Like agents directors have to disclose their personal interest, if any, in any transaction of the company. It should however be remembered that they are the agents of an institution and not of its individual members. The powers of directors are much more than those of an ordinary agent. An ordinary agent acts according to the instructions of his principal but directors do not. Once they are elected, they derive **their** powers from the articles and the Companies Act, Moreover the agents are not elected but appointed. Hence the directors are not agents in the true sense.

(2) Directors as managing partners

The directors are also sometimes described as managing partners because like a partner of a firm, they manage the affairs of the company and they are also usually important shareholders of the company. They do all proprietary functions like allotting shares, making calls, forfeiting shares etc. However all the partners of a firm act on the principle of mutual agency. But it is not so in the case of directors. A director has no authority to bind the other directors and shareholders. Moreover, directors are subject to retirement by rotation whereas partners of a firm are not. Hence, the directors are not managing partners in full sense,

(3) Directors as employees

Directors are not employees or servants of the company. They cannot claim their remuneration as preferential creditors in the event of winding up of a company under section 530 of the Companies Act 1965, But where any director, besides being a director, is also in the

service or employment of the company such as secretary, manager, accountant or otherwise **he** will be treated as an employee.

(4) Directors as trustees

Lord Lindley observed that although directors are not properly speaking trustees, yet they have always been considered and treated as trustees of money which comes to their hands or which is actually under the control and ever since Joint Stock Companies were invented directors have been held liable to make good moneys which they have misapplied.

29.11 POWERS OF BOARD

A company being an artificial person acts through its directors. The directors represent the directing mind or will of the company and control what it does. All the powers of management or the affairs of the company are vested in the Board of Directors. The directors' powers are normally set out in the articles. The shareholders cannot control the way in which the Board of directors' act provided its actions are within the powers given to Board. According to section 291 of the Companies Act, the Board is entitled to exercise all such powers and do all such acts, and things, subject to the provisions of the Companies Act as the company is authorised to exercise and do, However, the Board shall not exercise any power or do any Act or things which is required whether by the act or by the company in general meeting. The powers which vest in the Board can be classified under three different heads:

(1) Powers which can be exercised in accordance with the articles.

(2) Powers which can be exercised only at Board meetings.

(3) Powers which can be exercised with the consent of shareholders at general meeting.

The directors shall exercise their powers bonafide and in the interests of the company. But once specific powers of control and management have been granted by the company to its directors the company cannot without justification impose its will at a general meeting, The shareholders dictate to the directors the manner in which their executive authority is to be employed. Thus where the power to sell the assets of the company is vested in the Board and the Board thinks that it is not in the interest of the company to sell its assets, it is not bound to do so, notwithstanding a resolution to the contrary in the general meeting.

EXCEPTIONS

The relationship of the board of directors with the general body of shareholders is more of federation that are of subordinate and superior. Some powers are specially reserved for the board e.g. recommending dividends and declaring interim dividends, In certain exceptional situations however, the general body of shareholders is competent to act even in a matter delegated to the Board, for the inherent residuary and ultimate powers of a company lie with the general body of shareholders.

The exceptional situations are:-

(1) Directors acting mala fide: The general body of shareholders can interfere where it is proved that the directors have acted from some improper motive or arbitrarily or capriciously when the directors are themselves the wrongdoers against the company and have acted mala fide or beyond their powers and their personal interest is in conflict with their duty in such a way that they cannot or will not take such a case be entitled to take steps to redress the wrong.

(2) Incompetent Board: The general body of shareholders may exercise the powers vested in the board when there is no legally constituted board which could function or if there is a board but that is unable or unwilling to act. The shareholders have to step in where all the directors are interested in a transaction.

(3) Deadlock in the Board Where the directors are unable to act on account of a deadlock and the administration was at a standstill, the shareholders have the inherent power to take necessary steps to ensure the working of the company.

(4) Residuary Powers: The residuary powers of a company are decided in the general meeting of shareholders and shareholders can always exercise such residuary powers.

Powers to be exercised at Board meeting Under section 292 there are some powers which can be exercised in Board meeting:

(a) The power to fill up casual vacancies in the office of directors (section 262).

(b) The power to make donation to political parties (sub section (2) of section 293 (A).

(c) The power to accord sanction for specified contracts in which one or more directors are interested [section 297 (4)].

(d) Disclosure of interest by directors [section 299 (1)).

(e) The power to receive notice of disclosure of directors interest [section 299 (3) (f) The power to receive notice of disclosure of directors interest [section 299 (3)

(g) The power to appoint or employ a person as managing director [section 316 (2)].

(h) The power to invest in shares or debentures of any body corporate within the Limit specified in sub-section (2) of section 372 (section 372 (5)).

(i) The power to appoint or employ a person as its manager if he is the Manager or managing director of other company [section 386 (2)1,

(j) The power to make a declaration of solvency where it is proposed to wind up the company voluntarily [section 488(I)].

29.12 DUTIES OF DIRECTORS

Law imposes certain duties upon directors, in the interest of the public good and for the protection of those who invest money in the company The duties of a director vary from company to company and within one company. The directors may frequently have different responsibility. The duties of directors may be discussed under the following heads :

11) Fiduciary Duties

The first duty or obligation is not to exceed their authority and powers. Directors must not do any act which is ultra vires the company or illegal or without the sanction of the members in general meeting do any act which is beyond the authority conferred on them by the articles. If they do any such act and company suffers loss as a result, the company can recover the amount of its loss from them and it is not necessary for it to show that they acted negligently. It is also unlawful for directors to pay dividends out of share capital, and if they do so they are liable to make good any money expended in that way. The second obligation of directors is **to** act honestly and with utmost good faith. All their endeavours must be directed to the benefit of the company. Like any other agent a director must account to the company for any profit he makes the use of his position as a director.

(2) Duty of Care

A director like any other agent owes a duty to his company to exercise reasonable care in the management of its affairs and is liable to it in damages if he fails to do so. How much degree of care and skill the directors are bound to exercise will depend upon the circumstances of each case, in particular on the nature of company's business, the scale of its operations and the distribution of work between the directors and the staff. A director however, does not owe to his company, the duty to take all possible care or to act with best care. Indeed he need not exhibit in the performance of his duties a greater degree of care than may reasonably be expected from a person of his knowledge and experience.

(31 Duty not to delegate

Generally the principle of '**cielegatus**non-protest delega.re" applies to directors so that a director is expected to perform his functions personally and not to pass the responsibility on someone else. A delegate cannot further delegate. Shareholders have appointed him because of their faith in his skill, integrity and competence and they may not have the same faith in another person. However, delegation can be made to the extent to which it is permitted by the Act or articles of the company,

(4) Duty to disclose interests

An agent being in fiduciary position towards his principal, must ensure that his personal interest and his duty to this principal do not conflict. For the proper exercise of the function of a director it is essential that **he** should be disinterested, that is to say he should be free from any conflicting interest,

(5) Duty not to contract without Board's Consent

According to section 297 of the Companies Act, 1956 Board's sanction is required for certain contracts in which particular directors are interested. Section 297 deals with the contracts between the company and

(i) A director of the company;

(ii) his relative; **A** firm in which the director or his relative is a partner;

(iv) **A** private company of which the director **is a** member or a director.

However these provisions shall not affect :

(i) Contracts for the purpose of goods and materials from the company or the sale of goods and materials to the company by any director, relative, firm etc. for cash at prevailing market prices; or

(ii) Contracts for the sale, purchase or supply of goods in which either of the parties regularly trades or does business, provided the value **of** the goods does not exceed Rs. 5000 in any year; or

(iii) Any transaction of a banking or insurance company in the ordinary course of business,

29.13 DIRECTOR'S LIABILITY

Director's Liability can be considered under different heads :-

(1) Liability as shareholder

The liability of directors for payment of share money is ordinarily limited in the same way as that of other shareholders of the company. But by virtue of section 322, the memorandum of a company may make the liability of any or all directors or manager, unlimited. In that case the directors, manager and the member who propose a person for appointments as director or manager, must add to the proposal for appointment a statement that the liability of the person holding the office will be unlimited.

(2) Liability for breach of fiduciary duty

A director being in the fiduciary position of trustee for the company may incur liability for breach of his fiduciary duty to the company. Directors are personally liable for the following acts.

(a) For ultra vires acts The failure to act within their powers as where they do an act which is ultra vires, the company either because it is prohibited by law or because it is outside the powers of the company as defined by its memorandum or which is beyond the authority of the directors as defined by the articles may render the

directors liable to indemnify the company in respect of any consequent loss or damage.

(b) For Mala fide acts Apart from ultra vires acts, directors may incur liability to their company as for breach of trust or misfeasance if in their capacity *as* director, they act mala fide i.e. otherwise than honestly for the benefit of the company. It is on this ground that directors would be held liable to account for and surrender profits to their company.

(c) For negligence: As long as the directors act within their powers with reasonable skill and care as expected of them as prudent businessmen, they discharge their duty to the company. But if they are negligent in the discharge of their duties, they may be liable to their company for negligence.

(3) Liability to third parties

In certain circumstances directors may incur personal liability to third parties, either under the Companies Act or otherwise:-

(a) Under the Act Directors may become liable to third parties under the Act where they are responsible for the issue of prospectus which does not contain particulars required by the Act or which contains material misrepresentations. They may also become liable in respect of irregular allotment of shares. They may also become liable to third parties if in pursuance of sections 322 and 323, **their** liability has been made unlimited.

(b) Apart from the Act Independent of the act directors may incur personal liability to third parties in consequence of contracts made on behalf of the company. If the directors enter into a contract which is ultra vires of the company, the third party is entitled to recover damages from the directors as for breach of warranty of authority, unless the fact of the contract being ultra vices would have been apparent to the third party if he had referred to the **memorandum** of the company.

(4) Criminal liability

Directors may incur **criminal** liability either as common law or under any statute notably the Companies Act or The Indian Penal Code, Under the Companies Act criminal proceedings against directors may be instituted in pursuance of the following sections among others resulting in imprisonment :

(a) Section 44 (4) filing of prospectus containing untrue statement - two years imprisonment and/or fine upto Rs. 50,000.

(b) Section 58 A - (6) (b) - Inviting deposits in contravention of the rules or mariner or conditions - five years' imprisonment and fine.

(c) Section 58 **B Issuing** false advertisement inviting deposits two years imprisonment and/or Rs. 50,000 fine.

(d) Section 68 - Criminal liability for mis-statement in prospectus - imprisonment upto two years or fine upto Rs. 50,000 or both.

(e) Section 68 - fraudulently inducing **persons** to invest money - imprisonment unto five years or fine Rs. 1,00,000 or both.

(f) Section 73- failure to repay excess application money- imprisonment upto one year or fine upto Rs, 50,000,

(g) Section 106 concealing name of **creditor -** imprisonment upto one year or fine or both.

(h) Section 202 (1) undischarged insolvent acting as director - imprisonment upto two years or fine upto Rs. 50,000 or both.

(i) Section 207 - Default in distributing dividends - seven days simple imprisonment and fine.

(j) Section 209 A - Failure to assist Registrar or any officer so authorised by central government in inspection of books of account etc.- Imprisonment upto one year and fine not less than Rs. 50,000.

(k) Section 210 (5) Failure to lay balance sheet etc. **at** annual general meeting – imprisonment upto six months or **fine** up to Rs, 10,000 or both.

(l) Section 211 (8) Failure to comply section 211 regarding form of balance sheet and matter to be stated - imprisonment up to six months or fine upto Rs. 10,000 or both.

(m) Section 217 (5) Failure to attach to balance sheet a report of the board imprisonment upto six months for each offence or fine upto Rs, 20,000 or both.

(n) Section 221 (**4)** -Failure to supply information to auditor - imprisonment up to six months or fine upto Rs. 50,000 or both.

(o) Section 248 (4) Supplying wrong information to central government imprisonment up to six months or fine up to Rs. 50,000 or both.

(p) Section 250 (9) - Improper **issue of** shares -imprisonment up to six months or fine up to Rs. 50,000 or both,

(q) Section 293 A (5) - Contribution to political parties in contravention of section 293 A – three years imprisonment and fine.

(r) Section 295 (4) - Grant of loan to directors -simple imprisonment up to six months or fine upto Rs. 50,000,

(s) Section 308 (3) - Failure to disclose shareholding - imprisonment upto two years or fine upto Rs. 50,000 or both.

(t) Section 371 Giving loans to other bodies corporate in excess of limits prescribed under section 370 - imprisonment upto six months or fine upto Rs. 5000. Section 370 – imprisonment upto six months or fine upto Rs. 50,000.

(u) Section 407 (2) - Acting as director after removal by court - imprisonment upto one year of fine upto Rs. 50,000 or both.

(v) Section 483 (3) - False declaration of company's solvency - imprisonment upto six months or fine upto Rs. 50,000 or both.

(w) Section 538 to 542 and 550 - offences regarding companies - imprisonment ranges between two to five years or fine from Rs. 10,000 to Rs,1,00,000.

Keywords: Company Law, Director, Section, Liability, Dividend

29.14 SUGGESTED READINGS

(1) Company Law - Avtar Singh
(2) Company Law - N.D. Kapoor
(3) Modern Indian Company Law -M.C. Kuchhal

29.15 QUESTIONS FOR PRACTICE

1. Discuss the provisions of the Companies Act regarding the appointment of directors of a company.
2. "Directors are not only agents but are also in some sense trustees of the company.' Discuss.
3. Discuss the liability of a director for
   (i) Negligence
   (ii) Misfeasance

Short Answer Questions:

1. Define legal position of a director.
2. When does a director vacate his office automatically.
3. What is meant by share qualification of a director?
4. Can additional director be appointed by a company.
5. What is meant by resolution by circulation?

Long Answer Questions:

1. What are the restrictions on appointment of a director.
2. Discuss the liabilities of a director.
3. "A director cannot enter into a contract with the company" Explain the statement.
4. "The right of fire and hire rests with shareholders" discuss

Glossary:

1. **Agent:** anyone authorised to act on the behalf of another.
2. **Annual Meeting:** A yearly meeting of shareholders in which directors are elected and other general business is conducted.
3. **Debenture:** A long term det issued mainly to evidence an unsecured corporate debt.
4. **Dissolution**: The statutory procedure that terminates the existence of a domestic corporation.

Answer of Check Your Progress (Fill in the Blanks):

1. Three
2. The Promoters of the company
3. Annual General Meetin

(First YEAR) **BE 106**

Semester-I **BUSINESS ENVIRONMENT**

Lesson N. 30 **AUTHOR: TARANNUM MOHAN**

MANAGEMENT FRAUDS

STRUCTURE

30.0 Objectives
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30,2 Introduction
30,3 Types of frauds
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 30.8.1 Warning signals
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30.0 OBJECTIVES

After reading this chapter, the student should be able to

- Understand the root cause of corporate fraud and how to manage it.
- Become familiar with common frauds and their warning signals.
- Discover the best ways for the management to get involved in fraud **prevention** process.

30.1 DEFINITION

The frauds committed by the management of a company or a firm to obtain personal benefits by cheating others are known as management frauds.

Fraud in law means willful misrepresentation intended to deprive another of some right.

In the broadest sense, fraud isa deception made for personal gain. The legal definition of fraud varies by legal jurisdiction. Fraud is a crime and is also a civil law violation. In the criminal law of common law jurisdictions, it may be called "theft by deception. The law distinguishes between actual fraud, which is intentional and constructive fraud which is not deliberate.

30.2 INTRODUCTION

Cottrell and Albrecht (1994) point out that violent crime has clear physical evidence whereas fraud often goes unobserved directly. Fraud is called **white collar crime in** contrast to **more violent crime.**

Most Of the time, the management misrepresents facts in its books for showing higher profits for its companies. It is the duty of the auditors to catch these irregularities but it has

been observed that very often the auditors are not doing a very good job at it.

The *recent* failure of U.S. energy conglomerate Enron is a case in point which has shaken the American audit profession to its foundations. Congressional committees, frustrated investors, regulators and even the FBI are asking a tough question: "Where were the auditors?"

A 1999 study by the U.S. Committee of Sponsoring Organisations (C050) of over 200 financial statement frauds brought out certain startling facts. It concluded that a company's top brass (the chief executive officer and the chief financial officer) were directly responsible for fudging the books in at least 82% of the cases.

What has added to the increase in the number of such fraud cases is an increase in the advantages received from committing fraudulent acts and a decrease in the risk of being caught and punished.

There are various types of frauds like fraud by employees, fraud by management, fraud by non related outsiders. In this chapter *we* will focus on management frauds.

30.3 TYPES OF FRAUDS

Albrecht and Romney (1986) grouped frauds into two categories based on motivation. One factor is that motivates some persons to commit fraud on behalf of a company and those that motivate persons to commit fraud against a company.

There are three basic types of fraud: asset misappropriation, bribery and corruption, and financial statement fraud.

Most common and least expensive type is *asset misappropriation.* Any business asset can be stolen by employees or third parties, or by a collusion between the employees and third parties. It happens in over 91% of fraud schemes. It includes direct theft of cash or realisable assets, such as stock or intellectual property, such as price or customer lists, making false expense claims, payroll fraud, or theft of services.

Next is *bribery and corruption* which includes schemes such as cuts, kickbacks or commission, bid rigging, gifts or gratuities, and manipulation of contracts. According to conservative estimates 30% of the frauds that go uncovered are bribery and corruption.

The least common and most expensive type of fraud is financial statement fraud. This type of fraud is done in the books of account by the management as it is interested in showing a picture of the state of affairs of the company in such a way that suits them. Usually done to

- Show less profit - this can be done by showing less receipts or by showing less expenses and the objective of such actions could be to save tax or to avoid take over bids.
- Show more profit - this can be done by showing more receipts or by showing fewer expenses and the aim could be to attract more investments, loans or to attract shareholders etc.

Other types of frauds include

Computer fraud

In these cases computer can be used as a tool for committing a fraud. It includes sending emails intended to scare people, illegally using someone else's computer or using spyware to gather information about people, manipulating the share price of a company by publicising invalid news items on bulletin boards, diverting funds from one bank account to another by hacking.

Money laundering - This is the practice of engaging in financial transactions in order

to conceal the identity, source or destination of money. This is a main operation of the underground economy. It includes obtaining bank loans against assets derived from criminal activities or issuing company cheques to third parties and those parties issuing cheques to an individual.

Investment scheme fraud - It can also be viewed as third-party asset misappropriation. It entails taking money from customers on the promise of spectacular returns but using the cash for one's own purposes.

Intellectual property fraud - it is theft of patents, industrial design etc by employee or third party. Intellectual property fraud may include sale of price list or customer list or using critical business information to set up competition. Intellectual property theft varies from region to region with the highest percentage of respondents in Asia Pacific. 1P theft was seen as the highest threat in China (38 per cent) as compared to India (14 per cent).

Insurance fraud - it may include false claims, jacked up claims, multiple claims, obtaining cover on favourable terms on the basis of false information, deliberate under insuring to reduce premium.

30.4 WHY DO EMPLOYEES COMMIT FRAUDS?

- The majority commits frauds to meet their financial obligations.
- The most common reason for employees committing fraud had little to do with opportunity, but more with motivation
- Wages in kind - the more dissatisfied the employee, the more likely he or she was to engage **in** criminal behavior.
- Technical ability of the fraudster
- For a fraud to occur the fraudster should be able to rationalize his offence as something other than criminal activity.
- Opportunity to commit crime, which may include the existence of national and international social networks and transferable criminal skills.

30.5 WHO COMMITS FRAUDS?

Fraudsters usually fall into one of three categories:

1. Pre-planned fraudsters: this category includes people who start out from the beginning intending to commit fraud. These can be short-term players, like many who use stolen credit cards or can be longer-term, like bankruptcy fraudsters.
2. Intermediate fraudsters: these are people who start off honest but turn to fraud when times become hard or when there is dishonesty in personal life.
3. Slippery-slope fraudsters: these are people who simply carry on trading even when, objectively, they are not in a position to pay their debts. This can apply to ordinary traders or to major businesspeople.

30.6 WHY AUDITORS FAIL TO DETECT FRAUDS

- One of the major reasons is unwillingness of the auditors to look for frauds_ Auditors think that finding frauds is primarily a police detection activity and they do not consider it as their prime responsibility.
- In cases auditors place too much trust on Auditees. Year after year auditing leads to auditors becoming friendly with the company. A level of trust may develop over a period of time that makes the auditors lax.
- At times not enough emphasis is laid on audit quality. Audit reports mostly point

out on missing records or accounts that were not reconciled and miss out on fraud related issues.

- Fraud concerns receive inadequate support from management. Management most of the times would like auditors to skip or stop spending time on low-risk areas.
- Auditors sometimes fail to focus on high- risk fraud areas. At times auditors end up focussing to much on low-risk fraud areas and miss out on high-risk areas.

Check Your Progress:

(1) Which of the following is not a fraud risk category?

1. Misreporting 2. Recruitment fraud 3. Bribery and corruption 4. Financial statement fraud

(2) Which of the following would not be updated on the fraud risk register after an assessment?

1.Changing business model 2. Change of address 3.Changing operations 4.Changing structure

(3) Which of the following steps would not add value in a fraud risk environment?

1. Building an environment unfavourable to fraud 2. Making a list of politically exposed persons

3. Improved internal control system 4. Early identification of risks

(4) Which of the following is the fraud risk management team not attempting to safeguard?

Reputation 2. Assets 3. National security 4. Employees

30.7 FRAUD PREVENTION

30.7.1 Developing an anti-fraud culture

Attitudes within an organisation often lay the foundation for a high or low risk environment. It is a known fact that where minor unethical practices are overlooked larger frauds committed by higher levels of management may also be treated in a similar lenient way, in this environment there may be a risk of total collapse of the organisation either through a single catastrophic fraud or through the combined weight of many smaller frauds.

A Benchmark organisation will generally have;

(a) a mission statement which refers to quality or more unusually to ethics which defines how the

(b) organisation wants to be regarded externally

(c) a clear policy statement on business ethics with explanations about acceptable behaviour in risk prone circumstances.

(d) a route through which suspected fraud can be reported.

30.7.2 Risk Awareness

It is important to sensitise people about risk management. It has been seen that almost *every* time a major fraud occurs many people who were unwittingly close to it are shocked that they were unaware of what was happening. Therefore, it is vital to raise awareness through formal education and training programme as a part of the overall risk management and staff operating in high risk areas, such as procurement and bill paying and to those with a role in the prevention and detection of the fraud, for example human resources and staff with investigation responsibility.

30.7.3 Whistle-Blowing

Very many frauds are known or suspected by people who are not involved. The challenge for management is to encourage these innocent people to speak out to demonstrate that it **is** very much in their own interest.

In this are there are many conflicting emotions influencing the potential whistleblower.

1, working group/family localities
2. disinterest/ sneaking admiration
3. fear of consequences
4, suspicion rather than proof

Where fraud is committed by senior managers the predicament faced by the whistle blower is exacerbated. And this is where managements greatest challenges lies- to convince staff that everyone is responsible for combating fraud and the good health of complaint under the false claims act,

30.7.4 Sound Internal Control Systems

A company's system of internal control has as its principal aim the management of

risks that are significantly to the fulfilment of its business objectives with a view to safeguarding **the company's** assets and enhancing over time the value of the shareholders interest.

An internal control system comprises all those polices and procedures that taken together support a company's effective and efficient operation. .These procedures can include the division of responsibilities and checks and balances to reduce risk.

30.8 IDENTIFYING FRAUDS

It is almost impossible to develop a system where there is no possibility or chances of frauds being committed. **It** will never be possible to eliminate frauds because no system is completely fraud proof. **Many transactions** are able to by-pass control systems put in place to stop them. **However,** vigil and a little more attention paid to some of the most common indicators could sound alarm bells that something is not quite right and increase the chances that the frauds ter will be discovered.

Fraud Indicators can be classified into **two categories:**

1. Warning signals
2. **Fraud** alerts

30.8.1. Warning Signals

Warning **signals** are organisational indicators of fraud **risk. They have** been sub-divided into business risk, financial risk and environmental risk.

Business Risk

This has been sub divided into cultural issues, management issues, employee issues, process issues and transaction issues.

Cultural issues

- Absence of **an anti- fraud policy.**
- Failure of management to make a clear commitment to implementing a sound framework of internal control and demonstrating this at all times.

Management issues

- There are no steps from management in case of any deviations from the code of conduct or the policies.
- No effective oversight by the management which is comprised of a small group.
- Lack of clear management control of responsibility, authorities, delegation.
- A history of legal or regulatory violations within the organisation and claims against the entity alleging such violations.
- Frequent change of legal advisors or auditors.
- High turnover of financial personnels

Employee INSUCIS

- No checks to **see** that only appropriate employees are recruited taking references for past records.
- Employee relationships- internal and external.
- Unusual staff behaviour patterns.
- Where lifestyle is at variance with their known source of income.
- Remuneration based **on financial** performance.

- Employees working unsocial hours unsupervised.

Process issues

- Poor documentation **of internal controls.**
- Poor physical security of the assets,
- Lack of internal controls.
- No checks to ensure that sales are only made to appropriate customers.
- Continuing failure to correct major weaknesses in internal control where such corrections are practicable and cost-effective.
- Indications that internal financial information is unreliable.
- Poor management accountability and reporting systems.

Transaction Issues

- Large cash transactions.
- Poor documentation for specific transactions.
- Susceptibility of assets to misappropriation.

Financial Risk

- Rapid changes in profitability.
- Unusual transactions that have significant effect on earnings.
- Unusual transactions with related parties.
- Complex legal ownership, organisational structures,
- Significant pressures on management to obtain additional finance.
- Inadequate documentation about a client or a transaction.
- Extensive use of tax havens without a clear business justification.

Environmental Risk

"• Significant changes in customers demand,

- Highly competitive market conditions and decreasing profitability levels within the organisation.
- Rapid technological changes taking place within the industry, which may reduce the potential for product obsolescence.
- The introduction of new counting or other regulatory requirements including health and safety or environmental legislation, which could significantly alter the reported results of an entity.

30.8.2 Fraud Alerts

Fraud alerts are specific events which may be indicative of fraud. A list of possible fraud alerts is provided below.

- Supplies purchased in excess of need.
- Discrepancy between earnings and lifestyle.
- Unusual staff behaviour patterns.
- Missing's approval or authorisation signatures.

s Signature or handwriting discrepancies.

- Alteration of documents and records.
- Rubber stamp signatures instead of originals.
- Photocopies of documents instead of originals.
- Extensive use of correction fluid or erasures,
- Anonymous calls or letters.
- Execution as per authorisation missing.
- Subsidiary ledgers which do not reconcile with control accounts.

30.9 SUMMARY

A major reason why people commit fraud is because they are allowed to do so. There are a wide range of threats facing a business. The threat of fraud can come from inside or outside the organization, but the likelihood that a fraud will be committed will be greatly decreased if the potential fraudster believes that the rewards will be modest, that they will be *detected* and the potential punishment will be unacceptably high.

The main way of achieving this must be to establish a comprehensive system of control which increases the likelihood of detection and increases the cost to the fraudster.

30.10 PRACTICE QUESTIONS

1.What do you understanding by the term Management Fraud? What are the common frauds and what are their warning signals.

2. What is the root cause of corporate frauds and how to manage it?

30.11 SUGGESTED READINGS

- Singh Dharminder, Singh Nit, Bansal, R. K.; Company *Law and Auditing,* Unistar Books Pvt Ltd, Chandigarh, 1997
- Coenen, Tracy, *Essentials of Corporate* Fraud, John Wiley 8E Sons Inc, Hoboken, New Jersey, 2008
- Wells, T. Joseph, Corporate *Fraud Handbook Prevention* and *Detection,* second edition, John Wiley 86 Sons /no, Hoboken, New Jersey, 2007
- Moeller, Robert, *Brinks Modern Internal Auditing,* sixth edition, John Wiley 84 Sons Inc, Hoboken, New Jersey

Keywords: Fraud, Prevention, Internal Controls, anti-fraud culture, risk-awareness

Short Answer Questions:

1. What is money laundering?
2. Who commits frauds?
3. Explain various types of frauds?
4. What is whistle blowing?

Long Answer Questions:

1. Explain the root cause of corporate fraud and how to manage it?
2. How to identify frauds? Explain in detail.
3. What are fraud alerts? Explain its various types.
4. Define the 'Sound Internal Control' system?

Glossary:

1. Fraud: An act of deception, an intentional concealment or omission.
2. Misrepresentation: False presentation of information
3. Crime: An intentional wrong work
4. Risk: A rapid change in market or financial conditions

Answers of MCQs

1. Misreporting 2. Change of Address 3. Making List of exposed persons 4. National Security

Lesson No. 31 **CONVERSION BY HARPREET KOHLI**

WINDING UP

STRUCTURE

31.1 Objectives
31.2 Introduction
31.3 Modes of Winding up
  31.3.1 Compulsory Winding up by the Tribunal (Sec. 433)
  31.3.2 Voluntary Winding up
31.4 Petition for winding up (Sec.439)
31.5 Position of workers in winding up (Sec 439 A)
31.6 Consequence of winding up order
  31.6.1 Procedure of winding up
  31.6.2 Duties & Powers of Liquidator
  31.6.3 Self-Check Exercise
31.7 Voluntary winding up
  31.7.1 Modes of Voluntary winding up
31.8 Contributories under winding up
  31.8.1 Obligationsof Directors
  31.8.2 Provisions Applicable to Member's Voluntary winding up
  31.8.3 Provisions Applicable to Creditor's winding up
  31.8.4 Comparison between modes of voluntary winding up
31.9 Powers of liquidator in voluntary winding up (Sec, 512)
  31.9.1 Consequences of voluntary winding up
31.10. Antecedent And Other Transactions
31.11 Unregistered Company's Winding Up
31.12 Summary
31.13 Glossary
31.14 Keywords
31.15 Questions For Exercise
31.16 Answers For Self-Check Exercise
31.17 Recommended Readings

31.1 OBJECTIVES

The objectives of this chapter are:

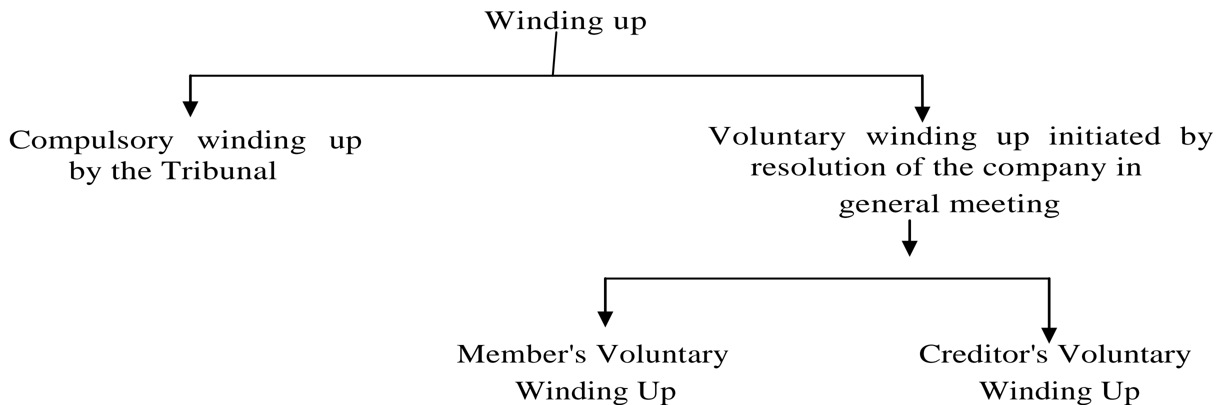
1 To discuss the various modes of winding up.
2 To elaborate on the grounds for compulsory winding up.
3 To elucidate the role of liquidator in winding up.
4 To compare and contrast member's voluntary winding up and creditor's Voluntary winding up.

31.2 INTRODUCTION

Winding up of a company refers to the process whereby all the affairs of the company are wound up and all its assets are realized, its liabilities paid off andthe balance if any, is distributed to itsthe shareholders in proportion to their holding in the company. So, it is method of putting an end to the life of the company. In the words of Prof. L.C.B. Cower," Winding up of a company is the process whereby its life is ended and its property administered for the benefit of its members and creditors. An administrator called a liquidator, is appointed and he takes control of the company, collects it debts and finally distributes any surplus among the members in accordance with their right.

The company is not dissolved immediately at the commencement of winding up. Its corporate status and powers continue, The term winding up and dissolution are sometimes erroneously used to mean the same thing. However they are very different in their meanings. Winding up is a process whereby all assets of the Company are realized and used to pay off the liabilities of the members. Dissolution of the company takes place after the entire process of winding up is over. Dissolution puts an end to the life of the company. A dissolution order passed by the Tribunal is equivalent to the death certificate of a company.

31.3 MODES OF WINDING UP



Following are the methods under which a company is wound up.

(a) Compulsory winding up by the NCLT (National Company Law Tribunal)

(b) Voluntary winding up which is of two kinds namely:

(i) Member's voluntarily winding up.

(ii) Creditor's voluntarily winding up.

31.3.1 Compulsory winding up by the Tribunal (Sec. 433)

A Company may be wound up at the order of the NCLT. This is also called compulsory winding up. A petition for winding up the company must be filed before the NCLT for winding up under the supervision of the Tribunal. It is primarily the NCLT, which has the jurisdiction to wind up companies in relation to the place at which registered office of the company is situated.

Situations under which a company may be wound up by the NCLT:.

(a) If it does not commence business within one year from its incorporation or it suspends business for a whole year.

(b) If the company passes a special resolution that it should be wound up by the Tribunal. It may be mentioned here that without such resolution act cannot be done by the directors themselves. It can be done only if a resolution to this effect has been passed at a general meeting of the company.[(Sec 433 (a)]

(c) If the number of members are reduced, in the case of a public company below seven and in case of private company below two, the company may be ordered to be wound up.

(d) A company may be ordered to be wound up if it is unable to pay its debts. Inability to pay the debts is explained in section 434. A company will be deemed to be unable to pay its debts if

(i) If a creditor to whom the company owes more than Rs. 500/- has served a notice. On the company in writing demanding that his debt be settled and the company has failed to pay or secure or compound that debt within 3 weeks.

(ii) If it is proved to the satisfaction of the Tribunal that the company cannot pay its debts.

(iii) If an execution or other process has not been satisfied by the company.

(e) If the company makes default in delivering the statutory report to the Registrar or in holding the statutory meeting. A petition requires previous approval of the central government or by a contributory or after 14 days after the last day on which the meeting should have been held. [(Sec 433 (b)]

(f) In the opinion of the Tribunal it is just and equitable to wind up the company:[(Sec. 433 R.]

(i) Where the substratum of the company is gone.

(ii) Where the whole object of the company is fraudulent.

(iii) Where thecompany is insolvent.

(iv) Where there is honest difference between a director and other directors.

(v) Where there has been mismanagement of funds by the directors.

(vi) Where there was a deadlock in the management of a public company.

31.3.2 Voluntary winding up

In case of voluntary winding up, the entire process is done without Tribunal supervision. When the winding up is complete with relevant documents are filed before the NCLT for obtaining the order of dissolution. A company may be wounded up voluntarily in the following ways.

By ordinary resolution

A company may be wound up voluntarily by passing an ordinary resolution when the period, if any, fixed for the duration of the company by the articles has expired. Similarly when the event, if any has occurred on the occurrence of which articles provide that the company is to be dissolved, the company may by passing an ordinary resolution to that effect commence its voluntary winding up.

The company must appoint liquidators for the purpose of winding up and fix their remuneration at a general meeting. On the appointment of the liquidators, the Board of Directors, managing Director and manager of the company cease to have any managerial power. The liquidator may transfer or sell the assets of the company and pay off its liabilities, If the winding up process continues more than one year, the liquidator must call a general meeting at the end of each year till theliquidation process continues.

Winding up of a Private Limited Company in the nature of partnership

For consideration of a petition for winding up of a private limited company, principles normally applied to the dissolution of the partnership firms apply also in case of private company. So if a private company in pith and substance is a partnership firm and the facts-would justify the dissolution of the partnership it may be ordered that company may be wound up-

In Ebrahimi Vs West bourne Galleries Limited (1972) 2 All E.R. 492, the House of Lords, while reiterating that the words 'Just and equitable' do not admit of a precise definition referred to the following circumstance which may be relevant in holding that a private company is in the nature of a partnership.

1. Whether it is an association formed or continued on the basis of a personal relationship, involving mutual confidence, for example whether a pre-existing partnership has been converted into a private limited company.
2. Whether the association i.e. the private company, is more or less a domestic concern of the members.

Loch Vs John Blackwood Ltd. (1924) A.C. 783. In a private company the managing director held most of the votes. He refused to hold general meetings, submit accounts to the shareholders and declare dividends. His object was to keep the petitioners in ignorance of the truth and acquire their shares at undervalue. It was also not possible for the petitions to obtain any relief by calling a general meeting or to evaluate and realise the true value of their shares. Held it was just and equitable that the company must be wound up.

JalduAnatnaRaghirana Vs East Coast Transport and Shipping Co. (1958) 28 Comp. Cos. 23. One of the 5 shareholders of a private company presented a petition for an order for the winding up of the company on the ground that there were serious misunderstandings among the shareholders of the company and one of the shareholder was actively engaged in promoting the interests of a firm which wasConducting a similar rival business. So it was held that company must be wound up.

3. Whether there is an agreement or understanding that all or some (for there must be sleeping members) of the shareholders shall participate in the conduct for the business.
4. Whether there is restriction upon the transfer of the members interests in the company so that if confidence is lost, or one member is removed from management, he cannot take out his stake and go elsewhere.

31.4 PETITION FOR WINDING UP

When an application is made by the company for the winding up then a petition is required, under the provisions of Sec. 439. A petition for the winding up may be presented under the following provisions:

(a) Petition by the company sec 439 (1) (a)

(b) Petition by any creditor or creditors sec 439 (1) (b)

(c) Petition by any contributory or contributories Sec 439 (1) (c)

(d) Petition by all or any of the prior parties whether together or separately sec. 439 (1)(d)

(e) Petition by the Registrar 439 (1) (e)

(f) Petition by the central govt. 439 (1) (f)

(g) Petition by the central government or a state government in a case falling under sec. 433 (h).

1. Petition by the Company

A company by passing a special resolution can represent its petition for winding up of the company. The petition for the winding up of the company must be backed by a special resolution of the general meeting.

In Patiala Banaspati Vs Allied Products Co. Ltd., Re.,.11,1.1./11.5,A1it was held that the winding up of the company was made by its managing director, it was rejected on the ground that the managing director or directors do not constitute the company but must have behind it the decision of the general meeting.

2. Petition by any creditor or creditors

Sec. 439 (1) (b) A petition may also be filed by the director or creditors. The term creditors is not only limited to one to whom a debt is due at the date of petition. Every person having a pecuniary claim competent to file a petition for the winding up of the company against company whether actual or contingent is a creditor and such a person or Persons who are creditors of the company are:

(a) A contingent or prospective creditor

This includes a holder of a bill of exchange not yet due or a holder of debentures not yet payable. But before a petition for winding up of a company presented by a contingent or prospective creditor is admitted, the leave of the NCLT shall be obtained for the admission of the petition. Such leave shall be granted if:

(i) In the opinion of the NCLT (National Company Law Tribunal) a reasonable security for costs has been given:

(ii) In the opinion of the NCLT, there is a prima facie case for winding up of the company.

(b) A secured creditor

A secured creditors is a much entitled to file a petition for the winding up of a company as an unsecured creditor to give uphis security and claim a balance before presenting the petition for winding up.

(c) A debenture holder

Where anytrustees have been appointed in respect of debentures, such trustees for the debenture holders are also deemed to be creditors.

(d) Any person who has a pecuniary claim against the company whether actual or contingent.

(e) The central or state govt. or a local authority to whom any tax or public charge is due.

(f) The legal representative of a deceased creditor.

Debt in Dispute

If any debt is in dispute, then creditor cannot get the winding up order. It is on the part of the NCLT to dismiss the petition or make it stand by until and unless it is not declared that the debt is valid.

NCLT's discretion

Any creditor who is able to satisfy the Tribunal that there are good grounds for a winding up order is prima facie entitled to an order but the NCLT may refuse the order if it is opposed by a majority in value of the creditors.

B.Karsug Ltd., Re J19551 All E.R. 854.A company was already in thecourse of voluntary winding up. Two creditors presented a petition for a compulsory winding up, but the overwhelming majority of the creditors could not show any grounds of hardship or injustice which the NCLT could exercise its discretion. The petition was disallowed.

3. Petition by any contributory or Contributories

Sec 439 (I) (C) If a person is liable to contribute to the assets of the company on the event of its being wound up then he is termed as contributory. He can present a petition for winding up a company even though he may be the holder of fully paid shares or that the company may have no assets at all, or may have no surplus assets left for distribution among the shareholders, after the satisfaction of its liabilities.

Where a fully paid up shareholder has made out a case for the winding up of a company, the petition should not be dismissed merely on the ground that he has not established there will be surplus assets available for distribution at the satisfaction of its liabilities.

Grounds: A winding up petition may be presented if

(a) The membership is reduced to below the statutory limit or

(b) He/she is original allottee of shares.

(c) He/she has held his shares for any 6 out of the previous 18 months.

Holder of forfeited shares

The holder of forfeited shares may apply for the winding up of a company within 1 year of the forfeiture of his shares provided. he/she has held the shares for 6 months during the 18 months proceedings the commencement of winding up.

Contributory whose call is in arrears

He/she may not be permitted to present a winding up petition unless he/she pays the call.

4. Petition by all or any of the Prior parties whether together or separately (Sec 439 (1) (d)

As per the provisions laid out in Sec. 433, all or any of the parties i.e. company, the creditors or the contributories may file a petition together or separately.

5. Petition by the Registrar

The Registrar can present a petition for winding up of the company on the following grounds:

(a) If there is default made by the company in delivering the statutory report to the Registrar or in holding the statutory meeting.

(b) If the company is unable to pay its debts.

(c) If the number of members is reduced in the case of a public company below 7 and in the case of private company below 2.

(d)Ifthe company does not commence its business within a year from its incorporation or suspends its business for the whole year.

(f) If the NCLT is of opinion that it is just and equitable that the company should be wound up.

A petition for winding up of a company on the ground that a default is made by the Registrar or in holding the statutory meeting shall not be presented except by the Registrar or by a contributory. Such a petition shall be presented before the expiration or 14 days after the last day on which the statutory meeting ought to have been held.

6. Petition by the Central government

Sec. 439 (1) (f)The Central government may by an authorised person on its behalf, file a petition for the winding up if the inspectors appointed by the Central Government may find that.

(1) The business of the company is being conducted with intent to

(a) Defraud its creditors, members or any other person.

(b) In a manner oppressive of any of its members.

(c) Otherwise for a fraudulent or unlawful purpose.

(d) the company was formed for any fraudulent or unlawful purpose.

(2) Persons concerned in the formation of the company or the management of its affairs have been guilty of fraud, misfeasance or other misconduct towards the company or towards any of its members.

7. Petition by the Central government or by a State government:

If the company acts against the interests of the sovereignty and integrity of India, friendly relations with foreign countries, public order, the security of state, then the company may be wound up.

Requirement of Statement of Affairs when a company is wound up

When a company files a petition of its winding up with the NCLT or opposes a petition for its winding up, it shall file a statement of its affairs with NCLT. In first case it shall file the statement along with the petition for winding up. The statement must be accompanied by:

a) The details of location of assets of the company and their value.
b) The details of all debtors and creditors with their complete addresses.
c) Such other details as the NCLT may direct.
d) The last known addresses of directors and company secretary of the company.

31.5 POSITION OF WORKERS IN WINDING UP

The position of workers Should also be considered while admitting a petition for winding up the company. In National Textile Workers in Union Vs P.R. Rarnakrishan (1983), the Supreme Court in a majority judgement held as follows:

1. The workers are having a right to be heard before the provisional liquidator as appointed by the company. But it should also be considered that if the workers are not so heard it would not be having any effect on appointing the provisional liquidation. It is open to the workers to apply to the Tribunal for vacating that order and it would be for the tribunal after considering the material produced before it and hearing the parties to decide whether that should be vacated or not.
2. The workers of the company are having equal standing in comparison to the shareholders and therefore they have an equal right to appear and oppose the winding up of the companies. Workers are not a marketable commodity to be purchased by the owners of capital, they are producer of wealth as well as capital.
3. The workers are entitled to appear at the hearing of the winding up petition whether to support or to oppose it so long as no winding up order was made by the Tribunal. The workers have the full right to be heard in the winding up petition, in any case i.e.

a) If the winding up petition is admitted,
b) An advertisement for the winding up is made.
c) Petition of winding up is accepted.

If the winding up order is made and the workers are aggrieved by it, they would also be entitled to prefer an appeal and contend in the appeal that no winding up order should have been made by the company judge.

31.6 CONSEQUENCE OF WINDING UP ORDER

Once an order is made by NCLT, its consequences date back to the commencement of winding up. There are some other consequences which are as following:-

(a) Intimation to official liquidator and the Registrar

Where the NCLT makes an order for the winding up of the company, it shall, within a period not exceeding two weeks from the date of passing of the order, cause intimation to be sent to the official liquidator and the Registrar of the order of winding up.

(b) Copy of the winding up order to be filed with the Registrar Sec. 455 (1), (1-A)

On the making up of the winding up order it shall be the duty of the petitioner and of the company to file with the Registrar within 30 days a certified copy of that order.

(c) Order for winding up deemed to *be* notice of discharge Sec. 455 (S)

The order for winding up shall be deemed to be notice of discharge to the officers and employees of the company, except when the business of the company is continued. Where a servant of the company is on a contract of service for a fixed term and that the term has not expired, on the date of the order of the winding up of the company, the order operates as a wrongful discharge and damages are allowed for breach of contract of service and the servant is free from his agreement not to compete with the company.

(d) Powers of NCLT

The NCLT, shall have jurisdiction to entertain or dispose of

(a) Any suit or proceeding by or against the company.
(b) Any claim made by or against the company.

The expression any claim means any claim which is legally enforceable.

(e) Submission of audited books and accounts to NCLT (Sec 446-A as inserted by the companies amendment act, 2002)

The directors and other officers of every company shall ensure that audited books of account of the company are completed and audited up to date of winding up order by NCLT. Further their accounts are to be submitted to the Tribunal at the cost of the company.

In case of default, the directors and officers are punishable with imprisonment up to one year and fine up to Rs, 1,00,000.

Suits stayed

When a winding up order has been made, no suit or other legal proceedings shall be commenced against the company except by leave of the NCLT. Similarly pending suits shall not be proceeded with except by leave of the NCLT. The suit of proceeding instituted without leave of the NCLT would be ineffective until leave was obtained, but once leave was obtained, the proceeding would be deemed instituted on the date of granting leave.

31.6.1 Procedure of winding up

There must be an official liquidator for the winding up of the companies, who may be appointed

(a) from a panel of professional consisting of accountants, advocates, company secretaries, cost and works accountants or firms having a combination of these professional which the Central Govt. may constitute.

(b) may be a body corporate consisting of such professional as approved by central government or

(c) may be a whole time officer appointed by the Central Government from time to time.

31.6.2 Duties & Powers of Liquidator

(a) Report

Sec 455 (1) (1) It is the duty of the official liquidator that as soon as he receives the statement of affairs of the company and not later than 6 months from the date of the order of winding up, submit a preliminary report to the NCLT. The following particulars are included:

(a) The amount of capital issued, subscribed, paid up and the estimated amount of assets and liabilities. The assets must be shown as per following criteria:

(i) Debts from contributories.

(ii) Cash and negotiable securities.

(iii) Debts due to the company and securities.

(iv) Moveable and immovable properties belonging to the company.

(v) Unpaid calls.

(b) The cause of the failure of the company as when the company has failed.

(c) If any further enquiry is required related to the formation, promotion, failure of the company or the conduct of business thereof.

(b) Additional reports

If in the opinion of official liquidator it is required to make further reports stating the manner in which the company was promoted or formed. Further if any fraud has been committed by any person in company's promotion for formation or since the formation thereof then additional reports may be prepared.

(c) Exercise and control of liquidator's powers (Sec. 460)

1) The liquidator shall in the administration of the assets of the company and the distribution there is among creditors, use his discretion in the administration of the assets of the company and in the distribution thereof among the creditors.

2) Direction from NCLT: If any particular matter arises during the winding up than the liquidator can apply to the NCLT. He/ She may also use his own direction in the administration of the assets of the company and in the distribution thereof among the creditors.

(3) Meeting of Creditors and Contributories: The liquidator may summon general meetings of the creditors or contributories whenever he thinks fit for the purpose of ascertaining their wishes.

(d) Proper Books

It is the duty of the liquidator to keep proper records of books for making entries or recording minutes of the proceedings at meetings and such other matters as may be prescribed. Any creditor or contributory of the company is having the privilege to inspect any such books personally or by his agent.

(e) Appointment of Committee of inspection (Sec. 464)

It is also on the part of NCLT that when it has made the order for the winding up, or at any time thereafter that it can appoint a committee of the inspection to act with the liquidator. He shall within 2 months as per directions of NCLT convene a meeting of the company creditors to determine the members of the committee of inspection. He/ She shall also, within 14 days from the date of creditors meeting, convene a meeting of the contributories to consider the decision of the creditors meeting with respect to the membership of the committee.

(f) Proceedings in Winding up

The liquidator shall conduct the proceedings in winding up the company and perform duties imposed by NCLT. He/She shall not make any secret profit out of his/her office. The acts of liquidator shall be valid not withstanding any defect that may afterwards be discovered in his appointment or qualification.

POWERS OF LIQUIDATOR

The powers of the liquidator in a winding up can be grouped into three categories:

1. With the sanction of NCLT.
2. Without the sanction of NCLT.
3. With the leave of NCLT in case of onerous contracts.

1. Powers of liquidator with permission of NCLT (Sec 457 (1)i

(a) To carry on thebusiness of the company so far as may be necessary for the beneficial winding up of the company.
(b) To sell whole of the undertaking of the company as a going concern.
(c) To raise money on the security of the company's assets.
(d) To sell the immovable or movable property and all its actionable claims with power to transfer the whole or sell the some in parcels.
(e) To institute or defend suits and other legal proceedings civil or criminal in the name or behalf of the company.
(f) To do all such other things as may be necessary for winding up the affairs of the company and distributing its assets. ((Sec. 457 (2))

2. Powers of the liquidator without the permission of NCLT

Following powers can be exercised by the liquidator without the permission of NCLT.

(a) To draw, accept, make and endorse any bill of exchange hundi or promissory note on behalf of the company in the course of business.
(b) To appoint any agent to conduct business which he is unable to do himself.
(c) To do all acts and execute documents and deeds on behalf of the company under its seal.
(d) To inspect the records and returns of the company or the files of the Registrar without payment of any fee.
(e) To prove, rank and claim in the insolvency or, any contributory for any balance against his/her estate and also to receive dividends.
(f) To take out in his official name, letters of administration to any deceased contributory, and to do any other act necessary for obtaining payment of any money due from a contributory or his estate.

Powers subject to control by the NCLT

Under the provisions of Sec. 457, the powers of the liquidator are controlled by the NCLT. To exercise their powers, any creditor or contributor or aggrieved person may appeal to the NCLT to exercise these powers. But these powers must be exercised by the NCLT. Sub Sections 2 (A), 2 (B), 2 (C), 2 (D), 2 (E), 2 (F) and 2 (G)have been added to section 457 by the companies (Second Amendment) Act, 2002 to give some more powers to the liquidators. These are :

(a) To appoint valuer, chartered surveyors, or chartered accounts to assess the value of the company's assets within 15 days after taking into his custody the property. (Sec. 457 (2 A) (b))
(b) To give an advertisement inviting bids for sale of the assets of the company within 15 days from date of receiving the valuation. (Sec. 457 (2 A) (c))

To appoint security guards to protect the property of that company.

3. Powers exercisable in case of onerous contracts:-

Theterm onerous means a right to property e.g. a hire purchase in which the obligations attaching to it excused the advantage to be derived from it. It is in the power of the liquidator to disclaim onerous contracts but it must be done within 12 months after the commencement of winding up, until and unless NCLT may extend the time.

31.6.3 **SELF-CHECK EXERCISE**

1. Official liquidator is appointed by the _____________.

2. When winding up takes place, shareholders are described as ____________.

31.7 VOLUNTARY WINDING UP

In case of voluntary winding up, the entire process is done without tribunal supervision. When the winding up is complete the relevant documents are filed before the NCLT for obtaining the order of dissolution. A company may be wound up voluntarily in the following ways:

(a) By Ordinary Resolution

A company may be wound up voluntarily by passing an ordinary resolution when the period, if any, fixed for the duration of the company by the articles has expired. Similarly when the event, if any has occurred on the occurrence of which the articles provide that the company is to be dissolved, the company may by passing an ordinary resolution to that effect commence its voluntary winding up.

The company must appoint liquidators for the purpose of winding up and fix their remuneration at a general meeting. On the appointment of the liquidators, the Board of Directors, managing Director and manager of the company cease to have any management power. The liquidator may transfer or sell the assets of the company and pay off its liabilities. If the winding up process continue to more than one year, the liquidator must call a general meeting at the end of each year theliquidation process continues.

(b) By special resolution

A company may at any time pass a resolution providing that the company be wound up voluntarily. Within fourteen days of the passing up the resolution the company shall give notice of the resolution by advertisement in the official Gazette and also in some newspaper circulating in the district of the registered office of the company.

31.7.1 Modes of Voluntary winding up

In case of voluntary winding up the entire process is done without the supervision of NCLT. When the winding up is complete the relevant documents are filed before the tribunal for obtaining the order of dissolution. A voluntary winding up may be done by the members or it may be done by the creditors also. The circumstances under which a company go for voluntarily wind up are:

(a) When an event happens that is specified in the articles that if it happens company must be dissolved.

(b) When the period fixed for the duration of the company in its articles has expired.

(c) The company has resolved by a special resolution in the general meeting that it must be dissolved.

(a) Member's Voluntarily Winding Up (Sec. 489)

In case of a company which is solvent and able to pay its liabilities in full but desires to be wound up voluntarily, the majority of its directors at a meeting of the board must make a declaration of solvency verified by an affidavit stating that in their opinion the company will be able to pay its debts in full within such period not exceeding 3 years from the commencement of the winding up as may be specified in the declaration. Such a declaration must be made within 5 weeks immediately preceding the date of the passing of the resolution for winding up the company and be delivered to the registrar before that date. The declaration must embody a statement of the Company's assets and liabilities.

A liquidator is appointed and his remuneration fixed by the company in general meeting of the shareholders. The remuneration so fixed is not to be increased in any circumstances whatsoever, with or without the sanction of the Tribunal. The liquidator is not to take charge unless his remuneration so fixed. The liquidator may transfer or sell the assets of the company and pay off its liabilities. If the winding up proceedings continue for more than one year the liquidator must call a general meeting at the end of each year the liquidation continues. At the last meeting, the accounts of the liquidator must be approved by the members. Such accounts must be filed by him with the registrar of companies and the official liquidator attached to the NCLT having jurisdiction over the company.

(b) Creditor's voluntary winding up

The company calls a general meeting of its creditors. Notices of the meeting regarding the winding up of the must be sent by post to all the creditors & the meeting may be held on the same day of general meeting or next day. Notice of the meeting of creditors have to be sent by post with the notice of the meeting. Appointment of the liquidator is made by the nomination both by the members and creditors at their respective meetings. If they nominate different persons ordinarily, the creditor's nominee shall be the liquidator.

The creditors may appoint a committee of inspection consisting of five persons. The company can also add five members to the committee. If the creditors do not accept the company's nominees, an application may be made to the court for settlement. The committee of inspection or where there is no such committee, the creditors shall fix the remuneration of the liquidator, failing which it shall be determined by NCLT. On the appointment of an liquidator, powers of the board come to an end. The procedure to be followed up by the liquidator is just the same as in the case of member's voluntary winding up, except that in addition to the meetings of the members, the liquidator has also to call meetings of the creditors.

31.7 CONTRIBUTORIES UNDER WINDING UP

Liability as contributories of present and past members are as follow:-

(A) In case if a company being wound up, every present and past member shall be liable to contribute to the assets of the company, to an amount sufficient for payment of its debts and liabilities and the costs, expenses of the winding up for and for the adjustment of the rights of the contributories considering the provisions of section 427 and also subject to the following qualifications:

(i) A past member shall not be liable to contribute in case it he has ceased to be member for one year or upwards before the commencement of the winding up.

(ii) No past member shall be able to contribute unless if appears to the Tribunal that the present members are unable to satisfy the contributions required to be made by them in pursuance of this act.

(iii) In case a company is limited by shares, no contribution shall be required form any past or present persons who are deemed to be contributory, includes any portion alleged to be a contributory.

(iv) A past member shall not be able to contribute in respect of any debt or liability of the company contracted after the ceased to be a member.

(B) Section 430

(1) In case a contributory dies either before or after he has been placed on the list of contributories, his legal representatives shall be able in the due course of administration, to contribute to the assets of the company in discharge of his liability and shall make contributions accordingly.

(2) If the legal representatives make default in paying any money ordered to be paid by them, proceedings may be taken for administering estate of the deceased contributory and compelling payment there out of the money due.

(3) Where the deceased contributory was a member of Hindu Joint Family governed by the Mitakshara School of Hindu law, his legal representative shall be deemed to include the surviving coparceners.

In the context where a contributory is adjudged insolvent either before or after he has been placed on the list of contributories:

(a) His assignees in insolvency shall represent him for all the purposes of the winding up and shall be contributories accordingly and may be called on to admit to prove against the estate of the insolvent or otherwise to allow to be paid out of his liability to contribute to the assets of the company.

(b) There may be proof against the estate of the insolvent, the estimated value of his liability to future calls, as well as calls already made.

31.8.1 Obligations of Directors

In the winding up of a limited company any director or manager of the company whose responsibility and liability comes under this act which is unlimited can contribute as an ordinary member, be able to make a further contribution as if he were, at the commencement of the winding up, a member of an unlimited company Provided that :

(a) A past director or manager shall not be able to able to make such further contribution, if he has ceased to hold office for a year or upwards before the commencement of winding up.

(b) A past director or manager shall not be able to make such further contribution in respect of any debt or liability of the company contracted after he ceased to hold office.

(c) Subject to thearticles of the company a director or manager shall not be able to make such further contribution, unless the NCLT deems it necessary to require the contribution in order to satisfy the debts and liabilities.

31.8.2 Provisions Applicable to Members' Voluntary winding up

1. Appointment and remuneration of liquidators

In the general meeting of the company, the company appoints one or more liquidators for the purpose of winding up its affairs. The remuneration paid to the liquidator is also fixed. Any remuneration so fixed shall not be increased in anycircumstances. The liquidator shall not take charge of his office before his remuneration is fixed as aforesaid.

2. The powers of the board cease on appointment of liquidator

All the powers of the board of directors, the managing or whole time directors cease on the appointment of liquidator, except when the company in general meeting or the liquidator may sanction them to continue,

3. Power to fill vacancy in office of the liquidation Sec. 4921

If a vacancy occurs by death, registration or otherwise in the office of any liquidator appointed by the company, the company in general meeting may fill the vacancy. The liquidator or contributories may convene the meeting for this purpose.

4. Notice of appointment to be given to the Registrar (Sec. 493)

The company shall give notice to the Registrar of the appointment of a liquidator or liquidators. The notice should also be given if any vacancy arises in the office of the liquidator. The notice shall be given by the company within 10 days of the event to which it relates.

5. Power of liquidator to accept shares etc. as the consideration for sale of property

It is on the part of the liquidator to accept shares, debentures or bonds for the sale as consideration.

6. Duty of Liquidator to call creditors meeting in case of insolvency

If the liquidator is at any time of opinion that the company will not be able to pay the debts in full within the period stated in the declaration, he shall forth summon a meeting of the creditors. He shall pay before the meeting a statement of assets and liabilities of the company. Thereafter the winding up will become creditors voluntary winding up. If the liquidator fails to comply with this provision, he/she shall be punishable with fine which may extend to Rs, 5000.

7. Duty to call general meeting at the end of each year (Sec. 496)

In the event of winding up continuing more than 1year, the liquidator shall call a general meeting *of* the company at the end of the first year from the commencement of the winding up. The liquidator can also call a general meeting at the end of each succeeding year.

8. Final meeting and dissolution

It is on the part of the liquidator to make up an account of the winding up, showing how the winding up has been conducted and how the property of the company has been disposed off. He/ She shall then call a general meeting of the company and Lay before it the accounts showing how the winding up has been conducted:-

The meeting shall be called up by an advertisement:

(a) Specifying the time, place and object of the meeting.

(b) Published not less than one month before the meeting in the official Gazette and also in some newspaper circulating in the district of the registered office of the company.

Provisions as to annual and final meetings in case of insolvency

If in the case of members voluntarily winding up, the liquidator finds that the company is insolvent, then the liquidator can call a meeting of the company and of each year and dissolution shall apply as if the winding up were a creditor's voluntary winding **up** and nor a members' voluntary winding up.

31.8.3 Provisions Applicable to Creditors' winding up

Provisions Applicable to creditors voluntary up (Sec. 500 to 509) The provisions applicable to creditors voluntary winding up are as following

1. Meeting of Creditors

The company shall call a meeting of the creditors of the company on the day on which there is to be held the general meeting of the company at which the resolution for voluntary winding up is to be proposed, or on the next day. The notices of the meeting should be immediately sent to all the creditors. The reason of the meeting should be advertised once at least in the official Gazette and at least in two newspapers circulating in the district of the registered office of the company.

It is the duty of the Board of Directors of the company to show a full statement of affairs of the company together with a list of the creditors and the estimated amount of their claims to be laid before the meeting. It shall also appoint one of their members to preside at this meeting. It shall be the duty of the director so appointed to attend the meeting and preside there at.

2. Resolution Notice to be given to the Registrar

Notice of any resolution passed at the creditor's meeting shall be given by the company to the Registrar within 10 days of the passing thereof.

3. Appointment of liquidator

All the members in the meeting and creditors may appoint a liquidator. If they nominate different persons, the creditor's nominee shall be liquidator. There is also provision that any director, member of creditor of the company or may apply to the NCLT for an order that the person nominated as liquidator by the company or any other person shall be the liquidator. The application shall be made to the NCLT within 7 days after the date on which the nomination was made by the creditors.

4. Appointment of Committee of Inspection

The creditors at their meeting may, if they think fit, appoint a committee of inspection consisting of not more than 5 persons. If such a committee is appointed, the company may also at a general meeting appoint not more than 5 members to the committee. But it is also considered that creditors if they think fit, resolve that all or any of the persons appointed by the company ought not to be members of the committee of inspection.

5. Liquidator's remuneration

The committee of inspection or if there is no such committee, the creditors may fix the remuneration of the liquidator where the remuneration is not so fixed. it shall be determined by the NCLT. The remuneration shall not be increased in any circumstances.

6. Board's powers to cease on appointment of liquidator

When the liquidator is appointed, all the powers of the Board of directors shall cease. There is also provision that committee of inspection or if there is nosuch committee, the creditors in general meeting, may sanction the continuance of the board.

7. Duty of the liquidator to call meeting at the end of each year

The liquidator shall call a general meeting of the company and the meeting of the company and the meeting of creditors every year, within 3 months from the close of every year.

8. Power to fill vacancy in the office of liquidator

If a vacancy occurs by resignation, death or otherwise in the office of the liquidator these the creditors can appoint the official liquidator in the general meeting but already existing liquidator should not be appointed by NCLT.

9. Power of liquidator to accept shares etc. as consideration for sale of property

As per the provisions of section 494 the liquidator can accept the consideration but the acceptance of the NCLT or committee of inspection must be taken.

10. Final meeting and dissolution

As and when the affairs of the company are fully wound up, the liquidator shall make up an account of the winding up showing how the winding up has been conducted and how the property of the company has been disposed of. He/She can then call a general meeting of the company and meeting of the creditors for the purpose of laying the account before the meeting and giving explanation thereafter.

31.8.4 COMPARISON BETWEEN MODES OF VOLUNTARY WINDING UP:-

	Features	Members' Voluntary Winding Up	Creditor's winding up
1.	Control of winding up	Members' control the winding up and creditors do not participate as insolvent,	Creditors' control the winding up so the winding up so the corresponding meeting of creditors is also held.
2.	Meeting	No meeting of creditors is held	Creditors' meeting **is** held.
3.	Declaration of solvency	There is declaration of solvency	No such declaration is there.
4.	Appointment of Liquidator	Liquidator is appointed by the company and his remuneration fixed by the company.	Liquidator is appointed by the creditors and his remuneration is fixed up by the creditors,
5.	Committee of Inspection	No Committee of Inspection	Creditors may appoint a committee of inspection.
6.	Powers of Liquidator	The liquidator can exercise certain powers with the sanction of a special resolution of company.	The liquidator can exercise certain powers with the sanction of the NCLT of the committee of inspection or of a meeting of the creditors.

31.9 POWERS OF LIQUIDATOR IN VOLUNTARY WINDING UP (SEC. 5121

The liquidators powers in the voluntary winding up shall be the same as those of the liquidator in winding up by the NCLT but there is only one difference. In case of winding up by the NCLT, the official liquidator has to obtain the sanction of NCLT to exercise certain powers. In a members voluntary winding up, the liquidator can exercise those powers with the sanction of a special resolution of the company.

4. (A) Powers Exercisable with sanction

A special resolution of the company is required to use these powers by the liquidator in case of members voluntary winding up. But as far as creditors' voluntary winding up is concerned, the liquidator can exercise these powers with the sanction of NCLT or the committee of inspection or in its absence of a meeting of creditors:

(a) To carry on the business of the company so far as may be necessary for the beneficial winding up of the company.

(b) To raise money on the security of the assets of the company.

(c) To institute or defend any suit or civil or criminal proceedings in thename and on behalf of the company.

(d) To see the movable and immovable property and actionable claims of the company by public auction or private contract.

But it must be noted that the exercise of these powers by the liquidator shall be subject to the control of the NCLT.

B. Powers Exercisable without sanction:-

Theliquidator in a voluntary winding up may exercise some powers without any sanction because these relate to matters of a routine nature.

(a) To draw, accept, endorse and make any bill of exchange hundi or promissory note in the name or behalf of the company.

(b) To appoint any agent to do any business which he cannot do himself.

(c) To inspect the records and returns of the company on the files of Registrar without payment of any fee.

(d) To do all acts and to execute deeds and other documents in the name and behalf of the company, under its seal.

(e) To provide, rank and claim in the insolvency of a contributory for any balance against his estate.

(f) To take out in his official name, letters of administration to any deceased contributory, and to do any act necessary for obtaining payment of any money due from a contributory or by his estate.

In addition to the above powers, the liquidator can, without obtaining the sanction, exercise also the following powers i.e.

1. The power of NCLT of making calls.
2. The power of the NCLT of settling a list of contributories.
3. The power of calling general meetings of the company for the purpose of obtaining the sanction of the company by ordinary or special resolution or for any other purpose.

31.9.1 Consequences of voluntary winding up

1. Creditors Consequences

A. When the company is solvent

A just and fair estimate of all the claims payable on a contingency and all claims against the company present and future should be made. So, when a solvent company is wound up, all creditors' claims should be fully met.

B. When the company is insolvent (Sec. 529)

So, when a company is insolvent the same rules are applicable **as** in insolvency for the company as to:-

(a) Debts provable.

(b) The valuation of annuities and contingent liabilities.

(c) The respective rights of secured and unsecured creditors.

Secured and unsecured creditors

The creditors may be secured or unsecured. A secured creditor has three alternatives before him:

(a) He may rely on his security and ignore the liquidation.

(b) He may value his security and prove the whole debt.

(c) He may surrender his security and prove the whole debt.

If a secured creditor instead of giving up his security and planning his debt proceeds to realise his security, he shall be liable to pay his portion of the expenses incurred by the liquidator for preservation of the security before its realisation by the secured creditor.

C. Overriding preferential payments Sec. 529)

A protects the interests of the workmen in case of winding up of a company. The sec. 529-A provides that workers are not deprived of their legitimate claims in the event of liquidation. So, Not withstanding anything contained in any other provision of the companies act 1956 or any other law for the time being in force, a company shall on its winding up, pay in priority to all other debts-

(a) Workmen's due

(b) Debts due to secured creditors,

These debts shall be paid in full unless the assets are insufficient to meet them, in which case they shall stand in equal proportions.

D. Preferential Payments

Some unsecured debts are having preference in payment in comparison to other unsecured as per the provisions laid on in sec. 529-A.

(a) All wage or salary or any employee, in respect of services rendered to the company and due for a period not exceeding 4 months within 12 months before winding up.
The amount shall not in case of any one claimant, exceed such sum as may be notified by thecentral government in the official Gazette.

(b) All amounts due in respect of any compensation or liability under the workmen's compensation Act, 1923, in respect of death or disablement of any employee of the company.

(c) The expenses of any investigation held under sec. 235 or 237, in so far as they are payable by the company.

(d) All sums due to any employee from a provident fund, a pension fund a gratuity fund or any other fund for the welfare of the employees maintained by the company.

(e) All revenues, cesses, taxes and rates due to the central government or a state government or a local authority at the relevant date. The amount should have become due arid payable within 12 months preceding the relevant date.

(f)All amounts due in respect of contributions payable during the 12 months before the winding up order under the Employees State Insurance act, 1948.

(g) All accrued holiday remuneration becoming payable to any employee on account of winding up.

2. Consequences as to servants and officers

It is considered that a winding up order shall be considered a notice of discharge to the officers and employees of the company except when the business of the company is continued. Such a discharge shall relieve them of all obligations under their contract of service.

3. Consequences as to costs

If assets are insufficient to satisfy liabilities the Tribunal may order for payment of the costs, charges and expenses of the winding up out of the assets of the company. The payment should be made in such an order as the tribunal may thinks fit. Similarly all charges, costs, expenses properly incurred in a voluntary winding up including the remuneration of the liquidator shall be paid out of the assets of the company in priority to all other claims.

4. Consequences as to proceedings against the company

If a winding up order has been commenced or the official liquidation has been appointed then no proceedings against the company shall be commenced except by leave of the NCLT. Similarly if any suit is pending against the company at the date of winding up order it shall not be preceded against the company, except by leave of the NCLT.

31.10. ANTECEDENT AND OTHER TRANSACTIONS:-

A. Fraudulent preference

In case of insolvency law, any transfer or payment or property by a debtor who is unable to pay his debts in full in favour of a creditor with aview to give him preference over other creditors, is deemed to be afraudulent preference if within 3 months of the date of transfer of property or payment of money he/she is adjudicated insolvent. Then in such a case transaction is set aside. In case of a company such transaction shall be set aside if it is entered into within 6 months before the commencement of the winding up of the company. Provided the company was unable to pay its debts in full and the transaction involves payments, transfers etc:-

But to prove that it is fraudulent preference under section 531 two conditions must be present:

(a) That the transaction took place within 6 months before the presentation of the winding up petition in the case of winding up by the NCLT,

(b) That the dominant motive in the mind of the company acting through its directions was to prefer one creditor to other creditors. If the dominant motive of the transaction is tainted with an element of dishonesty, question of fraud arises.

(B) Avoidance of Voluntary transfer

As per the section 531-A any transfer of property, moveable or immovable or any delivery of goods made by a company within a period of one year before the commencement of its winding up shall be void against the liquidator. But the following transactions are not covered by this rule:

(a) A transfer of property or delivery of goods in favour of a purchaser in good faith and for valuable consideration.

(b) A transfer of property or delivery of goods made in the ordinary course of business of the company.

(C) Avoidance of certain transfer

In the case of voluntary winding up any transfer of shares in the company, not being a transfer made to or with the sanction of the liquidator any alteration in the status of the members of the company, made after the commencement of the winding up shall be void.

(D) Disclaimer of onerous property

The liquidator of a company may, with the leave of the NCLT, disclaim onerous properties belonging to the company. The onerous properties include:

(a) land burdened with onerous covenants.

(b) shares or stock in companies.

(c) un-profitable contracts.

(d) Any other property which is un-saleable or is not readily saleable.

The NCLT shall helpthe liquidator in getting rid of onerous and burdensome contracts whenever it is necessary to safeguard the interests of the creditors and the shareholders of the company.

(E) Avoidance of certain transfer

In the case of voluntary winding up, any transfer of shares in the company, not being a transfer made to or with the sanction of the liquidation and any alternation in the status of the members of the company is being wound up by NCLT, the following shall be void:-

(a) Any sale held**,** without leave of the NCLT, of any of the properties or effects of the company after such commencement.

(b) Any attachment, distress or execution put in force, without leave of the NCLT against the estate or effects of the company after the commencement of the winding up.

31.11 UNREGISTERED COMPANY'S WINDING UP

Meaning

An unregistered company means association of persons less than 20 and more than 7 carrying on a business (but in case banking association number is 10) without being registered under the companies act or any other law for the time being in force in India. If any petition for the winding up of any unregistered company is presented before NCLT, then the number must be 7. The following are not included under the provision:

(a) A company registered under the companies Act, 1956.

(b) A company registered under any previous law.

(c) A railway company.

Winding up of unregistered companies (Sec. 583)

An unregistered company may be wound up under the companies Act, 1956. In such a case, all the provisions of the act with respect of winding up shall apply to an unregistered company,with the following exceptions:

(a) No registered company shall be wound up under this act voluntarily or subject to supervision of NCLT,

Grounds for winding up

An unregistered company may be wound up if:

(a) The company is unable to pay its debts.

(b) The NCLT is of the opinion that it isjust and equitable that the company should be wound up.

(c) 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.

Contributories

In the event of an unregistered company being wound up, every person shall be deemed to be a contributory who is liable to pay:

(a) The charges, costs and expenses of winding up of the company.

(b) Any sum for the adjustment of the rights of the members among themselves.

(c) Any liability or the debt ofthe company.

It is the duty of the contributory to contribute to the assets of thecompany all sums due from him in respect of any liability to contribute or pay, according to his liability. In the case of insolvency of death of any contributory, the provisions of the companies act, 1956 shall apply in case of legal representative of deceased contributions.

Directions as to Property in Certain Cases (Sec. 588)

If an unregistered company has no power to sue and to be sued in a common name or if for any reasons it appears expedient, the NCLT may direct that all or any part of the property movable, or immovable (including actionable claims) belonging to the company or held by trustees on its behalf, shall vest in the official liquidator by his official name. The official liquidator may after giving such identity if any, as the NCLT may direct to bring or defend in his official name any suit or legal proceedings relating to the property.

31.12 SUMMARY

In this chapter we have discussed the modes of winding up. The various grounds on which the NCLT can order the winding up of a company compulsory have also been discussed. The role of official liquidator in conducting the winding up proceedings has been explained. The official liquidator has a crucial role to play during the course of winding up. Voluntary winding up can be at the initiative of the members or creditors. The requirement of solvency is essential for the former mode of winding and insolvency is the pre-requisite for creditors' winding up. The various procedural aspects related with each mode have been dealt with.

31.13 GLOSSARY

1. Winding up - Process of putting as end to the life of a company.
2. Contributory - Every person liable to contribute to the assets of a company is the event of winding up.
3. Dissolution - On dissolution, the company is no more in existence and it takes place after the winding up is over.
4. Liquidator - A liquidator is a person with the legal authority to act on behalf of a company to sell the company's assets before the company closes in order to generate cash for a variety of reasons including debt repayment.
5. Secured Creditor- A secured creditor is any creditor or lender associated with an issuance of a credit product that is backed by collateral. Secured credit products are backed by collateral.

31.14 KEYWORDS

Liquidator, Auction, Creditor, Lenders, Company, NCLT.

31.15 QUESTIONS FOR EXERCISE

Short answer type questions

1. Explain liquidator.
2. Define NCLT.
3. Explain secured creditors.

Long questions

1, What are the different modes of winding up? {Refer Para 15.3)
2. Compare and contrast creditor's voluntary winding up an member's voluntary winding up. {Refer Para 15.8.4}
3. On what grounds can a company be compulsorily wound up.
4. Write short notes on :
   (a) Official Liquidator
   (b) Contributory
   (c) Who can file petition for winding up?

31.16 ANSWERS FOR SELF-CHECK EXERCISE

1. Tribunal
2. Contributory

31.17 RECOMMENDED READINGS

(1) Company Law : By Garg & Chawla

(2) Company Law : By N.D. Kapoor

(3) Taxmann's Business 84 Corporate Laws By V,S, Datey.

NATURE OF CONTRACT

STRUCTURE

32.0 Objectives
32.1 Introduction
32.2 Definition of contract
32.3 Essential elements of a contract
32.4 Classification of contract
32.4.1 Classification according to validity
32.4.2 Classification according to formation
32.4.3 Classification according to performance
32.5 GLOSSARY
32.6 Keywords
32.7 Questions
32.8 Answers to shorts questions.
32.6 Suggested Reading

32.0 OBJECTIVES

After reading this chapter, the student should be able tolearn**:**

(i) Understand various types of contracts.
(ii) Understand the essential elements of a contract.

32.1 INTRODUCTION

The law of contract deals with agreement which can be enforced through courts of law. The law of contract is the most important part of commercial law because every commercial transaction starts from an agreement between two or more persons. It determines the circumstances in which the promise made by the parties shall be legally binding on them. Law defines the remedies that are available in a court of law against a person. Who fails to perform his contract and the conditions under which remedies are available.

The law relating to contracts is contained in the Indian Contract Act, 1872. The act lays down certain general rules regarding contracts. The act is not exhaustive. There are other acts relating to particular types of contracts, e.g,, the Negotiable Instrument Act, The Transfer of Property Act, Partnership Act, Sale of Goods Act, etc.

The law of contract differs from other branches of law in an important respect. Itnot only lays down a number of rights and duties which the law will enforce, it consists rather of a number of limiting principles, subject to which the parties may create rights or duties which the law will uphold.

32.2 DEFINITION OF CONTRACT

Indian Contract Act, Sec. 2(h) defines contract as an agreement enforceable by law. Therefore, a contract is an agreement made between two or more parties which the law will enforce.

According to Salmond, a contract is, "An agreement creating and defining obligations between the parties."

Therefore, in a contract there must be (l) an agreement and (2) the agreement must be enforceable by law.

An agreement comes into existence whenever one or more persons promise to one or the others to do or not to do something. "Every promise and every set of promises, forming the consideration for each other is an agreement,' Sec. 2 (e). Some agreement cannot be enforced through the courts of law, e.g., an agreement to play cards or go to a cinema. An agreement which can be enforced through the court of law, is called a contract.

Contract = Agreement + Enforceable at Law

32.3 ESSENTIAL ELEMENTS OF A CONTRACT

An agreement becomes contract when it is enforceable by law if they are made by the free consent by parties competent to contract, or lawful consideration and with a lawful object and are not declared as void contracts. In order to become a contract an agreement, it must fulfil certain conditions, which may be called the essential elements of a contract and are explained as under:

1. Offer and Acceptance

In order to create a valid contract there must be a lawful offer by one party and a lawful acceptance of the same by the other party or parties. The word lawful' implies that the offer and acceptance must confirm to the rules laid down in Indian Contract Act regarding offer and acceptance. Theterms of the offer must be definite and the acceptance of the offer must be absolute and unconditional. The acceptance must be made according to the mode of prescribed and must be communicated to offeror.

2. Intention to create legal relationship

The parties which enter into contract must have the intention to create legal relation between them. If there is no such intention, there is no contract between them. Agreement of social or domestic nature like- to dine at a friend's house or agreement for getting pocket money from father by his son are not agreements intended to create legal relations and are not contracts. But acommercial agreement to buy and sell goods or an agreement to marry, are agreements intended to create some legal relationship and are, therefore, contracts.

3. **Lawful Consideration**

An agreement is enforceable by law when it is supported by consideration. The word 'consideration' implies an advantage or benefit moving from one party to the other or in simple words, it means something in return. An agreement to do something for nothing is usually not enforceable by law. But only those considerations are valid which are 'lawful'. The consideration may be an act or forbearance or a promise to do or not to do something. Consideration may be past, present or future.

4. Capacities of Parties

The parties to an agreement must be competent to contract. Every person is competent to contract if he is

(a) of the age of majority

(b) of sound mind

(c) not disqualified from contracting by any law.

5. Free Consent

It is essential for every valid contract that there must be free consent of both the parties to the agreement. There is absence of free consent if the agreement is induced by coercion, undue influence, mistake, misrepresentation and fraud. In case of mutual mistakes, the contract would be void, or in case of the consent is obtained by unfair means, the contract would be voidable.

6. Lawful Object

The object of an agreement must be lawful. But object has nothing to do with consideration. An object is lawful when it is not (a) illegal (b) immoral (c) opposed to the public policy (d) forbidden by law,

7. Not declared to be void

The agreement must be declared to be expressly void by law of the country. These agreements are covered under sec. 24 to 30 and 56.

8. Certainty and possibility of performance

The agreement must be capable of being performed and the terms of the contract must be precise and certain, If the agreement is vague and it is not possible to ascertain its meaning, it cannot be enforced by law. Thus, an agreement to buy hundred meters of cloth is void unless the kind and the price of the cloth is decided by both the parties.

9. Legal formalities

An oral contract is a perfectly good contract, except in those cases where writing and registration is required by some statute. But it is always in the interest of parties that the contract should be in writing. There may be some formalities also, which have to be complied with, in order to make an agreement legally enforceable.

The elements mentioned above must be present in order to make a valid contact. If any one of them is missing, an agreement cannot become a valid contract. An agreement which fulfils all the essential elements is enforceable by law and is called a contract. From this, it follows that every contract is an agreement but all agreements are not contracts.

32.4 CLASSIFICATION OF CONTRACT

2.4.1 Classification according to validity

(a) Valid Contract

An agreement becomes avalid contract when it is enforceable by law and it is possible only when all the above mentioned essentials of a valid contract laid down in sec. 10 are fulfilled. e.g. A offers to sell his car to B for Rs. 2 lakhs. B agrees to pay the price. This is a valid contract.

(b) Void Contract

A contract which ceases to be enforceable by law becomes void when it ceases to be enforceable by law. A contract may be originally valid at the time when it was made but it may become void subsequently. For example, a contract to import goods from America is a valid contract but it becomes void when a war breaks out between India and America. The law will not enforce such void contracts, nor can it be made valid by the parties.

(c) Voidable Contract

An agreement which is enforceable by law at the option of one or more of the parties thereto but not at the opinion of the other or others is a voidable contract. This happens when theconsent to a contract is not free and it would be open to the party whose consent has been so obtained to avoid the contract if he so desires. Such contracts are valid up to the time when they are rescinded or avoided, before that they are good or valid contracts.

Example X promises to sell his house to Y for rupees one lakh. His consent was obtained with undue influence by Y. The contract is voidable at the option of X. He may avoid the contract at his own will.

(d) **Illegal Contract**

A contract which is prohibited by law or against the public policy or criminal in nature or immoral is an illegal contract. Both illegal contracts and void contracts are unenforceable by law. All illegal contracts are void but all void contracts are not illegal. For example, any contract with minor is void but riot always illegal.

(e) Unenforceable Contract

The contract which cannot be enforced in a court because of some technical defects such as absence of writing or absence of a proper stamp. This type of contract is otherwise a valid contract and may be carried out by the parties concerned but in the event of breach or repudiation of such a contract, the aggrieved party will not be entitled to the legal remedies.

32.4.2 Classification according to formation

(a) Expressed Contract

Express contract is one which is expressed in words spoken or written. When such a contract is formed, there is no difficulty in understanding the rights and obligations of the parties.

(b) Implied Contract

Where the conditions of a contract are understood from the acts, conduct of parties or from surrounding circumstances, it is an implied contract. In other words, where the proposal or acceptance of any promise is made otherwise than in words, the contract is said to be implied. For example, there is an implied contract by getting treatment from doctor, getting into a bus, taking something from a store.

(c) Quasi-Contract

There are certain dealings which are not contracts strictly, though the parties act as if there is a contract. A contract is intentionally entered into by the parties. A quasi-contract, on the other hand, is created by law, initially parties may not be interested.

Example ; When some goods are delivered to a wrong person, he is under an obligation to pay for them or return them.

32.4.3 Classification according to performance:

(a) Executed Contracts

There are some contracts where the parties perform their obligation immediately, i.e., as soon as the contract is formed. Executed means that, which is done. An executed contract is one in which both parties have performed their respective obligations.

Example ; A agrees to sell his house to B for Rs. 75,000. When A receives payment and **B** gets the papers of house or when both the parties perform their obligations, the contract is said to be executed.

(b) Executory Contract

In this contract, the obligations of the parties are to be performed at a later stage. Executory means, which remains to be carried into effect. An executory contract is one in which both the parties have yet to perform their obligations.

Example : A agrees to sell the goods to B for Rs.10,000. Yet A has not delivered the goods and **B** has not made the payment. Both will perform their obligations in future. It is an executory contract.

If A has performed his obligation as has delivered goods to B, the contract is executed as to A and executory as to B.

(c) **Unilateral Contract**

In certain contracts, one party has to fulfil his obligation whereas the other party has already performed his obligation. Such a contract is called unilateral contract. In this contract, one party fulfils its obligations at the time of the contract or before the contract comes into existence and other party has yet to perform his obligation..

Example ; A goes to a doctor and gets the medicine from doctor. Here the doctor has fulfilled his obligation and As obligation to pay doctor, his feeis pending. So, it is an unilateral contract at that time.

(d) Bilateral Contract

A bilateral contract is **a** contract in which the obligations of both the parties to the contract are outstanding at the time of formation of the contract. In this way, bilateral contracts are similar to executory contracts.

32.5 GLOSSARY

1. **Consent**:- to agree to do or allow something : to give permission for something to happen or be done. He was reluctant at first but finally consented.

2. **Consideration:-** a payment or reward.

3. **Law:-** the system of rules which a particular country or community recognizes as regulating the actions of its members and which it may enforce by the imposition of penalties.

4. **Agreement:-** negotiated and typically legally binding arrangement between parties as to a course of action.

5. **Contract:-** a written or spoken agreement, especially one concerning employment, sales, or tenancy, that is intended to be enforceable by law.

32.6 KEYWORDS

Contract, Agreement, enforcement, condition, Consideration.

32.7 QUESTIONS

Check Your Progress

Short answer types questions:-

1. Define a valid contract.
2. Explain void contract.
3. Define the term minor.
4. What is lawful Consideration?

Long questions:-

1. What is the object and nature of law of contract?
2. All contracts are agreements but all agreements are not contracts.' Discuss the statement explaining the essential elements of a valid contract.
3. Distinguish between:
   (a) Valid, Void and Voidable Contracts
   (b) Executory and Executed Contracts
   (c) Express and Implied Contracts
4. Write notes on :
   (i) Unenforceable contract

32.8 ANSWERS TO SHORTS QUESTIONS.

Answer1:- An agreement becomes avalid contract when it is enforceable by law and it is possible only when all the above mentioned essentials of a valid contract laid down in sec. 10 are fulfilled.

Answer2:- A contract which ceases to be enforceable by law becomes void when it ceases to be enforceable by law. A contract may be originally valid at the time when it was made but it may become void subsequently.

Answer3:- Minor is a person who is not age of majority i.e below 18 years old.

Answer4:- An agreement is enforceable by law when it is supported by consideration. The word 'consideration' implies an advantage or benefit moving from one party to the other or in simple words, it means something in return.

32.7 SUGGESTED READING

- Kapoor N.D., *Merehantile Law,* Sultan Chand *85* Sons, New Delhi, 2002.
- Gulshan S.S., *Business Law,* Excel Books, New Delhi, 2003.

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Semester-I **BUSINESS ENVIRONMENT**

Lesson No. 33 **AUTHOR: DR. RITU LEHAL**

SALE OF GOODS ACT - I

MANAGEMENT OF COMPANIES — DIRECTORS

STRUCTURE

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33.1 Contract of sale
33.2 Essential element of a valid sale
33.3 Contract of sale, How it is made?
33.4 Sale and hire-purchase agreement
33,5 Subject matter of contract of sale of goods
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33.20 Answer of MCQs
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33.0 OBJECTIVES

After reading this chapter, the student should be able to :

(i) Understand essential elements of a valid sale.

(a) Understand rights and duties of the buyer.

33.1 CONTRACT OF SALE (SECTION 4)

A contract of sale of goods is a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a price. There may be a contract of sale between our part onwer and another. A contract of sale may be absolute or conditional, it is absolute when it is a sale pure and simple, transferring the property in absolute to thebuyer. It is conditional if there are conditions annexed to contract by the parties.

The term 'Contract of Sales" is a genetic term and includes both sale and an agreement to sell.

SALE OR ABSOLUTE SALE

Where under a contract of sale, the property in the goods is transferred from the Seller to the buyer, it is called a sale,

AGREEMENT TO SELL OR CONDITIONAL SALE

Where under a contract of sale, the transfer of the property in the goods is to take place at a future time or subject to some conditions therefore to be fulfilled, the contract is called agreement to sell. An agreement to sell becomes a sale when the time elapses on the condition, subject to which the property in goods is to be transferred is fulfilled.

The term 'property' as used in the Sale of Goods Act means general property in goods as distinguished from special property. If a owns certain goods, he had general property in the goods. If he pledges them to B, B will have special property in the goods.

33.2 ESSENTIAL ELEMENT or A VALID SALE

The following essential elements are necessary to constitute a sale of goods :

1. There must be two parties, i.e., buyer and seller, to affect the sale. The parties must be competent to contract.
2. There must be some goods, the property which is transferred from the seller to the buyer.
3. The goods which form the subject-matter of the contract of sale must be moveable and not immovable.Money, Actionable claims andImmovable properties etc, are excluded from the definition of goods.
4. A price in money must be paid or promised to be paid. The consideration, it must be in the form of money.
5. There must be a transfer of general property as distinguished from special property in goods from the seller to the buyer.
6. All the essential elements of a valid contract must be present.

33.3 CONTRACT OF SALE, HOW IT IS MADE ? (SECTION 5)

It is, like any other contract, made by ordinary offer, to buy or sell goods by one party and its acceptance to sell or buy goods respectively by the other party. It may be expressed or implied from the conduct of theparties. It may be:

(i) made in writing or
(ii) made by words (oral)
(iii) made partly in writing and partly by words of mouth, or
(iv) implied from the conduct of the parties, or
(v) implied from the course of business between the parties.

Payment of price or delivery of goods is, however, not the necessary condition unless otherwise agreed upon by the parties. The contract of sale may provide for the immediate delivery of the goods, or immediate payment or the price of both, shall be postponed.

33.4 SALE AND HIRE-PURCHASE AGREEMENT

A hire purchase agreement is a contract whereby the seller of goods agrees to transfer the property in the hire purchase when a certain fixed number of instalments of the price is paid by the buyer. Till that time, the instalments paid by the hire-purchaser are regarded as the hire charge for the use of the goods. If there is default by hire-purchaser in paying of instalment, the seller can recover the goods and the instalments paid by the hire-purchaser shall not be recoverable by him from the seller. This is because the ownership still rests with the seller. The hire-purchaser is entitled to use the goods by paying periodically, a certain fixed amount. He eventually becomes the owner of the goods, but until it happens there is not transfer of property from the seller to the hire-purchaser.

Example : B hires a piano from A on agreement that B should pay Rs. 100 monthly, as rent. The stipulation is that if he regularly pays the rent for 20 months, the piano becomes his property at the end of 20 months. Further, it is provided that B can return the piano at any time and need not pay any more. This is hire-

purchase agreement proper, if, however, it is agreed that 20 months' rent must be paid and that

he cannot return the piano, the agreement is a sale and not hire-purchase agreement.

33.5 SUBJECT MATTER OF CONTRACT OF SALE OF GOODS

Goods form the subject-matter of the contract of sale. According to Section 2(7), "goods means every kind of movable property other than actionable claims and money' and includes stocks and shares, growing crops, grass and things attached to or forming party of land which are agreed to be before sale or under the contract of sale.

An actionable claim is something which can be recovered only by means of a suit or action in a court of law. A debt from one person to another is actionable claim and cannot be brought or sold as goods. It can only be signed. Money also does not come under goods.

1. Existing Goods

There are the goods which are owned and possessed by the seller at the time of sale. These may be specified goods, ascertained goods or unascertained goods.

2. Future or Contingent goods

These are the goods which the seller does not possess at the time of the contract but which will be acquired, manufactured or produced by him at some future date, or on the happening of some contingency, e.g., The eggs yet to grow."

33.6 EFFECT OF DESTRUCTION OF GOODS

Goods damaged before making of contract : (Section 7) where there is a contract for thesale of specific goods, the contract is void if the goods without the knowledge of the seller have at the time when the contract was made, perished or become so damaged as not longer to answer to their description in the contract.

Example : immediately, the horse died at the time of agreement. Both A and B are ignorant of this fact. The agreement is void.

1. In the above example, the intention of the parties is completely frustrated and there is nothing on which the contract can operate and hence it is void. This rule is based either on the ground of mutual mistakes or on the ground of impossibility of performance.
2. Goods perishing after the agreement to sell but before the sale is effected (Section 8). Where there is an agreement to sell the specific goods, and subsequently the goods without any fault on the part of the seller or buyer perish or become so damaged as description in the agreement before the agreement is thereby avoided.

33.7 DELIVERY OF TITLE OF GOODS

A document of title to goods is one which is, mused in the ordinary course of business as proof of thepossession or control of goods. It authorised either by endorsement or delivery, it possesses, to transfer or receive goods represented by goods. It symbolises the goods and confers a right on the purchaser to receive the goods or to further transfer such right to another person. This may be done by mere delivery or proper endorsement.

Prices : (Section 9)

The price in a contract of sale must be expressed in money, it

(i) may be fixed by the contract itself, or

(ii) may be left to be fixed in an agreed manner, or

(iii) may be determined from the course of dealing between the parties.

Where the price is not determined in accordance with the foregoing provision, the buyer must pay the seller a reasonable price. What is reasonable price is a question of fact dependent on the circumstances of each particular case.

Conditions and Warranties : (Section 12)

A stipulation on a representation in a contract of sale with reference to goods which are the subject thereof may be condition or a warrenty.

If the parties regard a stipulation or representation as vital and essential to the main purpose of the contract, it is a condition. It forms the very basis of the contract. If there is a breach of condition, the aggrieved party can treat the contract as repudiated.

A warranty, on the other hand, is a stipulation which is subsidiary or collateral to the main purpose of the contract. It is not vital to the existence of the contract. If there is a breach of a warranty, the aggrieved party can only claim damages and it has not right to treat the contract as repudiated.

Whether a stipulation in a contract of sale is a condition, or a warranty depends in each case, on the construction of thecontract. A stipulation may be a condition, though called a warranty in a contract.

For example, A agrees to supply a suit to B by 15th November, which the later wants to wear on the day of his marriage to be held on 16th November, the time of the delivery of the suit is a condition. On the other hand, if the suit which A agrees to deliver to B by the15th November is required by the buyer to be used in the forthcoming winter season the time of delivery is a warranty. The court has to look to the intention of the parties by referring to the terms of the contract and the surrounding circumstances to judge, whether a stipulation is a condition or a warranty. A stipulation may be a condition though called a warrenty in a contract.

33.8 EXPRESSED AND IMPLIED CONDITION AND WARRANTIES

In a contract of sale, conditions and warranties may be expressed or implied. Expressed conditions and warranties are those which are agreed upon between the parties at the time of the contract and expressly provided in the contract. Implied conditions and warranties are those which are implied by law unless the parties stipulate to the contrary.

33.8.1 IMPLIED CONDITIONS

1. Condition as to title (Section 14)

In a contract of sale there is an implied condition on the part of the seller that

(i) In the case of a sale, he has a right to sell the goods, and

(ii) In the case of an agreement to sell, he will have a right to sell the goods at the time when the property is to pass.

2. Sale by description (Section 15)

Where there is a contract for sale of goods by description there is an implied condition that the goods correspond with the description. If the sale is by sample as well as by description, the goods must correspond both with the sample and the description.

3. Sale by Description (Section 17)

In the case of contract for sale by sample there is an implied condition :

(a) that the bulk correspond with the sample in quality;

(b) that the buyer shall have a reasonable opportunity of comparing the bulk with the sample;

(c) that the goods shall be free from any defect, rendering them unmerchantable, which would not be apparent of reasonable examination of the sample.

4. Conditions as to quality or fitness (Section 16)

The condition as to quality or fitness is implied :

(i) where the goods sold are such as the seller deals in ordinary course of business;

(ii) where the buyer relies on the seller's skill or judgement as to fitness of the goods for any particular purpose; and

(iii) where the buyer expressly or impliedly makes known to the seller that he wants the goods for that particular purpose.

5. Condition as to Merchantability (Section 16 (2))

Where goods are brought by description from a seller who deals in goods of that description (whether he is the manufacturer or producer or not), there is an implied condition that the goods shall be in a merchantable quality.

6. Condition as a Wholesomeness (Section 16 (3))

In case of eatables and provisions, there is, in addition to the implied condition as to merchantability, another condition that the goods shall be wholesome.

7. Condition Implied by Custom : (Section 16 (3))

An implied condition as to quality or fitness for a particular purpose may also be annexed by the usage of trade in the locality concerned.

3.8.2 IMPLIED WARRANTIES

There are two implied warranties in a contract of sale :

1. **Implied warranty of quiet possession :** In a contract of sale, unless there is a contrary intention there is an implied warranty that the buyer shall have and enjoy quiet possession of the goods.

2. **Implied warranty of freedom encumbrance :** In a contract of sale, unless there is a contrary intention, there is an implied warranty that the goods are free from any charge or encumbrance in favour of any third party not declared or known to the buyer before or at the time when the contract is made.

Caveat Emptor (Section 16)

The maxim "Caveat Emptor means "Let the buyer beware'. According to this rule the buyer himself should be careful while purchasing. If the goods are subsequently found to be unsuitable for his purpose, he cannot blame the seller of the same, as there is no implied undertaking by the seller that he shall supply such goods as suit the buyer's purpose. The rule of Caveat Emptor has been explained in the opening lines of Section 16.

For example : A purchases a horse from *B.* A needs the horse for riding but he does not mention this fact to B. The horse is not suitable for riding but is suitable only for being driven in carriage. A can neither reject the horse nor can claim any for being driven in carriage. A can neither reject the horse nor can claim any compensation from B.

Exception : The doctrine of Caveat Emptor has certain important exceptions. These are :

1. **Implied conditions and warranties :** The law implies certain conditions and warranties on the part of the seller and the buyer can rely them to avoid the applications of this maxim.

2. **Sale under a patent or trade name :** In the case of contract for the sale of a specified article under its patient or other trade name, it is not implied that the goods shall be reasonably fit for any particular purpose.

3. **Goods bought by description :** Where goods are bought by description from a seller who deals in goods of that description, there is an implied condition that the goods shall be of merchantable quality. But if the buyer has examined the goods, there is no implied condition as regards defects which such examination ought to have revealed.

4. **Usage of trade :** An implied warranty or condition as the quality or fitness for a particular purpose may be annexed by the usage of trade.

5. **Consent by fraud :** Where the consent of the buyer is obtained by the seller by fraud or where the seller knowingly conceals a defect which could not be discovered on a reasonable examination the doctrine of Caveat Emptor does not apply,

33.9 TRANSFER OF PROPERTY

Property, Possession, Risk : There are three stages to the performance of a contract of sale by the seller

(1) the transfer of the property in the goods ;

(2) the transfer of the possession of the goods; and

(3) the passing of the risk.

Transfer of property in goods from the seller to the buyer is the main object of the contract of sale. The term "property in goods" must be distinguished from "possession of goods". "Property in goods" means ownership of goods whereas "possession of goods" refers to the custody or control of goods. An article may belong to A although it is not in his possession. B may be in possession of that article although he is not its owner.

Example : A leaves his damaged radio-set with B for repair. The ownership of the radio-set is with A, but the possession is with B.

33.10 PASSING OF PROPERTY

The primary rules for ascertaining when the property in goods passes to the buyer are as follows :

1. When there is a contract for the sale of unascertained goods, no property in goods is transferred to the buyer unless and until the goods are ascertained.
2. Where there is a contract for the sale of specific or ascertained goods, the property in term is transferred to the buyer at such time as the parties to the contract intend it to be transferred. For the purpose of ascertaining the intention of the parties, regard is to be given to the terms of the contract, the contract of the parties and the circumstances of the case. Where the intention of the parties cannot be ascertained, the following rules shall apply :

Specific Goods (Section 20, 21 and 22)

In case of a contract for the sale of specific goods in a deliverable state, if the contract is unconditional, property passes as soon as the contract is entered into.

In case of a contract for the sale of specific goods, if the seller has to do something to put them in a deliverable state, property passes only when such thing is due and notice thereof given to the buyer.

In the case of contract for the sale of specific goods is in a deliverable state if the seller has to do something for the purpose of ascertaining the price, property will pass only when such act is done.

Unascertained Goods

it is a condition precedent to the passing of property under a contract of sale that the goods are ascertained. The condition is not fulfilled where there is a contract for sale of a portion of a specified larger stock. Till the portion is identified and appropriate to the contract, no property passes to the buyer.

According to Section 23(1), where there is a contract of the sale of unascertained or future goods by description and goods of that description are in a deliverable state and unconditionally appropriated to the contract the property in the goods there upon passes to the buyer. The appropriate may be done either by the seller with the assent of the buyer or by the buyer with the assent of the seller. Such assent may be expressed or implied, and may be given either before or after appropriation is made.

Appropriation of Goods

When unascertained goods are ascertained according to the description of the goods in a contract of sale, it is said the goods have been appropriated to the contract. The appropriation of goods is essentially the process of making the goods ascertained so that the property in them may be transferred to the buyer. Until goods are appropriated there is merely an agreement to sell. The agreement to sell becomes a sale only when the goods for which the contract is to operate are ascertained.

Essential of an Appropriation

1. The goods must be in a deliverable state.
2. The seller should earmark the goods for fulfilling the contract.

3. The goods should, so far as quality and quantity are concerned, confirm to

the description in the contract,

4. The goods should be unconditionally appropriated to the contract. The appropriation is unconditional when the seller does not reserve to himself the right of disposal of the goods,
5. The appropriation must be either by the seller with the assent of the buyer or by thebuyer with the assent of the seller.

Various ways of the Appropriation

The appropriation of goods may be made

1. By the seller with the assent of the buyer : This is more usual way. The selection of the goods by one party and the adoption of that act by the other converts that in which earlier was mere agreement to sell into an actual sale, and the property thereby passes,

2. By the buyer with assent of the seller This happens when the buyer is already in possession of a large quantity of goods. Where a warehouse man purchases some goods from a large quantity lying in his godown, he may appropriate the quantity purchased with the assent of seller. When this is done, ownership passes from the seller to the buyer.

Check Your Progress

Q1.Condition under the sales of Goods Act has been defined as a stipulation.

A. Collateral of the main purpose of the contract
B. Main purpose of contract.
C. Essential of the main purpose of the contract.
D. All the above.

Q2. The buyer shall have and enjoy quiet possession of goods. This is an ....

A. implied warranty as to title.
B. Implied condition as to title.
C. Implied warranty as to possession.
D. Implied condition as to possession.

33.11 DELIVERY TO CARRIER

A seller is deemed to have unconditionally appropriated the goods to the contract where he delivers the goods to the buyer or to a carrier or to transmission to the buyer, and does not reserve the right of disposal.

The delivery to carrier may be :

(I) Absolutely of the buyer Where the bill of landing orrailway receipt is made out in the name of the buyer and is sent to him, the presumption is that no right of disposal has been reserved by the seller in respect of those goods. The ownership in such a case passes from the seller to the buyer.

(ii) Absolutely for the seller : Where the bill of landing or railway receipt is taken by seller or by his agent and is sent to the agent of the seller to be delivered to the buyer in the fulfillment of certain conditions, the seller is deemed to have reserved the right of disposal of the goods. In such a case, the ownership does not pass to buyer until the necessary conditions are fulfilled and the documents of title are delivered to the buyer.

Goods sent on approval or on sale or structure basis (Section 24)

In case of goods delivered to buyer on approval or on sale or return, when he signified his approval or acceptance. If he retains the goods without giving notice of rejection, property passes when the time agreed for returning the goods expires or after a reasonable time has expired.

33.12 TRANSFER BY NON-OWNER Nemo dt Qui non habet

When the seller himself is the owner of goods which he sells or he is somebody's agent to dispose of the goods, he conveys the title on the goods to the buyer. Difficulty arises when the seller is neither himself the owner nor has, he any such authority from the owner to sell the goods. The general rule of law is that no one can transfer a better title than himself has. This is expressed in Latin maxim

"Nemo dat quod

have,"

This means "no one can give that which he has not got."Forexample, if A steals an article and sells it to B, B does not become the owner of the article. He does not acquire any title although he may have acted honestly and may have paid values for the goods. In other words that the title of the Transferee, i.e., the buyer of the goods, cannot be better than that of the transformer, i.e., the seller. This projects that the owner is true.

Section 27 also provides that where goods are sold by a person who is not the owner thereof does not sell them. This is, however exposed to certain exceptions.

Exceptions

1. Sale by a merchantile agent (Section 27)

A mechantile agent is one who in the customary course of his business, *has,* as such agent, authority either to sell the goods or to consign goods for the purpose of selling or to buy goods or to raise money on the security of good.

The buyer of goods from a merchantileagent, who has no authority from the principal to sell, gets a valid title to the goods if thefollowing conditions are satisfied:

(i) The agent should be in possession of the goods or documents of the title to the goods with the consent of the owner.

(ii) The agent should sell the goods while acting in the ordinary course of the business.

(iii) The buyer should not act in good faith.

(iv) The buyer should not haveat the time ofthe contract of sale received a notice that the agent has no authority to sell.

Example : P, the owner ofa car, delivered it to a merchantile agent for sale with instructions not to sell below a certain price without P's consent. A sold the car to T below the stipulated price and misappropriated the money. Held, T obtained goods title to the car.

2. Sale under the Implied authority of owner or title by estoppel (Section 27)

When the true owner by his conduct, or by an act or omission, leads the buyer to believe that the seller has the authority to sell and induces the buyer to buy the goods, he shall be estopped from denying the fact of want of authority of the seller. To the buyer in such a case gets a better deal than of the seller. e.g. In 0' Connor vi s clark, A was wagon owner and allowed B, his employee, to get his name painted on it. C purchased the wagon from B in good faith, it's valid because A does not stop fun doing so.

3. Sale by the one of several Joint owners (Section 28)

A buyer in good faith of goods of one or the several joint owners, who is in sale possession of the goods by the permission of the co-owners, sets good title to the goods.

4. Sale by a person in possession of goods under the voidable contract (Section 29)

When the seller of goods has obtained their possession under a voidable contract, but the contract has not been rescinded, he buys them in good faith and without notice of the seller's defect of title. If a contract under which the seller obtains goods is valid, then even an innocent buyer of the goods from such a seller does not acquire title to the goods.

5. Sale by seller in possession after sale [Section 30 (1)]

Where a seller, having sold goods, continues to be in possession of the goods or of the documents or title to goods and sells them either himself or through a merchantile agent to a person who buys them in good faith and without notice of the previous sale, the buyer gets a good title.

6. Sale by buyer in possession after sale [Section 30 (2)1

Where a person, having bought or agreed to buy goods obtained with the consent of the seller, possession of the goods, or document of the title to the goods, and sells

them either himself or through an agent, the buyer who acts in a good faith and without notice of any or other right of the original seller in respect of the goods, gets a good title.

7. Sale by an unpaid seller [Section 54 (3)]

Where an unpaid seller who has exercised his right or lien or stoppage in transit resells the goods, the buyer acquired a good title to the goods as against the original buyer.

8. Exceptions in the Acts

(a) Sale by a finder of lost goods under certain circumstances (Section169 of Indian Contract Act.)

(b) Sale by a pawnee or pledge under certain circumstances (Section 176 of the Indian Contract Act).

(c) Sale by an official Receiver of Official Assignee or Liquidator of companies.

(d) In all the above cases, even though the seller is not the owner of the goods, the buyer gets a valid title,

9. Sale in market overt

In England, person who buys goods in market Overt, obtains a goods title to the goods. 'Market overt' means an 'open public and legally constituted market where goods are sold in market overt, buyer acquires a good title to them respective of the seller's title provided.

(a) the goods are sold in accordance with the custom of the market; and

(b) the buyer acted in good faith and no reason to believe that the seller's title to the goods was either defective or non-existent.

33.13 PERFORMANCE OF CONTRACT

Delivery and Acceptance

It is the duty of the seller to deliver the goods of the buyer to accept and pay for them in accordance with the terms of the contract of sale. The contract may contain special terms as to delivery and acceptance. But in the absence of any such terms, it is the duty of the seller to deliver the gods and of the buyer to accept them. If there are no terms in the contract dealing with the matter, delivery at the goods payment of the price are concurred conditions, that is, they both take at the same as in a cash sale time as in a cash over a shop counter.

Delivery of goods (Section 33)

Delivery means voluntary transfer of possession of goods by one person to another. Delivery of goods sold may be made, by which the parties agree shall be treated as delivery the effect of putting the goods in the possession of the other.

Delivery of goods may be actual, symbolic or constructive.

1. **Physical or Actual delivery:** Where the goods are handed over by the seller to the buyer or his duly authorised agent, the delivery is said to be actual.

2. **Symbolic delivery:** Where goods are ponderous or bulky and incapable of actual delivery, e.g., hay-stack in a meadow, the delivery masymbolic. Handing over the key of a warehouse to the buyer is symbolic delivery of the goods to the buyer and is as effective as actual delivery, even though there is no change in the possession of the goods.

3. **Constructive delivery or delivery by attornment :** Where a third person (bailee) who is in possession of the goods of the seller at the time of the sale acknowledge to the buyer then he holds the goods on his behalf, there takes place a delivery by an allotment orconstructive delivery. This may happen in the following cases :

(a) Where the seller is in possession of the goods and hold them on behalf of the buyer.

(b) Where the buyer is in possession of the goods and theseller agrees to the buyer's holding the goods as owner.

(c) Where the third person in possession of the goods acknowledges the buyer that he holds them on his behalf.

Example : A sells to B 10 bags of wheat lying in C's godown. A gives an order to C, asking him to transfer the goods in his books to B, C assents to such order and transfers the goods in his books to B.This a delivery attornment.

33.14 RULES OF DELIVERY OF GOODS

1. **Mode of delivery (Section 33) :** Delivery should have the effect of Put in the goods in the possession of the buyer or his duly authorised agent. Delivery of goods may be (i) actual (ii) constructive or (iii) symbolic.
2. **Payment and delivery (Section 321 :** Delivery of the goods and payment of the price must be according to the terms of contract.
3. **Effect of part of delivery (Section 34) :** A delivery of the goods, progress of thedelivery of the whole, has the same effect for the purpose of passing the property in such goods, as delivery of the whole, but a delivery of the goods, with an intention of delivering it from the whole, does not operate as a delivery of the seller.
4. **Buyer to apply for delivery :** part from any express contract, the seller of goods is not bound to deliver them until the buyer applies for delivery. If the buyer does not apply for delivery, he shall have no cause of action against the seller.
5. **Place of Delivery :** The place at which the delivery of the goods is to take place must be specified in the contract. Where it is donme, the goods must be delivered at that place during business hours on a working day. Where there is no specific agreement as to place, the goods sold are to bedelivered at the place at which they are at the time of the sale.
6. **Goods in possession of a third party:** When at the time of the sale, the seller is bound to send of goods to the buyer, but no time sending them is fixed, the seller is bound to send them within a reasonable time.

But immediate delivery is contemplated. Demand or tender of delivery should be made at a reasonable hour. What is reasonable hour is a question of facts.

7. **Cost of Delivery :** Unless otherwise agreed, all expenses of and incidential to making of delivery shall *be* borne by the buyer.
8. **Delivery of wrong quantity :** The delivery of quantity of goods contracted for should be strictly according to the terms of contract. A defectivedelivery entitles the buyer to reject the goods. The three contingencies which may arise are :
   (i) Delivery of goods less than contracted for : Where the seller delivers to the buyer a quantity of goods less than be contracted sell, the buyer may reject them, but if the buyer accepts the goods so delivered he shall pay them at the contract rate.
   (ii) Delivery of goods in excess of the quantity contracted form where the seller delivers to the buyer a quantity of goods larger than be contracted to sell. The buyer may accept the goods included in the contract and reject the rest or he may reject the whole. If the buyer accepts the whole of the goods so delivered, he shall pay for them at the contract rate.
   (iii) Delivery of goods for save mixed with other goods, where the seller delivers to the buyer the goods he contracted to sell mixed with goods of a different description not included in the Contract the buyer may accept the goods which are in accordance with the contract and reject the rest, or may reject the whole.
9. **Instalment Delivery (Section 18)**

Unless it is a term of the contract of sale, the contract must be performed as a whole and account be divided either by the seller or buyer. The Powers may be expressed or be inferred from the circumstances of the case.

10. **Delivery to a carrier or wharfinger (Section 39)**

Where, in pursuance of a contract of sale, goods are delivered to a carrier for the purpose of transmission to the buyer or a wharfinger for sale custody, delivery of goods to them is primafacie deemed to a delivery of the goods to the buyer. In such a case, the seller must enter reasonable contract with the carrier or wharfinger on behalf of the seller responsible in damage.

33.15 ACCEPTANCE OF DELIVERY

Acceptance of something more than mere receipt or taking of goods by buyer, it means the final assent by the buyer that he has received the goods under performance of contract of sale. If he wrongfully refuses to accept the goods under the contract, he is liable for damages. According to Section 42 the buyer is deemed to have accepted the goods.

When the goods have been delivered to him and he does any act in relation to them which is consistent with the ownership of the seller, as the instance :

(a) where he re-sells the goods; or

(b) where he uses the goods in a manner proper only for the owner;

(c) where he makes some alteration in time, the buyer retains the goods without intimation to the seller that he has rejects them.

BUYER'S LIABILITY FOR REJECTING, NEGLECTING OR REFUSING DELIVERY

Buyer's liability in case of rejection of goods : When the seller is ready and willing to deliver the goods and requests, delivery of the goods.

(a) any loss caused by his neglect or refusal to take delivery;

(b) a reasonable charge for the care and custody of the goods, where the neglect or refusal of the buyer to take delivery amounts to a repudiation of the contract, the seller to sue for price or for damages.

33.16 RIGHT AND DUTIES OF THE BUYER

Rights of the buyer

1. To have delivery of the goods as per terms of the contract.
2. To repudiate the contract for breach of conditions or if the delivery of the goods is not according to the terms of the contract.
3. To sue the seller for damages if he wrongfully neglects or refuses to deliver the goods. He may also sue the seller for the return of the price if he has already paid it.

Duties of the Buyer

1. To take delivery of, and pay for, the goods.
2. To apply for delivery.
3. To take risk of deterioration incidental to the transit.
4. To be liable to the seller for any loss occasioned and neglect or refusal to take delivery.

33.17 RIGHT OF AN UNPAID SELLER Who is an unpaid seller ?

According to Section 45

A seller is deemed to be an unpaid seller :

(a) When the whole of the price has not been paid or tendered.

(b) When a bill of exchange or other negotiable instrument has been fulfilled by result of the dishonour payment, and the condition which it was received has not been fulfilled by result of the dishonour of the instrument, or otherwise.

The following conditions must be fulfilled before a seller can be deemed to be an unpaid seller :

(i) He must be unpaid and price must be due.

(ii) He must have an immediate right of action for the price.

(iii) A bill of exchange or other negotiable instrument was received but the same has been dishonoured.

When payment is made by a negotiable instrument, it is as usually a condition being that the instruments shall he duly honoured. If the instrument is not honoured, the seller is an unpaid seller. A seller who has a money decree for the price of the goods is still an unpaid seller if the decree has not been satisfied.

33.18 RIGHT OF AN UNPAID SELLER AGAINST THE GOODS

(a) Where the property in goods has passed to the buyer : In such a case,

an unpaid seller has, in addition to his other remedies, a right ofwithholding delivery similar to and co-existence with rights of lien and stoppage in transit where the property has passes to the buyer.

(b) Where the property in thegoods has passed on to the buyer. In such a case, an unpaid seller has the following rights against the goods :

1. Rights of the Lien (Section 47 to 49)

Lien is the right to retain possion of goods until the payment is made the unpaid seller of the goods who is in possession of them is entitled to retain possession of them until payment of tender of the price in the following case, namely :

(a) where the goods have been sold without any stipulation as to credit;

(b) where the goods have been sold on credit, but the term of credit has expired; and

(c) where the buyer becomes insolvent.

The seller may exercise his rights of lien not withstanding that he is in possession of the goods as agent or bailee for the buyer. But if he loses the possession of the goods also loses the rights of lion.

A lien is defined as a right to retain possession of goods until payment or tender of the price. The lien depends on actual possession and not on title. It is not affected even if the seller has parted with the document capable of transferring title.

The following conditions are necessary before an unpaid seller can exercise his right of lien :

(a) The ownership must have passed on to the buyer.

(b) The goods must be in the possession of the seller or under his control,

(c) The possession of the goods by the seller must not expressly exclude the rights of lien.

(d) The price or part of the price must remain unpaid.

Where an unpaid seller has made part delivery of goods, he may exercise his rights of lien on the remainder, unless such part delivery has been made under such circumstances as to show an agreement to waive the lien.

Termination of lien (Section 49)

The unpaid seller of goods looses his lien on the goods :

(1) When he delivers the goods to a carrier or other bailee for the purpose of termination to the buyer, without reserving the right of disposal of the goods.

(2) When the buyer or his agent lawfully obtains possession of the goods. The buyer in his case must obtain possession of the goods as buyer.

(3) By waiver thereof. A waiver is implied where the seller sells the goods on credit or grants a fresh term of credit.

The unpaid seller may waive his right to retain the goods or withhold delivery and he may do this either expressly or impliedly.

Right of Stoppage in transit (Section 60 to 62)

When the buyer of goods becomes insolvent, the unpaid seller who has parted with the possession of the goods has the right of stopping them in transit, that is to say, he may resume possession of goods as long as they are in the course of transit and may retain them until payment of tender of the price.

Duration of transit (Section 61) : Transit is an intermediate state, Goods are deemed to be in cause of transit from the time when they are delivered to a carrier or other bailee for the purpose of transmission of the buyer, until the buyer or his agent in that behalf takes delivery of them from such carrier or other bailee.

Transit comes to an end in the following cases

(a) If the buyer or his agent in that behalf, obtains delivery of the goods

before they arrive at the appointed destination.

(b) If, after the arrival of the goods at the appointed destination, the carrier or other bailee acknowledges to the buyer or his agent that he holds the

goods on his behalf.

(c) Where the carrier or the other bailee wrongfully refuses to deliver the goods of the buyer or his agent in that behalf.

(d) Where partly delivery of the goods has been made to the buyer or his agent in that behalf the remainder of the goods may be stopped in transit, unless such part delivery has been given in such circumstances as to show an agreement to give up the possession of the whole of the goods.

Right of re-sale (Section 64)

The unpaid seller can re-sell the goods :

(i) Where the goods are of perishable nature;

(ii) Where the unpaid seller has exercised his right of lien or stoppage in transit and given notice to the buyer of his intention to resale the goods,
and where the buyer has not within a reasonable time paid the price, and

(i) Where the seller expressly reserves a right of re-sale in case the buyer should make default.

As against buyer personally

I. Suit for Price (Section 55): Where under a contract of sale the property inthe goodshas passed to the buyer and the buyer wrongfully neglects or refuses to pay for the goods according to the terms of the contract, the seller may sue him for the price of the goods.

2. Damage for non-acceptance (Section 56) : Where the buyer wrongfully neglects or refuses to pay for the goods, the seller may sue him for damages for non-acceptance,

3. Repudiation of contract before sue due (Section 60) : Where the buyer to contract of sale repudiated the contract, before the date of delivery the seller may either treat the contract as subsisting and wait till the date of delivery or he may treat the contract as rescinded and sue for damages for the breach.

4. Suit for Interest The seller can recover interest on price from the date on which the payment becomes due, if there is a special agreement to that effect.

33.19 PACTICAL QUESTIONS

Q1. Make short note on followings:

(a) Unpaid Seller.

(b) Implied Warranty.

(c) Caveat Emptor

Q2. Contract of Sales. Also Explain Essential of Valid Sale.

Q3. Explain Delivery of Goods. Also Discuss Various Rules of Delivery of Goods.

33.20 ANSWERS OF MCQs

Q1. B Q2. C

33.21 SUGGESTED READINGS

1. Business Regulatory Framework : Garg K.C., Chawla RC,
2. Mercantile Law : Kapoor G.K.
3. Mercantile Law : Kapoor N.D.

33.22 GLOSSARY

Annexed : Seize/Capture

Immovable	: Fixed/Stable
Stipulation	: Precondition/Proviso
Implied	: Deducible/Implicit
Possession	: Propritorship/Control

MBA- DISTANCE EDU.(First Year) BE 106
Semester-I BUSINESS
ENVIRONMENT

Lesson No. 34 AUTHOR RAVI
GOYAL

SALES OF GOODS ACT II
(Sale by Auction Els Hire Purchase Agreement)

STRUCTURE

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34.2 Objective
34.3 Sale by Auction
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    34.4.1 Meaning
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34.12 Glossary

34.1 INTRODUCTION

An auction is a manner of selling property by bids. A sale by auction is complete when the auctioneer announces its completion by the fall of the hammer or in any other manner.

34.2 OBJECTIVE

The following Lesson deals with the law of sales of goods 1930, and in this chapter we deals with what is Auction Sales and What is Hire Purchase Agreement.

34.3 SALE BY AUCTION

34.3.1 Meaning

An auction is a manner of selling property by bids usually to the highest bidder by public competition. The auctioneer, who sells goods by auction, is an agent of the seller only. He may, however sell his own property as principal and need not disclose the fact that he is so selling. The auctioneer holds the goods as abailee. On a sale by auction, a contract is formed between the auctioneer and the buyer, and incurs Certain liabilities though not all liabilities of a seller.

34.3.2 The rules regarding auction sale are laid down in section 64 and are as

under

1. Where an auction sale is made in lots, each lot is prima facie deemed to be the subject of a Separate contract of sale.

2. A sale by auction is complete when the auctioneer announces its completion by the fall of the hammer or in any other customary manner. Until such announcement is made any bidder may withdraw his bid. This can be done by the bidder on the principle that each bid is only an offer by the bidder to the auctioneer and it may be retracted at any time before it is accepted. When the auctioneer announces the completion of the sale by the fall of the hammer, the sale is complete and the property in the goods passes immediately to the buyer.

   Dormant V. Skinner (1948), A purchased a car in an auction sale and gave false cheque for the price and obtained delivery of the car. D, the seller had inserted a clause inthe agreement that the property in the car would not pass to the buyer until the cheque was cleared. Before D could discover the fraud, A sold the car to Skinner. Held the property in the car had passed to A at the fall of the hammer and therefore the defendants acquired a good title to the car and the plaintiff could not recover it back.
3. A right to bid may be reserved expressly by or on behalf of the seller.
4. Where a right to bid is so reserved, the seller or any other person on his behalf may bid at the auction.
5. In case the sale is not notified to be subject to a right to bid on behalf of the seller, it shall Not be lawful---
   (a) For the seller to bid himself or to employ any person tobid at such sale, or
   (b) For the auctioneer knowingly to take any bid from the seller or any such person.
6. Any sale contravening the above rule may be treated as fraudulent by the buyer. He will be entitled to avoid it under section 19 of the Indian Contract Act. Knock-outs i.e., combinations among bidders not to bid against each other are not illegal. But if the object of the knock-outs is to depress the sale i.e. the price, the purchase may be fraudulent and therefore, voidable,
7. A sale by auction may be notified to be subject to a reserved or upset price. The seller, can fix a reserved price in order to protect himself against "knock-out" agreement. A combination of persons not to bid against one another at auction called Knock-outs is not illegal.
8. Ifthe seller makes use of pretended bidding to raise the price, the sale is void able at the option of buyer.

   When an auctioneer sells goods, he impliedly undertakes the following obligations.
   (a) He undertakes that such possession will not be distributed by his principal or himself.
   (b) He warrants his authority to sell.
   (c) He undertakes to give possession against the price paid in to his hands.

34.4 HIRE PURCHASE AGREEMENT

34.4.1 Meaning

A very significant development in the field of trade is 'instalment selling" which has gained acceptance among buyers and sellers all over the world. The hire-purchase system is quite popular business transactions in particularly transactions in consumer durables. Now days, we find offers like sale of Motor Cars, Motor-Cycles, Refrigerators, TVs, air-conditionals at 0% interest. Manufacturers tie-up with financers to sell such products to buyers on easy instalments terms.

Unlike cash-sales, where price has to be paid in lump sum at the time of taking delivery of goods and credit sales where full price is to be paid by the buyer on expiry of credit period allowed by the seller, in case of instalment system, the buyer is allowed to make the payment in easy instalments over a period of time. Hire Purchase Act of 1972 governs such transactions.

34.4.2 Definitions

1. Hire Purchase agreement

Means an agreement under which the goods are let on hire and under which thehirer has an option to purchase them in accordance with the terms of agreement and includes an agreement under which :

(i) The possession of goods is delivered by the owner there off to a person on condition that such person pays the agreed amount in periodical instalments;

(ii) The property in the goods is to pass to such person on payment of the last such instalment; and

(iii) Such person has a right to terminate the agreement at any time before the property so passes. That is, he has the option to return the goods in which case the need not pay instalments falling due thereafter. However, the hirer cannot recover the sums already paid as such sums legally represent hire charges of goods in question.

Special features of the Hire-purchase agreement are :

(i) The hire vendor transfers only the possession of Goods to hire purchaser immediately after the agreement of hire purchase is made.

(ii) Goods should be delivered by the hire vendor on the condition that the hire purchaser should pay the agreed amount in periodical instalments.

(iii) Hire-purchaser generally makes a down payment on signing the agreement and the balance of amount along with interest is paid in instalments at regular intervals for a Specified period.

(iv) Each instalment, including down payment if any) is treated as hire charge by the seller·

(v) Each instalment consists partly of interest and party of capital payment.

(vi) The property in goods is to pass to the hire-purchaser on the payment of the last instalment.

(vii) The hire-purchaser has the right to terminate the agreement at any time before the property so passes.

(viii) In case of default in respect of payment of even the last instalment, the hire vendor has the right to take the goods back without making any compensation.

2. Hire

Hire means any periodical sum payable by the hirer **to** the owner of the property under a hire-purchase agreement.

3. Hirer

Hirer meansthe person who acquires or has acquired the possession of goods from an owner under a hire-purchase agreement, and includes a person to whom the hirer's rights or liabilities under the agreement have passed by assignment or by operation of law.

4. Owner

Owner means the person who lets or has let, delivers or has delivered possession of goods to a hirer under a hire-purchase agreement and includes a person to whom the owner's property in the goods or any of the owner's rights or liabilities under the agreement has passed by assignment or by operation of law.

5. Hire-Purchase Price

Hire-purchase price means the total amount payable by the hirer under hire-purchase agreement to complete the purchase of, or the acquisition of property in the goods to which the agreement relates and includes any sum so payable by the hirer under the hire-purchase agreement by way of deposit or other initial payment on him under such agreement on account of any such deposit or payment, whether than sum is to be or has been paid to the owner or to any other person or is to be or has been discharged by payment of money or by transfer or

delivery of goods or by

any other means. But it does include any sum payable as penalty or as Compensation or damages for a breach of the agreement.

6. **Down Payment**

Initial payment made at the timeof signing hire-purchase agreement and taking possession of the goods.

34.4.3 Contents of Hire Purchase Agreement

According to' Sec. 4 of the Hire-Purchase Act, 1972. The following shall be the contents of any hire purchase agreement.

1. The hire purchase price of the goods.
2. The cash price of the goods, that is to say, the price at which the goods may be purchased by the hirer for cash.
3. The date on which the agreement shall be deemed to have commenced.
4. The number of instalments, the amount of each of those instalments and the date or the mode of determining the date, upon which it is payable, and the person to whom and the place, where it is payable.
5. Description of the goods covered by-the-agreement.

Check Your Progress

Q1. Auction sale is complete on the ________.

A. Delivery goods.
B. Payment of price.
C. Fall of hammer.
D. None of the above.

Q2. Amount paid at the time of hire purchase agreement is known as :

A. Instalment.
B. Down payment.
C. Cash price.
D. Hire purchase price.

34.5 HIRE-PURCHASE CHARGES

34.5.1 Meaning

'Hire-purchase charges' are the difference between hire-purchase price and cash price of the goods. Section 7 has restricted the hire charges, which can be levied by the owner. A statutory limitation is imposed on the amount that can be levied with respect to each cash price instalment. The H.P. charges may be determined by applying the formula :

$$SC = \frac{CIxRxT}{100}$$

Where SC represents the statutory charges

CI the amount of cash price instalment expressed in rupees or fractions of the rupee.

R represents the rate, and

T represents the time, expressed in years and fractions of years, that elapse between the date of agreement and the date on which the hire-purchase instalment corresponding to the cash price instalment is payable under the agreement.

The rate (R) is determined by the Central Government after consulting Reserve Bank of India but it should not be less than 10% p.a.

Cash price instalment in relation to a hire-purchase instalment is calculated as follows

$$\text{Cash Price Installment} = \frac{\text{Hire} - \text{purchase installment}}{\text{Hire} - \text{purcahse price}} \text{x Net cash Price}$$

Net cash price means cash price as specifically mentioned in the agreement less any deposit. The term deposit refers to initial payment whether actually paid or agreed to be paid because of delivery of goods or any other mode of settlement "Net hire-purchase price" means the hire-purchase price of the goods as specified in the agreement less:

(i) any amount payable to the hirer to cover the delivery of goods and included in the hire-purchase price.

(ii) any amount payable to cover registration or other fees and included in the hire-purchase.

(iii) any amount payable for insurance (other than third party risk insurance) of the goods and included in the hire-purchase price.

Where the net hire-purchase charges exceed the statutory charges, the hirer can either avoid the agreement or restrict his liability to statutory amount.

34.5.2 RIGHTS OF HIRE-PURCHASER

The hire-purchaser has following rights :

34.5.2.1 Right to Purchase

During the course of the hire-purchase agreement, the hirer may, after giving the owner at least 14 days' notice in writing of his intention to purchase the goods, complete the purchase of the goods by paying to the owner the hire-purchase price or the balance thereof as reduced by the rebate. Rebate is equal to two-thirds of an amount which bears to the hire purchase charges, the same proportion as the balance of the hire-purchase price not yet due bears to the hire-purchase price. Where hire-purchase charges mean the difference between the hire-purchase price and the cash price as stated in the hire-purchase agreement. The formula for calculating rebate is

$$= \frac{\text{Hire} - \text{purchase Charges x Balance of H.P. price not yet due}}{\text{Total Hire} - \text{purcahse price}} \text{x } \frac{2}{3}$$

Or

$$= \frac{\text{Hire} - \text{purchase Charges x No. of Instalment due}}{\text{Total No. of Instalment}} \text{x } \frac{2}{3}$$

34.5.2.2 Right to terminate

The hirer has, after giving 14' days' notice and returning the goods, right to terminate the agreement at any time before the property passes and the final instalment payment under the hire-purchase agreement falls due. However, the payments made by the hirer prior to the final payment are treated as payments in respect of hire, (i.e. hire charges) arid are not returned to the hirer if he does not continue the agreement. The provisions are as follows :

(1) The hirer can terminate the agreement at any time after giving 14 days' notice to the owner and redelivering or tendering the goods to the owner. Hire-purchase agreements may impose severe liability if the hirer wants to terminate the agreement To mitigate this, the Act provides :

(a) Where the sum-total of the amounts paid and the amounts due in respect of the hire-purchase price immediately before the termination exceeds one half of the purchase price the hirer shall not be liable to pay the amount so mentioned.

(b) Where the sum-total of the amounts paid and the amounts due in respect of the hire-purchase price immediately before the termination does not exceed one-half of the hire-purchase price, the hirer shall be liable to pay the difference between the said

sum-total and the said one-half, or sum named in the agreement whichever is less.

34.5.2.3 Right of hirer when goods are seized by the owner

Where the owner seizes the goods on the termination of the agreement, he has to refund to the hirer the amount by which the amounts paid by the hirer plus the value of the goods on the date of seizure exceed the hire-purchase price. The value of the goods is the best price that can be reasonably obtained for the goods by the owner less expenses incurred for seizing, repairing, storing, selling, etc., of such goods. He has to refund the amount within 30 days from the date on which notice is served by the hirer, failing which interest at 12% p.a. has to be paid on the amount from the date of expiry of thirty days. This is intended to ensure that an owner by exercising his right of seizure does not acquire any unconscionable benefit.

34.5.2.4 Owner require permission of court to repossess the goods

Goods can be repossessed only by making an application to the appropriate court in the following Cases :

(i) Where the hire-purchase price is less than Rs. 15,000 and one-half of the price is paid.

(ii) In other cases when three-fourths has been paid.

If goods are recovered in contravention of above provisions, the agreement is terminated and the hirer will be released from all liability and will have the right to recover from the owner all sums paid by him under the agreement. The surety also will have the right to recover all the sum paid by him under the contract of guarantee.

34.6 Difference Between Sales & Hire Purchase Agreement

Under hire-purchase agreement the owner of the goods lets them out on hire for a periodic rent on the terms that on completion of the agreed number of payments, the hirer is to have the option to buy the goods. On payment of the full amount, the property in the goods passes to him but the owner shall have the right to resume possession of the goods on the hirer's failure to pay any of the instalments of rent or any other breach by the hirer of the terms of the agreement.

Where the hirer agrees to buy the goods though the price is to be paid by instalments, he not merely acquires an option to purchase them in future, then the contract is a contract of sale and not a contract of hire-purchase. The essential feature of a hire- purchase agreement is that a person has a right to terminate the agreement for hire at his pleasure and is riot bound to pay the value of the goods. The difference between a contract of sale and hire purchase agreement are listed below.

	Sale	Hire-Purchase agreement
1. Nature of Contract	A sale is an executed contract in which the ownership is transferred from the seller to the buyer as soon the contract is entered.	In hire purchase agreement it become the property of buyer inly after certain numbers of instalment are paid.
2. Termination	The buyer in this case cannot terminate the contract as such is bound to pay the price of the goods.	Hire purchasers is at liberty to terminate contract at any stage and cannot be force to pay remaining instalments.
3. Resale	The buyer in a sale can resell the goods.	The hire purchaser cannot until he has paid all instalment of hire.
4. Implied Conditions & warranties	A sale is subject to the implied conditions & warranties.	A hire purchase agreement is not subject to such things.
5. Insolvency	In sale, seller takes the risk of any loss resulting from insolvency of the buyer.	In this, owner is not at any risk

6. Resale	The buyer can resell the goods. Resell unless he has paid all.	The hire purchaser can't the instalments.

34.7 DIFFERENCE BETWEEN HIRE PURCHASE AND INSTALMENT SALE CONTRACTS

In the case of hire, the ownership in property is never transferred to the hirer by the owner, i.e., the property must be returned to its owner. Whereas in the case of sale contracts, the ownership in property is transferred to the buyer immediately at the time of contract, i.e., the, property cannot be returned to its seller.

Difference between Hire purchase and Instalment System

'Instalment sale is different from goods sold under 'hire-purchase' agreement.

In 'instalment sale', 'possession' as well as 'ownership' of goods is transferred to the buyer immediately. The main differences between instalment sale and hire purchase are as follows :

	Instalment Sales	**Hire-Purchase**
1. Ownership	Ownership in goods passes to buyer the moment, transaction is completed.	Ownership passes at stipulated time, usually on payment of last instalment.
2. Right of Buyer	The buyer has no right to terminate the agreement by returning goods.	The buyer has the option to return the goods and terminate the agreement.
3. Right of Seller	The seller can only sue for theunpaid balances.	The seller can repossess the goods on default of payment by buyer.
4. Right of Disposal of Goods	The buyer has the right to dispose of the goods in any manner he likes.	The buyer being in the legal position of bailee has no right of disposal of goods.
5. Risk of Loss	Any loss of goods should be borne by the buyer as risk lies with the ownership.	If buyer take reasonable care of the goods expected of a bailee, nay loss occurring to goods has to be borne by the seller.

34.8 SUMMARY

From the above discussion u understand what is sales by auction and how it is done and what is hire purchase. An auction is a manner of selling property by bids usually to the highest bidder by public competition. The auctioneer, who sells goods by auction, is an agent of the seller only. He may, however sell his own property as principal and need not disclose the fact that he is so selling.

Under hire-purchase agreement the owner of the goods lets them out on hire for a periodic rent on the terms that on completion of the agreed number of payments, the hirer is to have the option to buy the goods. On payment of the full amount, the property in the goods passes to him but the owner shall have the right to resume possession of the goods on the hirer's failure to pay any of the instalments of rent or any other breach by the hirer of the terms of the agreement.

The essential feature of a hire- purchase agreement is that a person has a right to terminate the agreement for hire at his pleasure and is not bound to pay the value of the goods.

34.9 PACTICAL QUESTIONS

Q1. What is Auction sale and what are the various rules of regarding auction sales?

Q2. Define what is Hire Purchase Agreement and what are its contents and feature in details.

Q3. Make a difference between the followings :

(a) Hire Purchase Agreement & Sales.

(b) Hire Purchase & Instalment Sales.

34.10 ANSWERS OF MCQs

Q1. C Q2. C

34.10 SUGGESTED READINGS

1. Business Regulatory Framework : Garg K.C.,Chawla R.C.
2. Mercantile Law : KapporG.K.
3. Mercantile Law : Kappor N.D.
4. Principles of Mercantile Law : Singh Avtar
5. Business Laws : V.K. Sharma

34.11 GLOSSARY

1. disposal : removal/discarding
2. obligation : compulsion/ responsibility
3. compensation : reparation/reimbursement
4. repossess : take back/recapture
5. seized : in custody
6. terminate : come to an end

Lesson no.35 **Author: Harkirtan Kaur**

ISO 9000-14000

STRUCTURE

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35.1 OBJECTIVE

After reading this chapter, the student should be able to:

(i) Understanding about ISO standards.
(ii) Understanding about ISO 9000.
(iii) Understanding about ISO 14000,

35.2 INTRODUCTION

ISO standards that provide requirements or give guidance on good management practice are among the best known of ISO's offering.

The ISO 9000 and ISO 14000 families are among ISO's best-known standards ever. ISO 9001:2000 andISO 14001 (1996 and 2004 versions) are implemented by over a million organizations in 161 countries.

The ISO 9000 family addresses “quality management". This means what the organization does to fulfill:

- the customer's quality requirements, and
- applicable regulatory requirements, while aiming to
- enhance customer satisfaction, and
- achieve continual improvement of its performance in pursuit of these objectives.

The ISO 14000 family addresses "environmental management", This means what the organization does to:

- minimize harmful effects on the environment caused by its activities, and to
- Achieve continual improvement of its environmental performance.

The positive roles played in globalization by ISO's standards for quality and environmental management systems include the following:

- a unifying base for global businesses and supply chains - such as the automotive and oil arid gas sectors
- a technical support for regulation - as, for example, in the medical devices sector)
- a tool for major new economic players to increase their participation in global supply chains, in export trade and in business process outsourcing;
- a tool for regional integration - as shown by their adoption by new or potential members of the European Union
- in the rise of services in the global economy - nearly 33 % of ISO 9001:2000 certificates and 31 % of ISO 14001 (1996 and 2004 versions) certificates in 2005 went to organizations in the service sectors, and
- in the transfer of good practice - in 2005, the newcomers to ISO 9001:2000 and/or ISO 14001 certification were 13 developing countries in Africa and the Pacific, and two transition economies in Europe and West Asia

35.3 HISTORY OF ISO 9000

35.3.1 Pre ISO 9000

During World War II, there were quality problems in many British industries such as munitions, where bombs were exploding in factories during assembly. The adopted solution was to require factories to document their manufacturing procedures and to prove by recordkeeping that the procedures were being followed. The name of the standard was BS 5750, and it was known as a management standard because it specified not what to manufacture, but how the manufacturing process was to be managed. Accordin g to Seddon "In 1987, the British Government persuaded the International Organization for Standardization to adopt BS 5750 as an international standard. BS 5750 became ISO 9000".

35.3.2. 1987 version

ISO 9000:1987 had the same structure as the UK Standard BS 5750, with three 'models' for quality management systems, the selection of which was based on the scope of activities of the organization:

ISO 9001:1987 Model *for quality assurance in design, development, production, installation, and servicing* was for companies and organizations whose activities included the creation of new products.

ISO 9002:1987 Model *for quality assurance in production, installation, and servicing* had basically the same material as ISO 9001 but without covering the creation of new products.

ISO 9003:1987 Model *for quality assurance* in *firm/ inspection and test* covered only the final inspection of finished product, with no concern for how the product was produced.

ISO 9000:1987 was also influenced by existing U.S. and other DefenseStanderd ("MIL SPECS"), and so was well-suited to manufacturing. The emphasis tended to be placed on conformance with procedures rather than the overall process of management which was likely the actual intent.

35.3.3. 1994 Version

ISO 9000:1994 emphasized quality assurance via preventive actions, instead of just checking final product, and continued to require evidence of compliance with documented procedures. As with the first edition, the down-side was that companies tended to implement its requirements by creating shelf-loads of procedure manuals, and becoming burdened with an ISO bureaucracy. In some companies, adapting and improving processes could actually be impeded by the quality system.

35.3.4. 2000 Version

ISO 9001:2000 combines the three standards 9001, 9002, and 9003 into one, called 9001. Design and development procedures are required only if a company does in fact engage in the creation of new products. The 2000 version sought to make a radical change in thinking by actually placing the concept of process management front and center("Process management" was the monitoring and optimizing of a company's tasks and activities, instead of just inspecting the final product). The 2000 version also demands involvement by upper executives, in order to integrate quality into the business system and avoid delegation of quality functions to junior administrators. Another goal is to improve effectiveness via process performance metrics - numerical measurement of the effectiveness of tasks and activities. Expectations of continual process improvement and tracking customer satisfaction were made explicit.

35.3.5. Future version: 2008

TC 176, the ISO 9001 technical committee, has started its review on the next version of ISO 9001, which will in all likelihood be termed the ISO 9001:2008 standard, assuming its planned release date of 2008 is met, Early reports are that the standard will not be substantially changed from its 2000 version.

As with the release of previous versions, organizations registered to ISO 9001 will be given a substantial period to transition to the new version of the standard, assuming changes are needed; organizations registered to 9001:1994 had until December of 2003 to undergo upgrade audits.

The forthcoming ISO 9001:2008 international standard is likely to be published by October - November 2008.

35.4. CERTIFICATION

ISO does not itself certify organizations. Many countries have formed accreditation bodies to authorize certification bodies, which audit organizations applying for ISO 9001 compliance certification. Although commonly referred to as ISO 9000:2000 certification, the actual standard to which an organization's quality management can be certified is ISO 9001:2000. Both the accreditation bodies and the certification bodies charge fees for their services. The various accreditation bodies have mutual agreements with each other to ensure that certificates issued by one of the Accredited Certification Bodies (ACB) are accepted world-wide.

The applying organization is assessed based on an extensive sample of its sites, functions, products, services and processes; a list of problems ("action requests"or"non-compliances") is made known to the management. If there are no major problems on this list, the certification body will issue an ISO 9001 certificate for each geographical site it has visited, once it receives a satisfactory improvement plan from the management showing how

any problems will be resolved.

An ISO certificate is not a once-and-for-all award, but must be renewed at regular intervals recommended by the certification body, usually around three years. In contrast to the Capability Maturity Model there are no grades of competence within ISO 9001.

35.5 SELECTION AND USE OF THE ISO 9000 FAMILY OF STANDARDS

The ISO 9000 family of international quality management standards and guidelines has earned a global reputation as a basis for establishing effective and efficient quality management systems.

The need for international standards is very important as more organizations operate in the global economy by selling or buying products and services from sources outside their domestic market.

ISO 9000 series is called a usual quality system, and it is a standard system to guarantee the quality of products for customers. 14000 series is called an environment management system, and it related to prevention of environmental protection and pollution. ISO is a standard for the system and its acquisition is connected to business efficiency improvement, and continual improvement including improvement of the reliability of customers and product quality, and reduction of wastes.

ISO 9000 is a series of standards on product quality control. These standards can be applied to a service as well as hard goods. GCI has assisted a client in developing an ISO 9002 standard for the operation of a hazardous waste fuel supply facility in the U. K. ln our global economy the implementation of an ISO 9000 standard will facilitate acceptance of your goods or services worldwide. The ISO 14000 standards are a series of environmental management standards; essentially, they are quality standards like the ISO 9000 series but aimed exclusively at environmental management. A comprehensive understanding of the existing federal and local regulations alone will not be sufficient background for the development of an ISO 14000 standard. Development of such a standard requires a full and practical understanding of operations, environmental testing technologies and data management, to name a few of the areas encompassed by these standards. It is here where GCI's extensive experience can be most useful to our clients in developing such standards.

ISO 9001 specifies the basic requirements for a quality management system (QMS) that an organization must fulfil to demonstrate its ability to consistently provide products (which include services) that enhance customer satisfaction and meet applicable statutory and regulatory requirements. The standard can be used for certification/registration and contractual purposes by organizations seeking recognition of their quality management system.

ISO 9001 has been organized in a user-friendly format with terms that are easily recognized by all business sectors.

One will obtain the greatest value by using the entire family of standards in an integrated manner. It is highly recommended that you use ISO 9000 to become familiar with the basic concepts and the language used before one adopt ISO 9001 to achieve a first level of performance. The practices described in ISO 9004 may then be implemented to make quality management system more effective and efficient in achieving ones business goals and objectives. The ISO 9001 and ISO 9004 standards have been written to enable to relate them to other management systems (e.g., environmental), or to sector specific requirements (such as ISO/TS 16949 in the automotive industry) and to assist in gaining recognition through

national or regional award programmes.

This brochure provides with:

- An overview of the ISO 9000 core standards
- A step-by-step process to implement a quality management system
- Examples of typical applications of the documents; and
- Information on the ISO 9000 family of standards.

35.6 ISO 9000 ESSENTIALS

This section concisely describes the essential features of the ISO 9000 family.

The ISO 9000 family of standards represents an international consensus on good quality management practices. It consists of standards and guidelines relating to quality management systems and related supporting standards.

ISO 9001:2000 is the standard that provides a set of standardized requirements for a quality management system, regardless of what the user organization does, its size, or whether it is in the private, or public sector. It is the only standard in the family against which organizations can be certified - although certification is not a compulsory requirement of the standard.

The other standards in the family cover specific aspects such as fundamentals and vocabulary, performance improvements, documentation, training, and financial and economic aspects.

35.6.1. Implementation of ISO 9001:2000

Without satisfied customers, an organization is in peril! To keep customers satisfied, the organization needs to meet their requirements. The ISO 9001:2000 standard provides a tried and tested framework for taking a systematic approach to managing the organization's processes so that they consistently turn out product that satisfies customers' expectations.

35.6.2. Working of ISO 9001:2000

The requirements for a quality system have been standardized - but many organizations like to think of themselves as unique. So how does ISO 9001:2000 allow for the diversity of say, on the one hand, a "Mr. and Mrs." enterprise, and on the other, to a multinational manufacturing company with service components, or a public utility, or a government administration?

The answer is that ISO 9001:2000 lays down what requirements your quality system must meet, but does not dictate how they should be met in any particular organization. This leaves great scope and flexibility for implementation in different business sectors and business cultures, as well as in different national cultures.

I. The standard requires the organization itself to audit its ISO 9001:2000-based quality system to verify that it is managing its processes effectively - or, to put it another way, to check that it is fully in control of its activities.

2. In addition, the organization may invite its clients to audit the quality system in order to give them confidence that the organization is capable of delivering products or services that will meet their requirements.

3. Lastly, the organization may engage the services of an independent quality system certification body to obtain an ISO 9001:2000 certificate of conformity. This last option has proved extremely popular in the market-place because of the perceived credibility of an independent assessment.

The organization may thus avoid multiple audits by its clients, or reduce the frequency or duration of client audits. The certificate can also serve as a business reference between the organization and potential clients, especially when supplier and client are new to each other, or far removed geographically, as in an export context.

CHECK YOUR PROGRESS-1

1. ISO 9000 determines _______

A. The procedure used for quality control
B. Infrequent causes of variation
C. Performance of suppliers regarding quality
D. If the company practices its written procedures

2. ISO 9000 has been adopted in over _______ countries.

A. 117
B. 152
C. 178
D. 215

3. The ________ family is the world's best-known quality management standard for companies and organizations of any size.

A. ISO 9000
B. ISO 27000
C. ISO 14000
D. ISO 2018

35.7. ISO 14000 ESSENTIALS

The ISO 14000 environmental management standards exist to help organizations minimize how their operations negatively affect the environment (cause adverse changes to air, water, or land), comply with applicable laws and regulations).

ISO 14001 is the international specification for an environmental management system (EMS). It specifies requirements for establishing an environmental policy, determining environmental aspects and impacts of products/activities/services, planning environmental objectives and measurable targets, implementation and operation of programs to meet objectives and targets, checking and corrective action, and management review.

ISO 14000 is similar to ISO 9000 quality management in that both pertain to the process (the comprehensive outcome of how a product is produced) rather than to the product itself. The overall idea is to establish an organized approach to systematically reduce the impact of the environmental aspects which an organization can control. Effective tools for the analysis of environmental aspects of an organization and for the generation of options for improvement are provided by the concept of Cleaner Production.

As with ISO 9000, certification is performed by third-party organizations rather than being awarded by ISO directly. The ISO 19011 audit standard applies when auditing for both 9000 and 14000 compliances at once.

35.7.1. ISO 14000 Family

This section concisely describes the essential features of the ISO 14000 family:

The ISO 14000 family addresses various aspects of environmental management. The very first two standards, ISO 14001:2004 and ISO 14004:2004 deal with environmental management systems (EMS). ISO 14001:2004 provides the requirements for an EMS and ISO 14004:2004 gives general EMS guidelines.

The other standards and guidelines in the family address specific environmental aspects, including labeling, performance evaluation, life cycle analysis, communication and auditing.

ISO 14000 is a series of standards, and guideline reference documents, which cover the following:

1. Environmental Management Systems
2. Environmental Auditing
3. Eco Labeling
4. Life Cycle Assessment
5. Environments/ Aspects in Product Standards
6. Environmental Performance Evaluation

One of these standards in particular, ISO 14001, has assumed additional importance, because it is intended for registration by a third party.

35.7.2. An ISO 14001:2004 EMS

An EMS meeting the requirements of ISO 14001:2004 is a management tool enabling an organization of any size or type to

• identify and control the environmental impact of its activities, products or services, and to

• improve its environmental performance continually, and to Implement a systematic approach to setting environmental objectives and targets, to achieving these and to demonstrating that they have been achieved.

The ISO 14000 standards reflect different aspects of environmental management. The following list outlines the broad coverage of each:

1. Environmental Management Systems: 14001, 14002, 14004
2. Environmental Auditing: 19011
3. Environmental Labeling: 14020, 14021, 14022, 14023, 14024, 14025
4. Life Cycle Assessment: 14040, 14041,14042, 14043
5. Evaluation of Environmental Performance: 14031

Workings

ISO 14001:2004 does not specify levels of environmental performance. If it specified levels of environmental performance, they would have to be specific to each *business* activity and this would require a specific EMS standard for each business. That is not the intention.

ISO has many other standards dealing with specific environmental issues. The intention of ISO 14001:2004 is to provide a framework for a holistic, strategic approach to the organization's environmental policy, plans and actions.

ISO 14001:2004 gives the generic requirements for an environmental management system. The underlying philosophy is that whatever the organization's activity, the requirements of an effective EMS are the same.

This has the effect of establishing a common reference for communicating about environmental management issues between organizations and their customers, regulators, the public and other stakeholders.

Because ISO 14001:2004 does not lay down levels of environmental performance, the standard can to be implemented by a wide variety of organizations, whatever their current level of environmental maturity. However, a commitment to compliance with applicable environmental legislation and regulations is required, along with a commitment to continual improvement - for which the EMS provides the framework.

35.8. THE EMS STANDARD

ISO 14004:2004 provides guidelines on the elements of an environmental management system and its implementation, and discusses principal issues involved. ISO 14001:2004 specifies the requirements for such an environmental management system. Fulfilling these requirements demands objective evidence which can be audited to demonstrate that the environmental management system is operating effectively in conformity to the standard.

35.9. OBJECTIVES OF ISO 14001:2004

ISO 14001:2004 is a tool that can be used to meet internal objectives:

Provide assurance to management that it is in control of the organizational processes and activities having an impact on the environment assure employees that they are working for an environmentally responsible organization.

ISO 14001:2004 can also be used to meet external objectives:

• provide assurance on environmental issues to external stakeholders - such as

customers, the community and regulatory agencies
- comply with environmental regulations
- support the organization's claims and communication about its own environmental policies, plans and actions
- provides a framework for demonstrating conformity via suppliers' declarations of conformity, assessment of conformity by an external stakeholder - such as a business client - and for certification of conformity by an independent certification body.

CHECK YOUR PROGRESS-2

1.ISO 14000 standards are for the _________
A. Quality Management System
B. Environmental Management System
C. Administration
D. Supply chain

2. Which is the first environmental management system standard?
A. BS 7750
B. ISO 9000
C. ISO 9001
D. ISO 9004

3. In which year did the ISO create the ISO 14000 family of standards?
A. 1956
B. 1966
C.1978
D. 1996

35.10 SUMMARY

This lesson gives the knowledge about meaning about ISO standard. The ISO 9000 and ISO 14000 families are among ISO's best-known standards ever. ISO 9001:2000 and ISO 14001 (1996 and 2004 versions) are implemented by over a million organizations in 161 countries. The ISO 9000 family addresses "quality management". The ISO 14000 family addresses "environmental management'. The objectives, working of each standard is also given.

35.11 KEYWORDS International standard, International standard organization, environmental management system, life cycle analysis, environmental auditing, ISO 9000, ISO 14000.

35.12 PRACTICE QUESTIONS:

A. Short Questions:

Q1. Why do we need a Quality system?
Q2. What is two party quality system?
Q3. Define quality auditing?
Q4. What are the other quality systems?

B. Long Questions:

Q.1. Discuss ISO 9000? Discuss various versions of ISO 9000?

Q.2. Explain ISO 14000 family? Discuss ISO 14000 objectives and working

of ISO 14000?

Q3. What are the benefits of certification? Discuss the process of registration.

Q4. Consider your current place of employment or

35.12 GLOSSARY:

(i) ACB (Accredited Certification Bodies): An accredited registrar, also known as an accredited certification body (CB), is a company that has been certified by a recognized accrediting authority for its ability to audit and issue certification verifying that a company satisfies the criteria of a standard (for example, ISO 9001 or ISO 14001).

(ii) EMS (Environmental management system): As part of an organization's plan to execute its environmental policy and handle regulatory restrictions, an environmental management system (EMS) may be built in accordance with the ISO 14001 standard. An EMS directs resources toward satisfying the organization's policy commitments, which may include minimizing or eliminating the negative environmental consequences of its goods, services, and activities and/or boosting their positive benefits.

(iii) QMS (Quality management system): A quality management system (QMS) is a codified system for documenting processes, methods, and responsibilities for meeting quality policies and goals. A QMS aids in the coordination and direction of an organization's operations in order to fulfil customer and regulatory requirements while also continuously improving its effectiveness and efficiency.

35.13 SUGGESTED READINGS:

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ANSWERS:

Check your Progress-1:

1. D
2. C
3. A

Check your Progress-2

1. B
2. A
3. D

Lesson No. 36 AUTHOR: TARANNUM MOHAN

GLOBAL OUTSOURCING

STRUCTURE

36.0 Objectives
36.1 Introduction
36,2 Definition
36.3 Rationale for Global Outsourcing
36.4 Business Process Outsourcing
36,5 Rationale behind outsourcing
36.6 Process of Outsourcing
36.7 Reasons for Outsourcing
36.8 Criticism of Outsourcing
36.9 The Outsourcing Debate
36.10 India's Perspective
36.11 Summary
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36.13 Practice Questions
36.14 Glossary
36.15 Suggested readings

36.0 OBJECTIVES

After reading this chapter, the student should be able to:

- Understand the recent developments with reference to Global Outsourcing.
- Learn about the implications of the Business Process Outsourcing.

36.1 INTRODUCTION

In a world dominated by Internet, Intranet and the IT revolution, business and knowledge no longer have to be homegrown. In this increasingly competitive world, it can be contracted, to reduce the cost and maximize the profit, without compromising on quality and time. Such a contract is known as outsourcing, which is a powerful management tool for redefining and re-energizing any organization. It is useful, not only for maximizing the present profits of the organization, with the existing clientele, but it also relieves and enables employees to work on higher value-added jobs. It offers online support services that use the Internet as a platform to build the desired recognition value in the eyes of customers, through good customer servicing. Outsourcing business process helps in taking care of daily routines, and concentrates on the new business prospects. This process reduces overheads and increases profit and time to concentrate on new business avenues

36.2 DEFINITION

According to Webster's 10th Dictionary, the word outsourcing was coined in 1982. It can be defined as the transfer of an organization's entire non-core, but critical, business process/function to an external vendor who uses an IT-based service delivery.

By doing so, BP0 helps an organization to concentrate on its core competencies, improve efficiency, reduce cost and improve shareholders' value.

36.3 RATIONALE FOR GLOBAL OUTSOURCING

Why do everything yourself, when someone else can do it at low cost? In the current

scenario, the theory says exactly the same. The global market today is highly competitive and continuously changing. A company must, thus, focus on improving productivity and at the same time, cut down costs. This is the basic premise of outsourcing. In brief, business process outsourcing can be seen as a process in which a company delegates some of its in-house operations or processes to a third party. Thus, it is a transaction through which one company acquires services from another, while maintaining ownership and ultimate responsibility for the processes. The main motive for business process outsourcing is to allow the company to invest more time, money and human resources into core activities and building strategies, which fuel company growth.

36.4 BUSINESS PROCESS OUTSOURCING

In today's business environment, outsourcing is often not a decision that needs to be justified. BPO Companies are often considered **to** provide more flexible, faster, cheaper and effective services. The operations or processes being outsourced vary from manufacturing, to customer service, to software development, and much more. Most of the companies, that are looking to outsource, are multinationals, or companies from western countries and most of the BPO units are in countries such as India, China, Malaysia and even Russia.

Though IT outsourcing has been happening for so many years, an increased momentum has been-witnessed since the late 1900s, due to the rise of internet and communication technologies. This has given rise to many specialized BPO vendors across the globe, with India being a major hub, owing to its large computer-literate, English-speaking population, low billing rates, strategically favourable time zone and high quality. In India, the BPO market is expected to grow exponentially in the coming years.

The controversy that outsourcing has resulted in job losses in the USA, is largely seen as more political than economic in India. Ever since the US Senate passed the Bill on banning
government outsourcing to foreign countries in January, 2004, there has been a lot of resentment in Indian IT industry. By no stretch of imagination can the estimated 245,000 employees, now working in business process. Outsourcing in India, pose a threat to the 100 million workers in the US services sector. American businesses themselves, do not want to be restrained in any way from tapping cheaper sources outside the United States. The major US concerns comprise of the prediction that by 2015, roughly 3.3 million US business-processing jobs will have moved abroad. Research suggests that the number of US service jobs lost to offshoring will accelerate at the rate of 30 to 40% annually, during the next five years.

These fears are without proper basis as a large percentage of jobs in US require the consumer and the retailer to be present in the same place. Any job losses must be seen as a part of economic restructuring, with which the US economy is well acquainted.

Most of the jobs created in India are either in call centres or at IT firms. But call centres companies in both Britain and US suffer from rising staff turnover and struggle to recruit more people. In fact, 'not moving work abroad' would make the companies of developed countries less competitive. By focusing on creation of jobs, they could miss the chance to raise their productivity.

There are roughly 200 Fortune 500 companies, which outsource work to India.

According to NASSCOM (National Association of Software and Service Companies) estimates, over 50% of the Fortune 500 companies have incorporated offshore outsourcing into their strategies, and around 80% of these now use India as their development base. The leading companies in India, in both the IT and BPO industries are fighting hard to win a broader variety of work, particularly higher value activities. Examples include EXL Services, carrying

out a broad range of insurance work for British and American firms. ICICI One Source, another Indian BPO Company provides research services for consultants and investment bankers. Wipro and EXL services are applying the same management disciplines that GE applies to its industrial businesses to the way they provide services.

36.5 RATIONALE BEHIND OUTSOURCING

According to Forrester Research, 3.4 million jobs will be outsourced by 2015. That may sound enormous, but it implies an annual outflow of only 0.5% of the jobs in the industries affected. In an average year, the American economy destroys some 30 million jobs, and creates slightly more, dwarfing the effects of off-shoring. But what is the reason behind using outsourced model, by the traditionally vertically integrated firms, at an increasing rate, The analysis revealed that three main factors are responsible for this change, and they can be identified as:

I. The emergence of world-class service providers: Often, these companies get started, responding to the needs of one or more current customers. But once they do, the marketplace gets defined, and the power of the free-market economy takes over. Before long, it becomes difficult for any organization to justify in-sourcing when their capabilities are tested against a competitive market of specialized providers.

2. Technology: Technology is the leading area for outsourcing, but it is just as important as the top enabler of outsourcing. Once the physical barrier of where the work is done is broken, breaking the organizational barrier is a lot easier.

3. Competition: As competition (local, global, bricks and clicks) intensifies, organizations must simultaneously get more efficient and more effective to survive.

The overseas markets for the US that might be considered as "taking away our jobs" are product markets in themselves. Out of India's one billion population, 300 million is classified as middle class. This is larger than the entire US population, and represents an enormous marketing opportunity. In China, with a population of 1.2 billion, only about 5% (65 million) are considered middle class. Yet, given that China is early in its explorations into the market economy this is a significant potential market. Sweetening the pot, India and China offer preferential treatment to companies that participate in their local economies, such as reduced entry barriers, lower taxes 0 tariffs, and better currency exchange rates.

36.6 PROCESS OF OUTSOURCING

Deciding to outsource

The decision to outsource is taken at a strategic level and normally requires board approval. Outsourcing is the divestiture of a business function involving the transfer of people and the sale of assets to the supplier. The process begins with the client identifying what is to be outsourced and building a business case to justify the decision. Only once a high-level business case has been established for the scope of services urill a search begins to choose an outsourcing partner.

Supplier proposals

A Request for Proposal (REP) is issued to the shortlist suppliers requesting a proposal and a price. The suppliers are usually chosen based on location and at the lowest possible cost to the company.

Supplier competition

A competition is held where the client marks and scores the supplier proposals. This

may involve a number of face-to-face meetings to clarify the client requirements and the supplier response. The suppliers will be qualified out until only a few remain. This is known as down select in the industry. It is normal to go into the due diligence stage with two suppliers to maintain the competition. Following due diligence, the suppliers submit a -best and final offer" (BAFO) for the client to make the final down select decision to one supplier. It is not unusual for two suppliers to go into competitive negotiations.

Negotiations

The negotiations take the original RFP, the supplier proposals, BAFO submissions and convert these into the contractual agreement between the client and the supplier. This stage finalizes the documentation and the final pricing structure.

Contract finalization

At the heart of every outsourcing deal is a contractual agreement that defines how the client and the supplier will work together. This is a legally binding document and is core to the governance of the relationship. There are three significant dates that each party signs up to the contract signature date, the effective date when the contract terms become active and a service commencement date when the supplier will take over the services.

Transition

The transition will begin from the effective date and normally run until four months after service commencement date. This is the process for the staff transfer and the take-on of services.

Transformation

The transformation is the execution of a set of projects to implement the service level agreement (SLA), to reduce the total cost of ownership (TCO) or to implement new services. Emphasis is on 'standardisation and 'centralisation'.

Ongoing service delivery

This is the execution of the agreement and lasts for the term of the contract.

Termination or renewal

Near the end of the contract term a decision will be made to terminate or renew the contract. Termination may involve taking back services (insourcing) or the

CHECK YOUR PROGRESS-1

1. **Outsourcing is**
   A. Exporting
   B. Importing
   C. A firm having someone else do part of what it previously did itself.
   D. Building a factory in another country to produce for that country's market
   E. Going out of business

2. **How does offshoring affect an industry's productivity?**
   A. It reduces productivity by making workers anxious and unable to concentrate on their jobs.
   B. It reduces productivity by replacing workers with low-quality machines, produced abroad.
   C. It increases productivity by scaring workers into working harder.
   D. It increases productivity by eliminating the activities at which the firm is least efficient.
   E. It has no measurable effect on productivity, according to studies that have sought to measure it.

3. **Offshoring is**
   A. Substituting foreign for domestic labor.
   B. Subcontracting a part of production to another firm.
   C. Exporting d. Importing.
   D. Building a factory in another country to produce for that country's market

transfer of services to another supplier.

36.7 REASONS FOR OUTSOURCING

Organizations that outsource are seeking to realize benefits or address the following issues

Cost Savings: The lowering of the overall cost of the service to the business. This will involve reducing the scope, defining quality levels, re-pricing, re-negotiation, cost restructuring. Access to lower cost economies through offshoring called -labor arbitrage" generated by the wage gap between industrialized and developing nations.

Cost Restructuring: Operating leverage is a measure that compares fixed costs to variable costs. Outsourcing changes the balance of this ratio by offering a move from variable to fixed cost and also by making variable costs more predictable.

Improve Quality: Achieve a step change in quality through contracting out the service with a ***new*** service level agreement.

Knowledge: Access to intellectual property and wider experience and knowledge.

Contract Services will be provided to a legally binding contract with financial

penalties and legal redress. This is not the case with internal services.

Operational expertise: Access to operational best practice that would be too difficult or time consuming to develop in-house.

Staffing issues: Access to a larger talent pool and a sustainable source of skills.

Capacity management: An improved method of capacity management of services and technology where the risk in providing the excess capacity is borne by the supplier.

Catalyst for change: An organization can use an outsourcing agreement as a catalyst for major step change that can not be achieved alone. The outsourcer becomes a Change agent in the process.

Reduce time to market: The acceleration of the development or production of a product through the additional capability brought by the supplier.

Coraraodification: The trend of standardizing business processes, IT Services and application services enabling businesses to intelligently buy at the right price. Allows a wide range of businesses access to services previously only available to large corporations.

Risk management: An approach to risk management for some types of risks is to partner with an outsourcer who is better able to provide the mitigation.

36.8 CRITICISM OF OUTSOURCING

The downsides of global outsourcing can be specified as follows,

ii) Outsourcing work that was previously done in house results in a large number of workers being displaced and losing their jobs.

(ii) Companies tend to overestimate the savings to be had from going abroad and fail to recognize the problems, such as dealing with inventory, obsolescence and currency exchange rates.

(iii) For many manufacturers, the importance of direct labour is declining rapidly. Since it often accounts for just 7 to 15 percent of the cost of goods sold, hard goods and high-tech manufacturers often say that wage rates are hardly the most critical determinants of their overall economic performance. For the outsourcing of manufacturing operations in particular, the following concerns are raised,

- The danger of suppliers reaping undue advantages by imitating superior products or technologies.
- Exposure to supplier risks and issues of quality control.
- A possible change in supplier behaviour from collaborative to opportunistic.
- Difficulty in measuring actual costs of the supplier, typically above baseline costs, due to the experience curve.
- Potential problems with taking an outsourced function back, or substituting the suppliers when the outsourcing agreement terminates.

36.9 THE OUTSOURCING DEBATE

The practice of outsourcing has, of late, been the subject of intense debate. The primary contention being, is outsourcing just a new way of doing international trade, or is it something to fear as being fundamentally damaging to the economies of developed nations? The forces of outsourcing are being blamed for the relentless export of jobs from the rich to the poor countries, whereby outsourcing becomes a shorthand for the process by which good jobs in America, Britain or Germany become much lower-paying jobs in India, China or Mexico,

Research suggests that the number of US service jobs lost to offshoring will accelerate during the next five years. Several US states are considering legislation to prohibit or severely restrict their state governments from contracting with companies that move jobs to low-wage developing countries, and labour unions are notably the Communications Workers of America, are lobbying the Congress to prevent offshoring.

The argument against outsourcing can be refuted through a consideration of the following factors:

1 A large percent of jobs in United States are in service industries such as retailing, catering, tourism and personal care, that require the consumer and producer to be present in the same place and therefore, by their very nature, cannot be moved abroad.

2. Any job losses must be seen as part of an ongoing process of economic restructuring, with which US economy is well acquainted. Even when the economy is growing, mass layoffs usually from restructuring, are much higher than the job losses predicted from offshoring.

3. As jobs in call centres, back-offices operations, and repetitive IT functions go offshore, opportunities to train labour and invest capital to generate opportunities in higher value-added occupations, such as research and design will appear.

4. The industries said to be badly hurt by the migration of job overseas, report a shortage of workers at home, most of the jobs created in India are either in call centres or in IT firms. But call centres companies in both Britain and US suffer from rising staff turnover, and struggle to recruit more people,

36.10 INDIA'S PERSPECTIVE

India has made a strong niche for itself in the Information Technology Enabled Services and Business Process Outsourcing sectors. The $3.6 billion outsourcing industry in India has emerged as the single biggest employment generator in recent years.

In a study by the Hewitt Associates of US on global sourcing trends and outcomes, India got 60 percent preference amongst the global companies, while its closest competitor was China, with 32 per cent preference. Today, companies outsource to destinations like India because they see value in their investments in terms of quality service and financial spending.

In the 1990s, India was able to respond very quickly to the growth in demand for IT services. It had a sizeable number of English-speaking people, who were available in the job market at a low cost and were willing to work hard. There were also a lot of entrepreneurs and managers who could quickly make inroads, andtake advantage of this new business opportunity. This was coupled with some initiatives by the government, like the formation of software and other industrial parks. This helped togive the Indian IT sector a kick-start.

The BP0 sector in India has been growing at almost 60 to70 percent per annum. According to NASSCOM, each day, nearly 200 people join the Indian ITES-BPO industry. BP0 offerings are becoming more comprehensive. As pointed out in the McKinsey Institute study, the US economy benefits in outsourcing in more ways than one. A NASSCOM report estimated 60 per cent savings in costs for companies outsourcing to India. There exist 185 Fortune 500 companies which outsource work to India. Information Technology Enabled Services (ITES) provides opportunities for MNCs to reap the surplus in the service sector that did not exist earlier.

The business proposition of BPOs is to take over the non-core processes of companies

and bring in the best practices. From outside, companies are using BP0 to reach a wide range of goals. What was once viewed, primarily, as a way of reducing expenses, has now emerged as a means of achieving productivity gains. Short-term innovation cycles enhance customer intimacy, and enter new markets.

In the short run, the gains from outsourcing might be concentrated, however, in the long run; it holds promise for India and other developing nations. One of the longer-termpotential benefits of IT industry development (and globalization processes) is competency capacity building, which can spill over into other sectors, boost the local economic dynamism and competitiveness, and thereby facilitate processes that impact poverty. Off shoring also has demonstration and empowerment effects, and helps to inspire the country's youth and people, both **in** urban and rural areas.

Many Indian firms are rather good at being flexible, taking advantage of new business opportunities, ramping up manpower, being responsive in terms of prices, and improving in quality. They have also managed to form mutually beneficial strategic alliances with multinationals and their local subsidiaries.

CHECK YOUR PROGRESS-2

1. **___________ is a business practice in which a company hires another company or an individual to perform tasks, handle operations**
   A. Subcontracting
   B. Outsourcing
   C. Consulting
   D. Manufacturing

2. **Why are specialized outsource vendors more efficient in their offering of training than many organizations**
   A. Outsources can achieve economies of scale
   B. Outsource can charge for every transaction
   C. Outsourcers can maximize their capital
   D. Outsourcers can provide uninterrupted service.

3. **Why it is important to outsource transactional work**
   A. Because it adds value to non-core activities
   B. Because it frees up management time
   C. Because it reduces transaction time
   D. Because it is repetitive, predictable, and easily duplicated

36.11 SUMMARY

After its success in outsourcing, IT and IT enabled services. Indian pharrna companies are now beginning to recognize the opportunity that outsourcing presents. The largest driver for outsourcing in pharrna is the need to bring down costs.

In order to ensure that outsourcing industry contributes in the maximal possible way to the growth of economy, the authorities must act as facilitators. This implies a stronger emphasis on IT in education, and integration in modern global knowledge-based economy, The ability of multinationals and companies in richer nations to offer better wages and jobs to those in the developing countries, is putting pressure on emerging market governments, to pursue liberal economic policies, especially spending more on education and maintaining open borders with the outside world, for trade and foreign investment.

36.12KEYWORDS: Outsourcing, Cost restructuring, Foreign Investment, Economies of scale,

Business process outsourcing.

36.13PRACTICAL QUESTIONS:

A. Short Questions:

Q1. If a firm is planning to outsource globally, explain why the country with lowest wages is not always the best choice, even if your goal is to reduce cost of production.
Q2. Discuss how the purposes of outsourcing are changing from traditional to transformational.
Q3. How has COVID-19 affected companies use of remote and hybrid work models and plans to backshore?
Q4. What is the criticism of outsourcing?

B. Long Questions:

Ql. Discuss the pros and cons of Global Outsourcing.
Q2. How did the Global Outsourcing Process help business in India?
Q3. How should a globally dispersed supply chain be managed?
Q4. What should be the long-term strategic roles of foreign production sites?

36.14GLOSSARY

Business process Outsourcing (BPO): It is a type of outsourcing in which a third-party service provider is hired to perform one or more of a company's business processes. The third party is in charge of all operations linked to the business function.

Service Level Agreement (SLA): It outlines the products or services to be delivered, the single point of contact for end-user problems, and the metrics used to monitor and validate the processes effectiveness.

Total Cost of Ownership (TCO): It is an estimate of the costs associated with purchasing, deploying, using and retiring a product or piece of equipment. It quantifies the cost of a product across its entire existence.

36.15 SUGGESTED READING

1. Priya P. and Kannan N. (2005): *Global Competitiveness inBusiness Process Outsourcing, in* S. Ganesan and Justin Paul (edited) Business Management Practices, Policies and Principles.
2. Justin Paul (2007): *International Business,* Prentice Hall, 3rd Edition,
3, Justin Paul (2008): *Business Environment,* Tata McGraw-Hill, 2nd edition
4. Seth Rastogi (2006): *Global Management Solutions,* Thomson Learning
5. NASSCOM (2002 and 2003): Annual Reports and Estimates

ANSWERS:

Check your progress-1:

A. C
B. D
C. A

Check your progress-2

A. B
B. A
C. B

PUBLIC, PRIVATE AND COOPERATIVE SECTOR OF INDIAN ECONOMY.

STRUCTURE

37.1 Objectives
37.2 Introduction
37.3 Public Sector
 37.3.1 Objective
 37.3.2 Growth And Performance Of Public Enterprises
 37.3.3. Check Your Progress I
37.4 The New Public Sector Policy
37.5 Public Sector Rathnas
37.6 Government And Parliamentary Controls Over Public Enterprises
37.7 Check Your Progress Ii
37.8 Department Of Public Enterprises
37.9 Private Sector
37.10 Co-Operative Sector
37.11 Summary
37.12 Practice Questions
 37.12.1 Short Answer Type Questions
 37.12.2 Long Answer Type Questions
37.13 Glossary
37.14 Keywords
37.15 Suggested Readings
37.16. Answer Key

37.1 OBJECTIVES

After reading this chapter, the student should be able to:

(i) Understand the meaning and role played by the public sector in the Indian economy.
(ii) To have knowledge about the growth and performance of public enterprises.
(iii) To know the role played by the private sector in the Indian economy.
(iv) To know the role played by the cooperative sector in the Indian economy.

37.2 INTRODUCTION

The mixed economy of India is characterized by the co-existence of public, private, joint, and cooperative sectors. The pattern of industrial development of the country has been influenced to a very significant extent by the roles given to these sectors by the industrial policy.

37.3 PUBLIC SECTOR

The objective of accelerating the pace of economic development and the political ideology gave the public sector a dominant role in the industrial development of the nation-led growth of the state-owned enterprises (SOEs) sector In India.

37.3.1 OBJECTIVE

The public enterprises which were promoted as an instrument for the implementation of the government's socio-economic policies, had a multitude of objectives set for them, viz.,

1. To help in the rapid economic growth and industrialization of the country and create the necessary infrastructure for economic development.
2. To earn a return on investment and thus generate resources for development.
3. To promote redistribution of income and wealth.
4. To create employment opportunities.
5. To promote balanced regional development.
6. To assist the development of small-scale and ancillary industries,
7. To promote import substitution, save and earn foreign exchange for the economy.

37.3.2. GROWTH AND PERFORMANCE OF PUBLIC ENTERPRISES

There has been phenomenal growth in the public sector since the commencement of planning. In fact, even before the commencement of planning and the adoption of the goal of the socialistic pattern of society, the public sector was assigned an important role in the industrialization and development of the country. The Industrial Policy Resolution of 1948 made it very clear economic development of the manufacture of telephone, telegraph, and wireless apparatus, excluding radio receiving sets, and mineral oils. The Industrial Policy Resolution of 1956 enlarged the role of the public sector and stated:

Schedule A to the Resolution enumerated 12 industries, the future development of which would be the exclusive right of the state. Schedule B to the Industrial Policy Resolution, 1956, contained a list of 12 industries that would be progressively state-owned and in which the state would, therefore, generally take the initiative in establishing new units.

At the beginning of the 1990s, the public sector was dominant in many industries. The PSEs continued the entire output In the case of petroleum, Lignite, copper, and primary lead, about 98 of zinc, with over 90 percent of coal, more than half of steel and aluminum, and about one-third of fertilizers. The performance, of many public, enterprises has been far from satisfactory. One can, of course of the public sector towards GDP, employment generation, export, etc.

A variety of factors have been identified for the unsatisfactory performance of a large number of public enterprises. While the project formulation has improved over the years, huge costs and overruns continued to take place in project implementation. This was on account of problems of land acquisition, procurement of equipment, civil work, and other imponderables.

The public sector is generally criticized for inadequate generation of internal resources. The Department of Public Enterprises points out that the generation of internal resources by public enterprises is constrained by the following factors.

1. Public Sector Enterprises were set up not only for commercial consideration but also for factors such as the generation of employment, promoting balanced regional development, etc.
2. Low return on investment on account of price constraints imposed on certain infrastructural goods and services of public enterprises.
3. A number of sick units in the private sector facing closure had to be taken over by the Government and these units form a sizeable part of the Central Public Sector.
4. Number of industries promoted in the public sector with long gestation period.
5. The impact of escalation in the prices of various inputs and periodical age revision.

37.3.3. Check your progress I:

1) Public sector organisations are primarily accountable to _____________ and_________.

2) ______________________is the challenge associated with the growth of the public sector.

37.4 THE NEW PUBLIC SECTOR POLICY

According to the industrial policy announced on 24-7-1991, the following have been set as the priority areas for the growth of public enterprise.

1. Essential infrastructure goods and services.
2. Exploration and exploitation of mineral resources.
3. Technology development and building of manufacturing capabilities in areas

which is crucial in the long-term development of the economy where private sector investment is inadequate.

4. Manufacture of products where strategic considerations predominate such as defence equipment.

Accordingly, the number of industries reserved for the public sector was pruned to 8. These 8 industries were (i) Arms and ammunition and lilied items of defenseequipment, defense aircraft, and warships (ii) Atomic energy. (iii) Coal and lignite. (iv) Mineral oils. (v) Mining of iron ore, manganese ore, chrome ore, gypsum, sulfur, gold, and diamond, (vi) Mining of copper, lead, zinc,' tin, molybdenum, wolfram, (vii) Minerals specified in the schedule to the Atomic Energy (control of production and use) Order, 1958. (viii) Railway transport.

The new industrial policy also indicated that the public sector would withdraw from the following cases

1. Industries based on low technology
2. Small-scale and non-strategic areas
3. Inefficient and unproductive areas
4. Areas with low or zero social responsibility or public purpose,,
5. Areas where the private sector has developed sufficient enterprise and resources

The main elements of 'the current Government policy towards Public Sector undertakings (PSUs) are

a) Bringing down Government equity in all non-strategic PSUs to 26 percent or lower, if necessary.
b) Restructure and revive potentially viable PSUs.
c) Close PSUs that cannot be revived
d) Fully protect the interest of workers.

37.5 PUBLIC SECTOR RATHNAS

Governmentin July 1997 unfolded its strateu to grant autonomy to some PSUs on an experimental basis. The objective of the new approach was t select some vanguard PSUs to support them in their drive to become global giants. The government, after detailed and in-depthinterministerial discussions, selected nine PSU to make them truly world-class entities and it euphemistically named these as Navaratnas.

These are Bharat Heavy Electricals Ltd. (BHEL), BharatPetroleum Corporation Ltd. (BPCL), Hindustan Petroleum 'Corporation Ltd. (HPCL), Indian Oil Corporation Ltd. (IOC), Indian Petrochemicals Corporation Ltd. (1PCIA, National Thermal Power Corporation Ltd. (NTPC), Oil and Natural Gas Corporation Ltd. CONGe), Steel Authority of India Ltd. (SAIL) and Videsh Sanchar Nigam Ltd. (VSNL). Two more enterprises. GAIL and MTNL were later given the same status. It was decided that these PSEs would have the freedom to incur capital expenditure, decide upon joint ventures, set up subsidiaries/offices abroad, enter into technological **and** strategic alliances, raise funds from capital markets (international and domestic), and enjoy substantial operational and managerial autonomy.

The Boards of these PSEs have been broad-based with the induction of non-official parts-
time professional directors. All the measures have been taken with the objective of making the PSEs competitive. Greater operational, financial, and managerial autonomy has also been granted to 97 other profit-making enterprises referred to as Mini-Ratnas, to make them more efficient and competitive. The Study Team on Public Sector Undertakings has mentioned the following as the principal characteristics of Departmental Undertakings,

37.6 GOVERNMENT AND PARLIAMENTARY CONTROLS OVER PUBLIC ENTERPRISES

A certain amount of autonomy is a necessary condition for the efficient functioning of any enterprise, and public enterprises are no exception to this. However public enterprises have been established with public funds to serve social purposes, and hence, there should be public control over them to ensure that they discharge their duties promptly and efficiently and fulfill their objectives. Public control is exercised through the government and Parliament, the representatives of the people. Government and Parliament control over public enterprises does not mean that the enterprises should not have any autonomy. They should necessarily have a certain amount of autonomy. It is the general policy, overall performance, and decisions with long-term implications that are generally sought to be controlled by the Government and Parliament. Autonomy vs. Accountability has been, however, one of the unsettled issues in public enterprises.

In the early days, the government tended to exercise too much control, and limited powers were delegated to enterprises. However, on the recommendations of the Administrative Reforms Commission, it was decided to reserve only the following well-defined powers for the government,

1. Appointments of executives and full-time and part-time members of the Boards of Directors
2. Sanctioning of capital programs involving expenditure of a certain magnitude.
3. Approval of five-year annual plans of development and capital budgets.
4. Authorization of capital to be raised and the conditions thereof.
5. Approval of the revenue budget 1, where a deficit was required to be met by the government,
6. Calling for returns, accounts, and other information on the activities of the enterprise.
7. Giving directions to the enterprise on matters involving national security or substantial public interest.

37.7 Check your progress II:

1) In a parliamentary system, which branch of government is responsible for overseeing public enterprises?

2) Which parliamentary committee is often responsible for examining the performance of public enterprises?

37.8 DEPARTMENT OF PUBLIC ENTERPRISES

The Department of Public Enterprises acts as a nodal agency for all PSEs and assists in policy formulation pertaining to the role of PSEs in the economy as well as in laying down policy guidelines on performance improvement and evaluation, financial accounting, personnel management, and related areas. It also collects, evaluates, and maintains information on several areas in respect of PSEs. DPE also provides an interface between the Administrative Ministries and the PSEs, In Milling its role it associates itself with other Ministries and organizations as premier management institutes in the country.

Role and Tasks

Theimportant roles and tasks of the Department are the following

A. General Policy relating to the Public Sector.
B. Matters relating to the issue of Presidential Directives and guidelines to the Public Sector enterprises,

C. Formulation of policy guidelines pertaining to Public Sector Enterprises in areas like performance improvement and evaluation, financial management, personnel management, board structures, wage settlement, training, industrial relations, vigilance, performance appraisal, etc.
D. Matters relating to reservations of posts in the Public Sector enterprises for certain classed of citizens,
E. All matters relating to the Memorandum of Understanding between the Public Sector enterprises and the Administrative Ministries /Departments.
F. Matters relating to delegation of powers to the Board of Directors.
G. To undertake in-depth studies in respect of significant areas of functioning of Central PSEs.
H. Matters relating to the International Centre for Public Enterprises (ICPE).
I. Matters relating to the Standing Conference of Public Enterprises (SCOPE)
J. To monitor and evaluate the performance of PSEs and to act as a repository of data and to bring out an Annual Survey for the Parliament.

37.9 PRIVATE SECTOR:

In a mixed economy, the private sector, too, has an important role to play. Indeed, it is because of the appreciation of the positive role the private sector can play, and certain limitations of the public sector, that many socialists advocate a, mixed economic system. The Industrial Policy Resolution of 1956, which still remained the core of India's Industrial policy and which assigned a dominant role to the public sector in a number of vital industries, has made it very clear that as an agency for planned national development, in the context of the country's expanding economy, the private sector will have the opportunity to develop and expand. It is thus clear that the adoption of the principle of the socialist pattern of society did not mean the end of the private sector. Instead, the private sector was assigned, and was expected to play, a very important role.

According to the Industrial Policy Resolution, of 1956, it was expected that the development of the industries outside the Schedules A & B would be undertaken ordinarily through the imitative and enterprise of the private sector. Though it was open to the state to start any industry even in this category. It was the policy of the state to encourage the development of these industries in the private sector, in accordance with the programs formulated in successive Five-Year Plans, by ensuring the development of transport, power, and other services, and by appropriable fiscal and other measures. The state will continue to foster institutions to provide financial aid to these industries, and special assistance will be given to enterprises organized on cooperative lines for industrial and agricultural purposes. While shortcomings still exist, it must be said to the credit of the government that remarkable progress has been achieved on these lines. It may also be pointed out here that a number of private sector enterprises that already existed in theindustries included in Schedule A have been allowed to develop further.

The Industrial Policy Resolution of 1956 has also made it clear that industrial undertakings in the private sector have necessarily to fit into the framework 'of the social and economic policy of the state and will be subject to control and regulation in terms of the industries (Development and Regulation) Act and other relevant legislation. The Government of India, however, recognizes that it would, in general, be desirable to allow such undertakings to develop with as much freedom as possible, consistent with the targets and objectives of the national plan. When there exist in the same industry both privately' and publicly owned units, it would continue to be the policy of the state to give fair and non-discriminatory treatment to both of them.

The preceding paragraphs give some idea of the government's policy towards the private sector and the industrial spheres open to that sector. Even in the areas where the private sector has been, allowed, its operations and development have been regulated by the government in the public interest. The large industrial houses and foreign concerns, particularly, had been subject to a number of checks and controls. Their role had been confined to important areas like the heavy investment sector, the core sector, and the export sector and backward is development. The government's policy was to prefer small and new entrepreneurs to large industrial houses in the private sector, wherever possible.

The joint sector also reflects to some extent the importance of the role of the private sector. With the new industrial policy announced on July 24, 1991, and modifications introduced thereafter, the role of the private sector has been substantially expanded. Now private enterprises are allowed in all but two industries. Only a very small number of industries are now industrial licensing (i.e., except in these industries there are no entry and growth restrictions on the private sector). The scope of the private sector is increased by the withdrawal of the State from many industries and the privatization sector would, in our view, include units in which both public and private investments have taken place and where the State takes an active part in direction and control.

37.10 CO-OPERATIVE SECTOR

In India, the cooperative sector has been assigned an important role in the development of many sectors. The First Five Year Plan envisaged the cooperative sector to cover a number of vital areas like agriculture, rural and small-scale industry, retail distribution, housing, etc.

The important objectives of the development of the cooperative sector are the prevention of concentration of economic power; wider dispersal of ownership of productive resources, active involvement of people in development programs, augmentation of the productive resources and speedier economic development, liquidation of Unemployment and poverty, etc.

One of the important aspects of the development of the cooperative sector in India, as in a number of other countries, is state participation.

According to Weerman, the following are the main background factors or influences that lead to a relationship between the state and co-operatives in developing countries."

1. The need to give legal recognition to cooperative societies and to provide for their proper management and supervision in the interest of the movement.
2. The need to safeguard the rights of the people vis-a-vis these societies.
3. The need to prevent any abuse or privileges accorded to co-operatives.
4. The need to promote the movement because:
    a It is, per se, desirable and nobody other than the government is likely to take the initiative in promoting it.
    b. It is the best means of national development.
    c. It solves the problem of lack of leadership and local personnel for the diffusion of new ideas and techniques.

The important ways in which the state patronizes the co-operative movement in India are State partnership in the share capital of co-operatives; loans to societies; subsidies and grants; guarantees; contribution to risk fund; tax concessions; legal concessions and sanctions; training and educating; help from the reserve Bank and other banking organizations that help the cooperatives; and supply of government officers on deputation

The co-operative ideas tool a concede shape in India for the first time in 1904, when the co-operative Credit Societies Act- a measure designed to combat rural indebtedness and provide for the registration of credit societies - was passed, Later, in 1912. The Co-operative Societies Act provided for the registration of non-credit societies a- well as federations of co-operatives. Since then, the co-operative movement has made, especially in the fields or agricultural credit, marketing and processing of agricultural produce, supply of farm inputs and distribution of consumer goods. By far the largest number of societies arc in the agricultural credit sector. The primary, agricultural credit societies cover over 96 per cent of the rural areas.

Processing and Industrial Co-operatives

Our industrial policy statements have emphasized the role of the co-operative sector in the industrialization of the country, especially by developing cottage, village and small-scale industries. In the large and medium industries sector, certain agro-industries like sugar, jute and cotton have been considered to be ideally suited for the co-operative sector. At one time the Government of India had also made it **a** policy new sugar factories would be allowed only in the public and cooperative sectors. Today, there are about 45,300 industrial co-operatives with a membership **of** nearly 2.5 million, The National Federation of Industrial Co-operatives assists in the marketing of the products of member societies.

Storages Distribution and Marketing Co-operatives

The National Co-operative Development Corporation is responsible for the planning, promotion and financing of the **programme** of augmenting the storage capacity of the cooperatives at various levels. **There are** a very large number of rural godowns and marketing godowns. There are also a number of cold storage units. Co-operatives in India play a significant role in the distribution of agricultural inputs, such as fertilizers, seeds, pesticides, agricultural implements and credit. A large share of the total fertilizes distributed in India are sold through the co-operative distribution system.

The co-operatives have also diversified their activities to cover **new** lines of business, like the production, processing and distribution of improved agricultural implements and the setting up of agro-service centers

The Co-operative marketing structure consists of a large number of primary cooperative marketing societies, covering all the important agricultural markets in the country. The National Agricultural Co-operative Marketing Federation (NAFED), which represents the co-operative marketing societies in the country, promotes inter State and export trade of farm produce.

Functional Co-operatives

Co-operatives for the weaker sections of society provide increased employment and income opportunities to different sections of the community, such as small and marginal farmers and fishermen. Functional co-operatives for dairy, fishery and poultry mainly relate to the service of the reaker sections. There are also a very large number of primary housing co-operative in the country.

Multi-Purpose Co-operatives

As part of the programme of economic development of tribal, primary co-operatives in tribal areas were reorganised to enable them to function as multi-purpose societies providing short, medium and long-term credit to tribal, undertaking collection and **marketing of**

agricultural and minor forest produce, arranging for supply of agriculture inputs as well as essential consumer goods. State-level co-operative tribal development corporations/ federations have been established in a number of States to serve as apex organizations for the marketing of minor forest produce and consumer goods.

National Level Co-operative Federations

A major development over the past decade has been the emergence of national cooperative federations which have added a new dimension to the co-operative infrastructure. With the National Co-operative Union of India at the apex, the other national-level co-operative organizations, include the National Agricultural Co-operative Marketing Federation, the All-India State Co-operative Banks Federation, the National Federation of Cooperative Sugar Factories, the National Co-operative Land Development Banks Federation, the. National Co-operative Consumer's Federation, the National Federation of Industrial Cooperatives, the All-India Federation of Co-operative Spinning Mills, the National Co-operative Housing Federation, the National Co-operative Dairy Federation of India, and the National Federation of Co-operative Urban Banks and Credit Societies.

Problems

While the overall progress of the co-operative movement appears to be striking, *there* are wide regional disparities. The level of development of agricultural co-operative is not uniform in all the States. Many co-operative societies are virtually defunct. Many others are languishing due to financial, organizational and administrative problems.

The cooperative movement in India is very adversely affected by political overshadowing. Many ea-operatives are controlled by politicians and/or the economically powerful members.

37.11 SUMMARY

On the basis of the ownership pattern the industrial sector consist of public, private and cooperative sectors. Public and cooperative sectors had been promoted by the government to prevent concentration of economic power in private sector. With all industries open to the private sector without any entry and growth restrictions, the current industrial policy has no specific tenets in favour of the public or cooperative sectors.

37.12 PRACTICE QUESTIONS

37.12.1 Short answer type questions:

Q.1. Why does the government have a significant role in the public sector of the Indian economy?

Q.2. What is the distinctive feature of the cooperative sector in India?

37.12.2 Long answer type questions:

Q.1.Explain the role of the public sector in the Indian economy, citing examples of key public sector enterprises.

Q.2. Explain the concept of the cooperative sector in India and its role in promoting inclusive development.

37.13. GLOSSARY

Public sector ratnas - In the context of the Indian public sector, the term "Ratnas" refers to a recognition given to certain government-owned companies that have demonstrated exceptional performance and have been categorized as "Navratnas" or "Maharatnas." These are prestigious titles conferred by the Indian government to public sector enterprises based on their financial strength, operational efficiency, and strategic management.

Agro-industries: Agro-industries refer to the various businesses and economic activities involved in the processing, transformation, and value addition of agricultural products from the primary sector (farming) to produce goods that are suitable for further consumption or industrial use.

37.14 KEYWORDS

1. **Public Sector**- portion of the economy composed of all levels of government and government-controlled enterprises.
2. **Private Sector**- The private sector is the part of the economy that is not run by the government. It comprises the businesses and enterprises that are controlled by private individuals and groups for the purpose of making a profit.
3. **Co-operative sector-**Cooperative sector companies are run and controlled by a group of individuals.
4. **Functional Co-operatives-** Co-operatives or co-ops are associations of people with common social, cultural, and economic goals and needs. They are autonomous organizations that function democratically.
5. **Multi-Purpose Co-operatives -**A multi-purpose cooperative is a business that is a mixture of two or more different types of cooperatives.
6. **National Level Co-operative Federations-**

37.15 SUGGESTED READINGS

(i) Francis Cherunilam "Business Environment"
(ii) Government of India, Third Five Year Plan. (iii)
Government of India, Fourth Five *Year* Plan.
(iv) Government of India, Sixth Five Year Plan.
(v) K.R.Gupta "Pricing in Public Enterprises"

37.16. ANSWER KEY:

Check your progress I:

1) Government and public
2) Increased Bureaucracy

Check your progress II:

1) Legislative
2) Finance Committee

Short answer type questions:

Q.1. Why does the government have a significant role in the public sector of the Indian economy?

Answer: The government's involvement in the public sector is to ensure equitable distribution of resources, address market failures, and provide essential services that may not be adequately addressed by the private sector.

Q.2. What is the distinctive feature of the cooperative sector in India?

Answer: The cooperative sector involves joint ownership and democratic control by its members, who work together to meet common economic, social, and cultural needs.

Long answer type questions:

Q.1.Explain the role of the public sector in the Indian economy, citing examples of key public sector enterprises.

Answer: The public sector in the Indian economy plays a crucial role in promoting social welfare and addressing market failures. It is owned and operated by the government at various levels. Public sector enterprises are involved in key sectors such as infrastructure, healthcare, education, and defense. For instance, Bharat Heavy Electricals Limited (BHEL) contributes significantly to the power and engineering industry. The public sector's focus on essential services ensures equitable access to critical resources and services, contributing to the overall development of the nation.

Q.2. Explain the concept of the cooperative sector in India and its role in promoting inclusive development.

Answer: The cooperative sector in India is characterized by joint ownership and democratic control by its members. Cooperative societies are formed to address the common economic, social, and cultural needs of their members. These can include agricultural cooperatives, credit cooperatives, and consumer cooperatives. The cooperative sector promotes inclusivity by fostering a sense of community and shared responsibility. Members benefit from collective decision-making, access to credit, and market support. An example is Amul, a cooperative that has transformed the dairy industry, demonstrating the potential of collective action in achieving economic and social objectives. The cooperative sector contributes to rural development, poverty alleviation, and empowering marginalized communities.

Lesson **No. 38** **AUTHOR; RAKESH KUMAR**

CAPITAL MARKET AND ITS DEVELOPMENT IN INDIA

STRUCTURE

38.0 Objectives
38.1 Introduction
38.2 The Primary Market
38.3 The Secondary Market
38.4 Check Your Progress I
38.5 Economic Functions Of The Stock Market
38.6 Government Securities Market
38.7 The International Capital Market
38.8 Check Your Progress Ii
38.9 Capital Market In India
38.10 Merchant Banking
38.11 Secondary Market Reforms
38.12 Practical Questions
38.13 Glossary
38.14 Keywords
38.15 Suggested Readings
38.16. Answer Key

38.0 OBJECTIVES

After reading this chapter, the student should be able to

(i) Understand the features of the capital market.

(ii) Understand various types of capital markets.

(iii) Understand major reforms in the secondary market.

38.1 INTRODUCTION

The capital market is the market for long-term funds, just as the money market is the market for short-term funds. It refers "to all the facilities and the institutional arrangements for borrowing and lending term funds (i.e. medium-term and long-term funds). It does not deal in capital goods but is concerned with the raising of money capital for investment. The demand for long-term money capital comes predominantly from private sector manufacturing industries, agriculture, and from the government largely for economic development. As the central and state governments are investing not only in economic overheads such as transport, irrigation, and power development but also in basic industries and sometimes even consumer goods industries, they require a substantial sum from the capital market. The supply of funds for the capital market comes largely from individual savers, corporate savings, banks, insurance companies, specialized financial agencies, and the government. The capital market can be usefully divided into the primary market and the secondary market. The primary market deals with the selling of new securities when they are first issued by the issuing corporation. Since many of the initial buyers of these securities will eventually want to resell them, there is a secondary market for previously issued securities. The stock market, for example, is a secondary market in corporate securities.

38.2 THE PRIMARY MARKET

When a corporation decides that it wants to acquire new funds from the outside, it will frequently do so through the intermediation of an investment banker. Investment bankers are

specialists in the marketing of new securities They advise the corporations in the design of the security - what type of security should it be common stock, preferred stock, or bond; if a bond, what rate of interest should it bear, what should be its maturity provisions, and so on so that it will best serve the needs of the corporation and the buying public. Although there are several possible arrangements, the investment banking house will typically underwrite a new issue of securities. The investment house assumes a substantial measure of risk in an underwriting operation, large issues of new securities usually will be syndicated among several investment banking firms.

Many corporations engage in the private placement of securities. Private placement means that the issuer of securities sells them directly to the investors, without the underwriting services of an investment banker. This method of marketing new issues has several advantages, foremost among these is that it is cheaper since underwriting costs are avoided.

38.3 THE SECONDARY MARKET

The secondary market in corporate securities can be sub-divided into two parts, the registered stock exchange and the over-the-counter market.

(1) Stock Exchange

Stock exchanges are voluntary associations of members who come together to buy and sell for the general public the securities of the big corporations. Only certain securities are traded on the exchanges the so-called listed stocks and these are bought and sold by auction. Since the members of exchanges generally have branches throughout the country, the stock exchanges are truly a national market in which virtually anyone may participate.

(2) Over-the-Counter Market

The over-the-counter market is the market for those securities not listed on the stock exchanges. Used in the broadest sense, it includes all transactions in securities, other than those taking place on the national stock exchanges. The over-the-counter market has very low entry barriers, and traders may range in size from very large houses doing international business to one-person firms that trade only in local markets.

38.4 Check your progress I:

1) The money market where debt and stocks are traded and the maturity period is more than a year is known as______________.

2) ______________ is a market where new securities are bought and sold for the first time.

3) __________bonds are supported with income from the project and are offered to back specific ventures.

38.5 ECONOMIC FUNCTIONS OF THE STOCK MARKET

The role of the secondary market is to make the primary market possible. Suppose, for example, a corporation needs to buy a machine with a life expectancy of twenty years. It may want to issue a twenty-year bond to do this. But who would buy such a bond if they had it for a full twenty years? With a secondary market, the initial purchaser of the bond knows that, if necessary, it can be resold to someone else in a year or two. In this fashion, the secondary market in securities is said to give liquidity to primary issues.

38.6 GOVERNMENT SECURITIES MARKET

In most developed and underdeveloped countries, large quantities of government securities are issued, to finance government operations and to re-finance maturing debt. This mechanism is sometimes known as debt management. The treasury can issue new government debt instruments and sell them to financial institutions and the general public. (These securities are not available to the general public in most of the less developed countries).

These government securities can be of two types:

(i) Marketable government securities
(ii) Non-Marketable government securities

The securities that can be sold in the secondary market are termed as marketable securities and those that cannot be sold in the secondary market are known as non marketable securities.

38.7 THE INTERNATIONAL CAPITAL MARKET

The central feature of such a market is that it makes possible the lending and borrowing of funds in a currency outside the country of its origin. For example, it became possible for an Englishman, in London, to lend dollars to another Englishman in London. The capital market aspect of such a market is called the Eurobond market.

The Eurobond market is a market where bonds are denominated in a currency other than that of the country in which they are issued. For example, a French firm may engage a German investment banking syndicate to sell dollar-denominated bonds, and Italian and English investors may be the principal buyers of such bonds. It is particularly in this broader sense that the Eurobond market is international in character.

One thing to be noted about the Eurobonds is that these bonds are denominated in dollars.

38.8 Check your progress II:

1) ________________is the primary function of a market in an economy.

2) Which institution regulates international capital flows and financial stability on a global scale?

3) Which financial instrument is commonly traded in the international capital market for short-term borrowing and lending?

38.9 CAPITAL MARKET IN INDIA

Indian capital market before independence could not develop, since there were few companies. Most of the British enterprises in India looked to the London capital market for funds. Individual investors were few and limited to the upper class in urban areas. Specialized issue houses could not develop in India and the managing agency system performed to some extent the function of promotion, issue, and underwriting of new capital issues.

The rapid expansion of corporate and public enterprises since 1951 has necessitated the development of the capital market in India. Indian capital market is divided into the gilt-edged market and the industrial or corporate securities market.

The gilt-edged market refers to the market for government and semi-government securities backed by the Reserve Bank of India. The securities traded in this market are stable in value and subscribed by the banks and other financial institutions. The industrial securities market refers to the market for shares and debentures.

Government securities differ from the industrial securities market in many important respects:

(i) More uncertainty regarding yield, management, addition to capital, etc. is involved in industrial securities.

(ii) Financial institutions are compelled by law to invest a specified part of their demand and time liabilities in government securities.

(iii) The average value of the transactions in the government securities market is very much larger than in the case of shares and debentures of the companies.

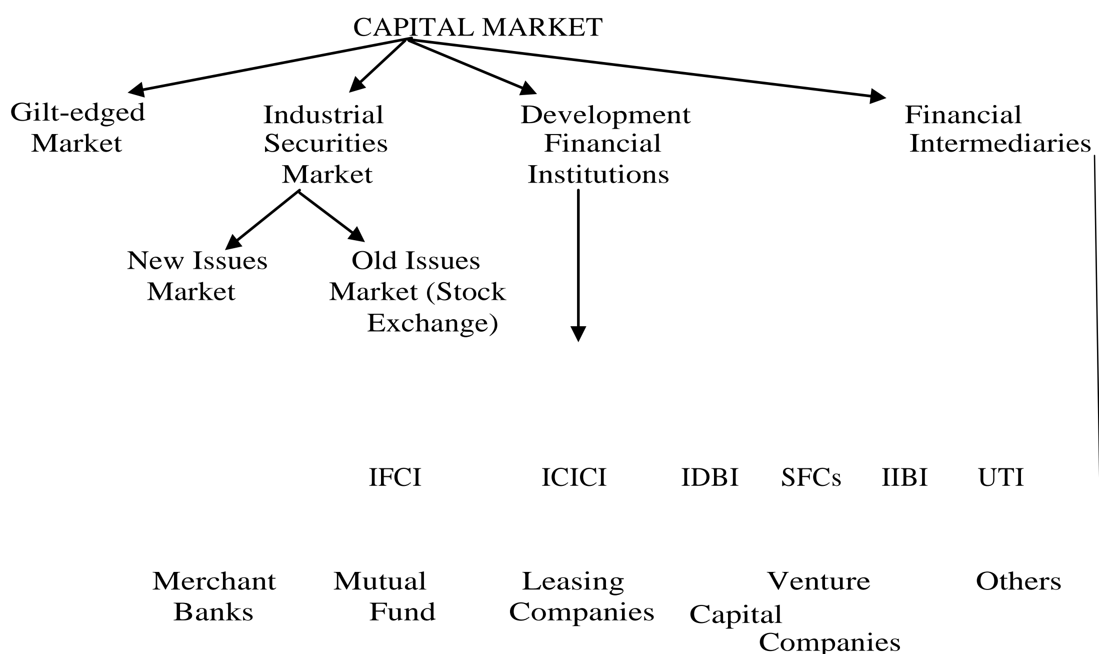
(iv) Gilt edged market is an 'over-the-counter market.

(v) RBI plays a dominant role in the gilt-edged market through its open market operations.

The capital market, in India, started growing after independence. A very important indicator of the growth of the capital market is the growth of Joint stock companies or the corporate sector. The volume of capital market transactions has increased sharply; its functioning has been diversified. New financial instruments have appeared in the market.

Specialized financial institutions set up after independence to promote industrial growth have been doing useful work in subscribing to the shares and debentures of new and old companies, giving loan assistance, underwriting new issues, and so on.

The following table will give us an idea of the structure of the capital market in India:



(Source: Ruddar Datt and Sundharam: Indian Economy, 2003 ed.)

Moreover, over-the-counter exchange of- India (OTCEI) has been promoted jointly by ICICI, UTI, IDBI, IFCI, GIC, LAC, SBI Capital Markets, and Can Bank Financial Services. It has been registered as a stock exchange with the SEI31 and has commenced operations from October 1992. Its main aim is to provide small and medium companies access to the capital market to raise capital cost-effectively. OTCEI is a ringless, electronic, and national exchange that trades in selected scrips and debt instruments. The OTCEI operates in Mumbai with regional windows in other metropolitan cities and representative offices in a few major cities.

Commercial banks are important constituents of the Indian capital market, but their operations have so far been confined to the purchase and sale of government securities. Their holding of industrial securities viz; shares and debentures are very small. In recent years, banks have been increasing their participation in term lending by subscribing to the shares and debentures of specialized financial institutions- They are also setting up financial subsidiaries known as merchant banks, mutual funds, leasing companies, etc. to mobilize funds from investment in industrial securities. These are discussed below, one by one.

38.10 MERCHANT BANKING

A few merchant banks have been set up by private financial service companies in association with foreign banking and money market institutions and some have been set up by firms and individuals engaged in brokerage and financial advisory business.

Merchant banks in India manage and underwrite new issues, undertake syndication of credit, they advise corporate clients on fundraising and other financial aspects. Unlike the merchant banks abroad, Indian merchant banks do not undertake banking business viz, deposit banking, lending, and foreign exchange services. At present, in India, merchant banks are subject to two types of authorities, the SEBI and RBI.

Leasing and Hire Purchase Companies

Leasing has proved a popular financing method for acquiring plants and machinery, especially for small and medium-sized enterprises. Their growth is due to the advantage of speed, informality, and flexibility to suit individual needs. The Narasimham Committee recognized the importance and growing role of leasing and hire purchase companies in the financial intermediation process.

Mutual Funds

Several public sector banks and financial institutions have set up mutual funds on a tax-exempt basis, virtually on the same footing as UTI. They have attracted strong investor support and have shown significant progress. The government has now decided to throw the field open to the private sector and joint sector. At present, SEBI has the authority to lay guidelines and supervise and regulate the working of mutual funds. The guidelines issued by SEBI relate to advertisement and disclosure etc_ The investors have to be informed about the status of their investments in equity, debentures, government securities, etc.

Venture Capital Companies

There is significant scope for these in the context of the emergence of technocrat entrepreneurs who have technical competence and expertise but lack financial capital. The technocrat entrepreneurs need the support of venture capital companies. The importance of venture capital companies is to give commercial support to new ideas and the introduction of new technologies. There is a high degree of risk involved in venture capital financing. Venture capital financing is one of the more recent entrants into the Indian capital market.

Apart from these, the government of India has been instrumental in setting up a series of new financial intermediaries to serve the financial needs of commerce and trade in the areas of venture capital, credit rating leasing, etc. We refer to :

(i) Risk Capital and Technology Corporation (RCTC) which assists in the form of risk capital and technology ventures.

(ii) Technology Development and Information Company of India Ltd. to sanction project finance to new technology ventures. (Now known as ICICI Venture Funds Management Co. Ltd.)

(iii) Infrastructural Leasing and Financial Services of India Ltd. to focus on leasing of equipment and infrastructural development.

(iv) The Credit Rating Information Service of India Limited (CRISIL) to undertake the rating of fixed, deposit program, convertible and non-convertible bonds 8r. debentures and credit assessment of companies.

(v) Stock Holding Corporation of India Limited to help in the transfer of shares, debentures, and other securities by replacing the present system which involves voluminous paperwork.

All these institutions have been set up after the mid-eighties and are still in the formative stage but they are bound to be of special importance for the Indian capital market.

Stock Exchange in India

For the existence of the capitalist system of economy and the smooth functioning of the corporate form of organization, the stock exchange is an essential institution.

The first organized stock exchange in India was started in Bombay when the Native Stock Brokers Association - now known as Bombay Stock Exchange - was formed by the brokers in Bombay. In 1894, the Ahmedabad Stock Exchange was started to facilitate dealings in the shares of textile mills there.

The Calcutta Stock Exchange was started in 1908 to provide the market for shares of plantation and Jute mills. The number of stock exchanges rose from 7 in 1939 to 21 in 1945. Under the Securities Contract (Regulation) Act 1956, the Government of India has so far recognized 15 stock exchanges. Bombay is the premier exchange in the country and nearly 70% of all transactions in the country are done in that exchange.

Securities and Exchange Board of India (SEBI)

To overcome the shortcomings and drawbacks in the Indian capital market and to regulate the capital market, the Government of India repealed the Capital Issue Act of 1947, abolished the Office of the Controller of Capital Issues (CCI), and set up SEBI in 1988.

Initially, SEBI was set up as a non-statutory body. In January 1992 it was made a statutory body. SEBI was authorised to regulate all merchant banks on issue activity, lay guidelines supervise and regulate the working of mutual funds, and oversee the working of stock exchange in India. SEBI has made efforts to introduce practices and greater transparency in the capital market in the interest of the investing public and the healthy development of the capital market.

Primary Market Reforms

Recently, **the** following primary market reforms were introduced:

1. Companies issuing capital in the primary market are now required to disclose all material facts and specific risk factors with their projects. SEBI has also introduced a code of advertisement for public issues to ensure fair and truthful disclosures.
2. To reduce the cost of issues, SEBI has made underwriting of issues optional, subj ect to the condition that if an issue was not underwritten and was not able to collect 90% of the amount offered to the public, the entire amount collected is to be refunded to the investors.
3. Merchant banking has been statutorily brought under the regulatory framework of SEBI. Merchant bankers have now a greater degree of accountability in the offer document and issue process.
4. SEBI has advised stock exchanges to amend the listing agreement to ensure that a, listing company furnished annual statements to the stock exchanges showing the variations between financial projections and projected utilization of funds in offer documents and the actual utilization. This would enable shareholders to make comparisons between promises and Performance-
5. The government has now permitted the setting up of private mutual funds and a few have already been set up. To improve the scope of investments by mutual funds, mutual funds are permitted to underwrite public issues.
6. Since 1992, the GOT allowed Indian companies access to international capital markets through Euro equity shares. GDR issues are also launched for the same purpose.
7. The government of India has also liberalized the investment norms of NRIs. so that NRIs and overseas corporate bodies can buy shares and debentures without the permission of RBI.

8, The requirement to issue shares at a par value of Rs, 10 and Rs. 100 has been withdrawn. But shares cannot be issued in the decimal of a rupee.

9, The Government has allowed Foreign Institutional Investors (VII), pension funds, mutual funds, investment trusts, assets or portfolio management companies, etc, to invest in the Indian capital market provided they are registered with SEBI.

38.11 SECONDARY MARKET REFORMS

Recently, the following secondary market reforms were introduced in the Indian Capital Market.

1. Three new stock exchanges at the national level were set up in the 1990s, These are Over the Counter Exchange of India (1992), the National Stock Exchange of India (1994), and the Inter-Connected Stock Exchange of India (1999).
2. The process of dematerialization of securities through the depository system and their transfer through electronic book entry is pursued vigorously. For this, the National Securities Depository Ltd. was set up in 1996, and the (central Depository Service Ltd. in 1999.
3. Issuing companies are required to make continuing disclosures under the listing agreement. All listed companies are required to furnish to stock exchanges and also publish unaudited financial results every quarter. Disclosure of material information is to be made available to the public.

4. Stock exchanges have undergone major structural reforms. Boards of the stock exchange have been made broad-based. Stock exchanges, brokers, and sub-brokers have been. brought under the regulatory purview of SEBI.
5. To investigate frauds in the stock market using a multidisciplinary team of experts, it has been decided to set up a serious Fraud Office (SFO) in the Department of Company Affairs.

The government is arming SEE' with all necessary powers to control and regulate the securities market on the one side and effectively protect the interest of the shareholders on the other. SEI-3I has been empowered to file complaints in courts and to notify its regulations without prior approval of Govt. It is empowered, to impose monetary penalties on capital market intermediaries and other participants for a listed range of violations. SEBI also has the power to summon the attendance of and call for documents from all categories of markets connected with the securities market. To resolve the conflicts of interest in the governance of various stock exchanges, new governance mechanisms with a separation between, ownership, management, and trading rights have been evolved.

38.12 PRACTICE QUESTIONS

38.12.1 Short answer type questions:

Q.1. How does the primary capital market differ from the secondary capital market?

Q. 2. What factors contribute to the development of the capital market in India?

38.12.2 Long answer type questions:

Q.1. Explain the concept of the capital market and its components in India. How has the capital market evolved over the years?

Q.2. Discuss the role of SEBI in the development of the capital market in India. How has SEBI contributed to investor protection and market regulation?

38.13 GLOSSARY OF RELEVANT TERMS USED:

1. **Convertible Bonds**- Convertible bonds are a type of corporate debt security that gives bondholders the option to convert their bonds into a predetermined number of shares of the issuer's common stock.

2. **Non-convertible Bonds**- Non-convertible bonds are a type of debt security that does not include the option for bondholders to convert their bonds into a predetermined number of shares of the issuing company's common stock.

3. **Venture Capital Companies-** Venture capital (VC) firms are investment firms that provide funding to startups and small businesses that are deemed to have high growth potential.

4. **Merchant Banks-** Merchant banks, also known as investment banks in some regions, are financial institutions that provide a range of financial services to corporations, governments, and high-net-worth individuals.

38.14 KEYWORDS

1. **Securities and Exchange Board of India (SEBI)-** The Securities and Exchange Board of India (SEBI) is the leading regulator of securities markets in India, analogous to the Securities and Exchange Commission in the U.S.
2. **Leasing and Hire Purchase Companies -** Hire purchase (HP) or leasing is a type of asset finance that allows firms or individuals to possess and control an asset during an agreed term while paying rent or installments covering depreciation of the asset, and interest to cover capital cost.
3. **Mutual Funds-** A mutual fund is a pool of money managed by a professional Fund Manager. It is a trust that collects money from a number of investors who share a common investment objective and invests the same in equities, bonds, money market instruments and/or other securities.
4. **Over-the-Counter Market-** An over-the-counter (OTC) market is a decentralized market in which market participants trade stocks, commodities, currencies, or other instruments directly between two parties and without a central exchange or broker.

38.15 SUGGESTED READINGS

a. Bedi Suresh, i3Lesiness Environments, Excel Books, New Delhi, 2004.
b. Cherunilam Francis, *Business* Eneironittemt, Himalaya Publishing House, Mumbai, 2005.

38.16. ANSWER KEY:

Check your progress I:

1) Capital Market
2) Primary Market
3) Revenue

Check your progress II:

1) Distribution
2) International Monetary Fund (IMF)
3) Foreign Exchange (FOREX)

Short answer type questions:

Question 1: How does the primary capital market differ from the secondary capital market?

Question 2: What factors contribute to the development of the capital market in India?

Long answer type questions:

Question 1: Explain the concept of the capital market and its components in India. How has the capital market evolved over the years?

Question 2: Discuss the role of SEBI in the development of the capital market in India. How has SEBI contributed to investor protection and market regulation?