

Economic and Social Environment

By: Namrata Gupta

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ECONOMIC AND SOCIAL ENVIRONMENT

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Economic Environment of Business

INTRODUCTION

After studying this chapter, you will be able to understand the environment of business, its definition and classification. The basic propositions of business environment states that business is an economic activity, firm is an economic unit and business decision-making is an economic process. The economic environment of business refers to the wide characteristics of the economics system in which a business firm operates. There are some critical elements of macro-economic environment which can be used separately for analytical purposes. The new economic policy which was announced in July 1991, has a bearing on Industrial Licensing, Foreign Investment and Foreign Technology Agreements, MRTP regulations and Public Sector. We will also come to know that the business environment influences business management. The economic environment of business exercises a strong influence on the non-economic environment of business and a device called interaction matrix can be helpful in understanding the relationship between two sets of variables e.g. economics and non-economics factors. Being a manager, to become successful in day-to-day business operations, a person has to remain alert to the environment.

CHAPTER AT A GLANCE

ENVIRONMENT OF BUSINESS

Environment is a complex phenomenon. It furnishes the macro-context whereas business firm is a

micro unit. Any of the business firm has to operate within environment system like values of society, beliefs of leaders, monetary policies of central banks, attitude towards foreign capital and enterprise etc. They are different from country to country. Some factors may be common. The environmental factors influence the production, consumption and marketing of the product. It can be classified into market and non-market environment, economic and non-economic environment.

The term environment also consists of several subsets, e.g. economic environment, socio-cultural environment, politico-legal environment, technological environment etc. It represents the totality of all kinds of environments which have an impact on business, within a country, the environment differs not only over space but also over time within a country. The state of the economy at present and what it was in the past influenced the Indian economy of tomorrow. The environment may be classify into market environment and non-market environment depending upon the market forces like demand, supply etc. Economic environment is formed and shaped by the factors like fiscal policy, the monetary policy the industrial policy resolutions, physical limits on output, price and income trends, nature of economic system at work, tempo of economic development, national income plan etc. The non-economic environment has economic implications. Therefore, environment is the sum total of history, geography, culture, sociology, politics and economics of a nation.

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SOME BASIC PROPOSITIONS

Three basic propositions are that business is an economic activity, which includes the task of adjusting means to the ends. Secondly, a business firm is an economic unit as to transforms inputs into outputs and thirdly, business decision-making is an economic process, which states that for decision-making one has to choose from the alternative actions.

(i) Business is an Economic Activity: An economic can assume the different forms such as consumption, production, distribution and exchange. Depending upon the form of economic activity being undertaken and organised, the nature of business is differs.

Sometimes the target has to be matched with the given resources and sometimes the resources have to be matched with the given target. In any way, optimising the outcome of economic activities is the task of business.

(ii) A business Firm is an Economic Unit: The size, structure, location and efficiency of the business firm under consideration determines the nature of input requirements and the type of output flows. The complete process of creating, mobilisation and utilisation of the surplus constitutes the economic activity of the business firm.

(iii) Business Decision-making is an Economic Process: A choice from a set of alternative courses of action is involved in decision-making. Because resources are limited in supply and most resources have alternative uses, a business firm seriously thinks about the optimum allocation of resources. Therefore, the primary consideration in evaluating the business policies, business strategies and business tactics of a corporate entity in any national economy is the economic environment of business.

ECONOMIC ENVIRONMENT

Economic environment is the broad characteristic of economic system in which a business organisation operates. The process of decision-making is different in every economy depending on the way of finding out the solutions to the problems. Some of the basic observation concerning the nature and functioning of modern economies are free market mechanism and centralised planning, secondly, welfare state like growth, efficiency and equity and thirdly, modern economies are not closed' but 'open'.

The economic environment of a business refers to the broad characteristics of the economic system in which a business firm operates. The business sector has economic relations with the Government, the capital market, the household sector and the foreign sector. These sectors together influence the trends and structure

of the economy. All the economies whether capitalist, socialist, communist or mixed, have certain fundamental problems. The main economic problems of every economy are What to produce? How to produce? For Whom to produce? When to produce?

Certain points made about the organisation and functioning of modern economies are:

- (i) Both “free market mechanism” and “centralised planning” exist in different degrees in most economies.
- (ii) Positive intervention by the Government in day-to-day economic affairs has existed in most economies. The “Welfare State” principle induces the Government to enforce minimum wages, commodity controls, fair trade practices etc. through legislation whose basic objectives are growth, efficiency and equity.
- (iii) Modern economies are actively engaged in international trade and cooperation as they are not “closed” but “open”.

Both economic and non-economic environment have an important bearing on managerial decisions.

CRITICAL ELEMENTS

The critical elements of macro-economic environment are economic system, nature, anatomy and functioning of economy, economic planning, policy and proposals, controls and regulations, legislations, trends and structures and economic problems and prospects. They are not always be mutually exclusive but can be treated separately for analytical purpose.

The ownership, control and management of enterprises reveals the nature of the economic system. The physical framework of the environment is defined by the level of economic development and the structure of the economy. The national economy is a combination of the household sector, the corporate business sector, the Government administration, the capital market and the foreign sector. The transactions of money affected the flows of consumption, investment, saving, income, employment and output.

The essential question arises—Does money matter? Has different answers:

- (i) Money does not matter at all (*Classical*)
- (ii) Money matters least (*Keynesian*)
- (iii) Money matters most (*Monetarist*).

Economic planning gives a direction to the changes in the economic environment. The national economic environment of business is determined by the existing macro-economic policy framework. The economic trends like income, money supply, prices, production, employment, balance of trade and payments, foreign exchange earnings etc. decide the course of prevailing economic environment.

INDIAN ECONOMIC ENVIRONMENT

The national economic environment of a country can be described in its data and system environment. A series of policy formulations and legislations has evolved in India, which was started with Industrial Policy Resolution of 1948, Industries Act 1951, Directive Principles of State Policy 1950, MRTP Act 1969, FERA 1973 and 80 on. A new economic policy was announced in July 1991 bearing Industrial Licensing, Foreign Investment and Foreign Technology Agreements, MRTP regulations and public sector.

The system environment encompasses the entire institutional framework of the economy. India has a complex mixed economic systems as:

- (a) India has a multiplicity of sectors i.e. private, public, joint, co-operative, worker's sector and also "tiny sectors".
- (b) India has a multiplicity of mechanisms at work: five-year plans, annual plans during plan holidays, pointed economic reforms and reconstruction programmes etc. There is a complex system of liberal rules, strict regulations, control mechanisms, planning and a host of price regulations.
- (c) The social welfare function in India is defined by the multiplicity of objectives which are conflicting in nature sometimes.

During the decade of the 1980s the Indian mixed economy took a decisive direction. The purpose of this policy was to attain socio-economic objectives like optimum utilisation of capacity, import substitution, maximum production, employment generation, etc. Some important provisions of the policy of 1980, were: regularisation, automatic expansion, promotion, revival of sick units, development and reorientation of public sector.

The New Economic Policy: The new economic policy which was announced in July 1991, has a bearing on:

(i) **Industrial Licensing:** To exploit and meet the emerging domestic and global opportunities and challenges the system of industrial approval needed a number of changes to activity encourage and assist Indian entrepreneurs.

(ii) (a) **Foreign Investment and Foreign Technology Agreements:** The Government announced its decision to grant approval for investment upto 51% foreign equity in high priority industries regarding direct foreign investment.

(b) **Foreign Technology Agreements:** Where the acquisition of technological capability receives priority, there is a great need for promoting an industrial environment.

(iii) **MRTP Regulations:** The New policy was the removal of the threshold limits of assets in respect of MRTP companies and dominant undertakings. The MRTP Commission will be empowered and authorised to initiate investigations regarding monopolistic, restrictive and unfair trade practices.

(iv) **Public Sector Policy:** The consequent low rate of return has inhibited the ability of public enterprises to regenerate themselves in terms of new investment as well as in technology development which makes them a burden on rather than an asset to the Government.

Challenge of Global Competition and Quality Standards

The competitive strength of a company is determined by the price and quality. Since the policy of liberalisation was initiated in 1991, industrial enterprises in India have been exposed to competitive markets both within and outside, after years of protection from foreign competition.

ECONOMIC ENVIRONMENT AND BUSINESS MANAGEMENT

The business environment influences business management as the critical elements of both interact with each other. The critical elements of business management are planning, direction, organisation, coordination, leading and motivation and evaluation. The success of any business enterprise, in a large measure, would depend upon the proper understanding of the business environment. The environment and management thus influence each other.

The existing business environment may act a constraint for business management. The environment is not limited to the institution of the Government, for the management. In adjusting to the environment a good amount of managerial skill is required. In the context of environment, corporate managers analyse the strengths (S), weaknesses (W), Opportunities (O) and Threats (T). The environment and Management thus influence each other. The existing environment affects size, structure, location, integration and growth of business.

ECONOMIC AND NON-ECONOMIC ENVIRONMENT: THE INTERACTION MATRIX

Economic and non-economic environment of business influence each other, a device called interaction matrix is very helpful in understanding the relationship between two sets of variables For example economic and non-economic factors.

There are few specific interactions which are as follows:

- (i) The social environment affects and gets affected by the economic environment of business.

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- (ii) The educational-cultural environment and the economic environment of business are also interdependent.
- (iii) The politico-legal environment and economic environment of business are also interlocked.
- (iv) The historical environment and the economic environment of business are interdependent.
- (v) Interaction between the physical environment of a country and the economic environment of business in that country.

ACTIVITY 1

Can you now recapitulate the various criteria on the basis of which a business environment may be classified?

Ans. Criterion

1. Space—Local, regional, national and international environment.
2. Time—Past, present and future environment.
3. Forces—Market and non-market environment.
4. Factors—Economic and non-economic environment.

ACTIVITY 2

Briefly answer each of the following questions:

Q. 1. What is an Economic Problem?

Ans. Economic problem is a fundamental problem of economy which asserts that the resources are limited and human wants are unlimited. So, it creates an economic problem of scarcity of resources.

Q. 2. What is the Optimum Economic Activity?

Ans. The basic task of the business is to take out the perfect outcome of economic activities. Sometimes the target is to be set-up in order to resemble or matched the resources which are given and sometimes vice-versa. An optimum economic activity involves or includes the resources to the targets. Its different forms are consumption, distribution, production and exchange. As each and every business wants to achieve its level best.

Q. 3. Why, or why not, should the organisation you work for be treated as an Economic Unit?

Ans. Every firm plans carefully the perfect or optimum allocation of resources in order to get perfect production on resources are: men, machine, money, material etc. A business firm transform inputs into outputs. These inputs and outputs are determined by size, structure, location and ability of the considered business firm. Different type of activities like mining, farming, transport etc. can be performed. But profit maximisation is the only motivational objective to perform all the activities. When the value of output is more than the value of input or revenue is surplus over the cost, it is 'profit'? Therefore, in order to create,

mobilise and utilise the surplus, organisation should be treated as an economic unit.

ACTIVITY 3

Get some printed literature concerning your own organisation or any other business organisation, or you can even read the 'corporate news' in magazines like *Business India, Business World, Business Today*. Attempt an economic interpretation of facts and figures that you have at your disposal. You may begin by asking similar questions as given in Activity 2. Briefly jot down the points.

Ans. Alaska Airlines to cut jobs!

Alaska Airlines, a unit of Seattle-based Alaska Air Group Inc, recently announced to slash 1,000 jobs and reduce its flight departures by 15% on grounds of record oil prices and an economic slowdown. The company will commence these job cuts, almost 10% of its entire workforce and would affect everyone from pilots to cabin crew to technicians/service staff, from 9th November this year. Alaska Airlines, which posted a \$50 million loss in the first half of the current year, had earlier announced to cut 80 management jobs, but this addition only came in the recent times. The company has also revealed that its previous steps to offset record costs that include increasing fees and adding charges, reducing fuel consumption and deferring capital projects, was simply not enough. Thus, more evasive action is expected.

Q. 1. What is an Economic Problem?

Ans. Hiking oil prices and economic slow down are the major economic problems faced by Alaska airlines.

Q. 2. What is the optimum economic activity?

Ans. Alaska has been slashing down jobs of its employees and facing the problems of 50 million dollars. Whereas, optimum economic activity will be to slash down the expenses by reducing fuel consumption etc. and meet the objectives successfully for earning profits.

Q. 3. Why, or why not, should the organisation you work for be treated as an economic unit?

Ans. Because it is facing economic problems and any decision is affecting the economy as a whole.

ACTIVITY 4

List some of the basic observations concerning the nature and functioning of modern economies in general.

- Ans.1.** Free market mechanism and centralised planning.
- 2.** Welfare state like : growth, efficiency equity.
- 3.** Modern economies are not 'closed' but 'open'.