

NCERT Solutions Class 12
Business Studies Principles and Functions of
Management
Chapter 3 Business Environment

Multiple choice questions

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Question 1: Which of the following does not characterise the business environment?

- (a) Uncertainty
- (b) Employees
- (c) Relativity
- (d) Complexity

Solution:

Among the options given above, employees do not characterize business environment. Business environment refers to the external forces such as individuals, enterprises, situations, and other such forces that affect the performance of the organisation. For example, changes in government's economic policies, rapid technological developments, political uncertainty, changes in fashions and tastes of consumers and increased competition in the market — all influence the working of a business enterprise in important ways. Employees are

integral to an organisation and does not characterise its environment.

Question 2 : Which of the following best indicates the importance of the business environment?

- (a) Identification
- (b) Improvement in performance
- (c) Coping with rapid changes
- (d) All of them

Solution :

All the options given above indicate the importance of business environment. A good understanding of environment by business managers enables them not only to identify and evaluate, but also to react to the forces external to their firms. The importance of business environment and its understanding by managers can be appreciated if we consider the following facts:

- It enables the firm to identify opportunities and getting the first mover advantage
- It helps the firm to identify threats and early warning signals
- It helps in tapping useful resources
- It helps in coping with rapid changes
- It helps in assisting in planning and policy formulation

- It helps in improving performance

Study of business environment helps in identifying the positive changes as well as threats or hindrances that affects the performance of an organisation. Thereby, it helps them in taking appropriate measures for improving the performance. In addition, a careful study of the continuously changing environment helps the organisation in coping with it in a better manner.

Question 3 : Which of the following is an example of social environment?

- (a) Money supply in the economy
- (b) Consumer Protection Act
- (c) The constitution of the country
- (d) Composition of family

Solution:

Elements of Business Environment:



Social environment refers to the social forces such as customs, traditions, social values, social trend etc. that affect the business opportunities and performance. Among the options given in the question, composition of family represents an example of social environment. For example, the health-and fitness trend has become popular among large number of urban dwellers. This has created a demand for products like organic food, diet soft drinks, gyms, bottled (mineral) water and food supplements. This trend has, however, harmed business in other industries like dairy processing, tobacco and liquor.

Question 4 : Liberalisation means

- (a) Integration among the economies
- (b) Reduced government controls and restrictions

- (c) Policy of planned disinvestment
- (d) None of them

Solution :

Liberalisation means reduced government controls and restrictions such as licenses and quotas. Liberalisation of the Indian industry has taken place with respect to:

- (i) abolishing licensing requirement in most of the industries except a short list,
- (ii) freedom in deciding the scale of business activities i.e., no restrictions on expansion or contraction of business activities,
- (iii) removal of restrictions on the movement of goods and services,
- (iv) freedom in fixing the prices of goods services,
- (v) reduction in tax rates and lifting of unnecessary controls over the economy,
- (vi) simplifying procedures for imports and exports, and
- (vii) making it easier to attract foreign capital and technology to India.

Question 5: Which of the following does not explain the impact of Government policy changes on business and industry?

- (a) More demanding customers
- (b) Increasing competition
- (c) Change in agricultural prices

(d) Market orientation

Solution:

Among the options given above, change in agriculture prices does not explain the impact of government policy changes on business and industry. Government policy changes such as liberalisation, privatisation and globalisation affect the working of business organisations. More demanding customers, increasing competition and market orientation all explain the impact of such policy changes. On the other hand, change in agricultural prices is independent of the government policy changes and takes place due to change in the demand and supply of agricultural products.

Short answers questions

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Question 1 : What do you understand by business environment?

Solution :

Business environment refers to all the external forces that affect the performance of a business organisation. Such forces can be economic, social, political, technological or legal. Thus, individuals, consumers, government, legal matters all compose business environment. For example,

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

Business environment, has the following features:

- Business Environment is sum total of external forces
- Business Environment includes Specific and general forces which directly or indirectly impact the firm
- Different elements or parts of business environment are closely interrelated.
- Business environment is dynamic in that it keeps on changing.
- Business environment is largely uncertain as it is very difficult to predict future happenings.
- Business environment is a complex phenomenon that is relatively easier to understand in parts but difficult to grasp in its totality.

- Business environment is a relative concept since it differs from country to country and even region to region.

Question 2: Why it is important for business enterprises to understand their environment? Explain briefly.

Solution:

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

i. *Identification of Opportunities and getting the first mover advantage:* Opportunities

refer to the positive external trends or changes that will help a firm to improve its performance. Environment provides numerous opportunities for business success. Early identification of opportunities helps an enterprise to be the first to exploit them instead of losing them to competitors.

ii. *Identification of Threats and early warning signals:*

Threats refer to the external environment trends and changes that will hinder a firm's performance. Besides

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

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

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

v. *Formulating Plans and Policies:* A continuous study of environment helps an organisation in the identification of the opportunities and threats. Thereby, it guides the

organisation in framing suitable plans and policies in view of the current scenario.

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

Question 3: Mention the various dimensions of business environment.

Solution :

The following are the dimensions of business environment.



i. *Economic Environment*: It comprises of the economic variables such as interest rates, income, stock market indices that affect the functioning of the enterprises. For

example, an increase in income affects the demand for goods and services of the enterprises.

ii. *Social Environment*: Social environment refers to the social forces such as customs, traditions, social values, social trend etc. For example, religious celebrations provide business opportunities to many enterprises such as those producing sweets, decoration items, etc.

iii. *Technological Environment*: Technological environment includes technological changes and improvements. For example, introduction of computers, internet, new telecommunication facilities, etc. all affect the business enterprises. An improvement in the technology used in the manufacturing of a product provides new business opportunities for the enterprises while on the other hand, is a threat for the enterprises using obsolete technology.

iv. *Legal Environment*: It comprises of the legislation and rules passed by the government such as the Companies Act, Trade union Act, etc. These legislation govern how an enterprise functions and behaves. Knowledge of these legislation is essential for enterprises as their noncompliance can lead to legal trouble for them.

v. *Political Environment*: Political conditions such as peace and stability, law and order compose political business environment. It directly affects the functioning of enterprises. Political stability, thus, builds up

confidence among business people to invest in the long term projects for the growth of the economy. Political instability can shake that confidence. Similarly, the attitudes of government officials towards business may have either positive or negative impact upon business. For example, a situation of political unrest erodes confidence of the investors and thereby, makes it difficult for the enterprises to function smoothly.

Question 4: Briefly explain the following:

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

Solution :

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

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

iv. Procedures regarding exports and imports were relaxed
v. Reduction in tax rates and lifting of unnecessary controls over the economy,
vi. Making it easier to attract foreign capital and technology to India.

vii. Freedom in fixing the prices of goods services

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

i. Disinvestment of the public-sector enterprises

ii. Establishing Board of Industrial and Financial Reconstruction for the revival of the sick and loss-making enterprises.

iii. Diluting the stake of government in the public-sector enterprises.

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

i. Removal on restriction on imports

ii. Abolishing the export duty

iii. Reducing import duty

Question 5: Briefly discuss the impact of government policy changes on the business and industry.

Solution:

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

i. *Increased Competition:* As a result of the policies such as relaxation of the licensing policy and reduction of import duties, the competition faced by the domestic firms increases. India companies experienced competition in service industry such as telecommunication, banking, insurance, etc.

ii. *Increased Demand:* As competition increases, the choice of goods and services for the consumers also increases. Thus, consumers also gain from quality products and greater variety.

iii. *Change in Business Policies:* The government policies directly impact the functioning of the business enterprises. As a result, they have to alter their policies appropriately.

iv. *Technological Changes:* As competition increases firms tend to find new and innovative ways to survive in the market. In such a scenario, technological improvements become imperative.

v. *Need for Trained Personnel:* Innovations and improvement in product, application of improved

technologies requires skilled and trained personnel. Thus, there arises a need for the development of human resources.

vi. *Greater Market Orientation:* With increased competition, the production has become market oriented. That is, the enterprises produce as per the demand market.

vii. *Less Reliance on Budgetary Support by Public Sector Enterprises:* To survive the increased competition, the public sector enterprises must improve efficiency and productivity rather than relying on budgetary support to cover their losses. On the whole, the impact of Government policy changes particularly in respect of liberalisation, privatisation and globalisation has been positive as the Indian business and industry has shown great resilience in dealing with the new economic order. Indian enterprises have developed strategies and adopted business processes and procedures to meet the challenge of competition. They have become more customer-focused and adopted measures to improve customer relationship and satisfaction

Long answers questions

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Question 1: How would you characterise business environment? Explain, with examples, the difference between general and specific environment.

Solution :

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



Business environment has the following characteristics.

i. *Aggregate of External Forces:* Business environment is the total of all the external forces such as individuals, consumers, government, legal matters that affect the

performance of an organisation either positively or negatively.

ii. *Interrelation*: Different forces of business environment are closely related to each other. For example, an increase in the income of the consumers increases the demand for consumer durables such as television, refrigerator, etc.

iii. *Ever Changing*: Business environment is dynamic and ever changing in nature. For example, consumer tastes and preferences, technology, government rules and policies keep changing continuously.

iv. *Uncertainty*: Business environment is uncertain. Changes in different forces of the environment cannot be predicted easily. In addition, dynamism of the forces makes it even more uncertain.

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

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

Specific Environment and General Environment

Specific environment refers to those external forces that affect an organisation directly. That is, they are the forces that are specific to a particular organisation or a company. For example, a change in tastes and preferences of consumers towards the products of a company, directly affects its demand. Similarly, a delay in the supply of raw material from the suppliers directly affects the production of a company. On the other hand, general environment refers to those external forces that affect all the organisations. As against specific forces, general forces do not pertain to a particular organisation, rather they affect the performance of all the organisations. Thus, such forces affect a particular organisation only indirectly. For example, a change in technology affects the quantity and quality of production of all the organisations. Similarly, a change in political conditions affects all companies simultaneously.

Question 2: How would you argue that the success of a business enterprise is significantly influenced by its environment?

Solution:

The success of a business enterprise is significantly influenced by its environment. The following points highlight the importance of understanding of environment for business enterprises:

i. *Identification of Opportunities and getting the first mover advantage:* Opportunities

refer to the positive external trends or changes that will help a firm to improve its performance. Environment provides numerous opportunities for business success. Early identification of opportunities helps an enterprise to be the first to exploit them instead of losing them to competitors.

ii. *Identification of Threats and early warning signals:*

Threats refer to the external environment trends and changes that will hinder a firm's performance. Besides positive opportunities, a study of business environment helps an enterprise in the identification of threats or negative signals that may adversely affects its functioning. Thereby, it enables it to take appropriate preventive measures.

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

the enterprises have an understanding of what the environment desires and what it can offer.

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

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

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

Question 3: Explain with examples, the various dimensions of business environment.

Solution:

The following are the dimensions of business environment.

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

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

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

iv. *Legal Environment:* It refers to the legislation and rules passed by the government such as the Companies Act, Trade union Act, etc. Knowledge of these legislation is essential for enterprises as their non-compliance can lead to legal trouble for them. For example, an exportimport company in India has to follow the rules and regulations as stated under the EXIM policy and the Foreign Trade (Development and Regulation) Act, 1992. Similarly, the refining, processing, distribution, sale of petroleum, petroleum products is governed by the Petroleum and Natural Gas Regulatory Board Act, 2006.

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

Question 4: What economic changes were initiated by the government under the Industrial Policy, 1991? What

impact have these changes made on the business and industry?

Solution:

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

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

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

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

were free to expand the scale of their business according to the market conditions.

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

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

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

(vii) ***Foreign Investment Promotion Board-***This board was set up to encourage and channelise foreign investment in India. The impact of these changes on the business and industry is highlighted in the following points.

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

service industry such as telecommunication, banking, insurance, etc.

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

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

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

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

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

(g) Less Reliance on Budgetary Support by Public Sector Enterprises: To survive the increased competition,

the public-sector enterprises have realised the need for improving the efficiency and productivity. They have reduced their reliance on budgetary support to cover their losses.

Question 5: What are the essential features of

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

Solution:

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

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

(ii) *Augmentation of Production:* Enterprises became free in deciding the scale and size of production and the price of the products. The MRTP companies (companies having

assets worth more than Rs 100 crore) were free to expand the scale of their business according to the market conditions

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

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

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

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

(ii) *Establishing Board of Industrial and Financial Reconstruction*: This board was established

for the revival of the sick and loss-making enterprises.

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

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

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

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

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

(iii) *Encouragement to Foreign Capital Investment*: With the aim of encouraging foreign capital investment various

steps were taken such as increasing the equity limit of foreign capital, setting up of special economic zones, introduction of Foreign Exchange Management Act (FEMA).

Case Problem

Lately many companies have planned for significant investment in organised retailing in India. Several factors have prompted their decisions in this regard. Customer income is rising. People have developed a taste for better quality products even though they may have to pay more. The aspiration levels have increased. The government has also liberalised its economic policies in this regard and permitted even cent percent foreign direct investment in some sectors of retailing.

Questions 1. Identify changes in business environment under different heads — economic, social, technological, political and legal that have facilitated the companies' decisions to plan significant investments in organised retailing.

Solution:

- Economic: Income of customer raised because of new employment opportunities.
- Social: Customer developed taste towards better quality products even though they pay extra money for it.

- Technological: Advancement in technology made customer and retailer convenient.
- Political: Government liberalised Foreign Direct Investment policies.
- Legal: Government providing right to customer.

Question 2. What has been the impact of these changes with regard to globalisation and privatisation?

Solution:

Impact of these changes with respect to privatisation and globalisation has led retailers to make investment in organised retailing. Which in turn increased the competition, customer demand and because of this more employment opportunities surfaced.