

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

Very Short Answer questions

Question 1 : What is meant by business environment?

Solution :

Business environment refers to all the external forces including economic, political, social, technological and legal that affect the performance of a business organisation. It is the sum total of all the individuals, the control of a business enterprise but has the power to affect its performance.

Question 2 : How does understanding of business environment help in improving performance of a business?

Solution :

Organisations that carefully study their business environments and accordingly adopt suitable plans and policies are better able to improve their performance in the long run. The enterprises which keep a check on the environment not only perform well in the present scenario but also continue to succeed in the future.

Question 3 : Give an example to show that a business firm operates within numerous inter related factors constituting the business environment.(Hint: example highlighting the inter relatedness of dimensions of business environment).

Solution :

- All the elements of the business environment including its various dimensions of economic, legal, political, technological and social are closely interrelated to each other. A change in one of these will lead to a corresponding change.

- For example, the Government of India has introduced a new policy which focuses on using eco-friendly products for safeguarding the environment. This is a part of the political dimension of the business environment. Now the different organizations would invest in Technologies to produce efficient eco-friendly goods. This is a part of the political dimension of the business environment.

- Another example is that people are now focusing on using organic food products for health concerns. This is a part of the social dimension of the business environment.

However, it presupposes an economic dimension that the people now have more disposable income than before.

Thus we can say that all the business dimensions are interrelated to each other.

Question 4 : Krishna Furnishers Mart started its operations in the year 1954 and emerged as the market leader in the industry because of their original designs and efficiency in operations. They had a steady demand for their products but over the years, they found their market share declining because of new entrants in the field. The firm decided to review their operations and decided that in order to meet the competition, they need to study and analyze the market trends and then design and develop their products accordingly. List any two impacts of changes in business environment on Krishna Furnishers Mart's operations. (Hint: increase in competition and Market orientation).

Solution :

The impacts of changes in business environment on Krishna Furnishers Mart's operations are:

1. Increased competition
2. Necessity for change
3. Market orientation
4. Innovation in designs (any two)

Question 5 : Name any two Specific forces of business environment affecting business.

Solution :

Specific forces directly affect individual enterprises in the day to day operations. Examples of specific forces:

1. Investors loyalty

2. Customer tastes and preferences
3. Strategies of Competitors
4. Terms and conditions of the Suppliers (any two)

Short answers questions

Question 1 : Why it is important for business enterprises to understand their environment? Explain.

Solution :

Business environment refers to all the external forces including economic, political, social, technological and legal that affect the performance of a business organisation. It is the sum total of all the individuals, the control of a business enterprise but has the power to affect its performance. It is important to understand of the business environment because of the following reasons:

- a. Business environment includes all the forces, factors and Institutions which can directly or indirectly affect the performance of the business. It is an aggregate of all the external forces.
- b. All the forces and the factors which can affect the business organisation are interrelated to each other.
- c. The business environment is dynamic in nature. It is flexible and constantly changing. For example, the taste and preferences of the customers continue to change.
- d. The business environment is uncertain in nature. It is not easy to predict the future.

e. It is relative in nature. It differs from a region to another region. For example, the political conditions may differ from one region to another.

f. The business environment is the aggregate of various forces. This makes it complex and difficult to understand. It is easier to understand the effect of the individual forces but not of the aggregate forces.

Question 2 : Explain the following terms:

- a. Liberalisation
- b. Privatization
- c. Globalisation

Solution :

Liberalization refers to the removal of all the unnecessary controls and restrictions on the Government of a country. These controls include any form of license, permit, and quota. In 1991, India has introduced its new economic policy. It had liberalized the industrial sector in the following forms:

- a. Industrial licensing was abolished. The license was required only for the six industries of cigarettes, liquor, defense equipment, dangerous chemicals, industrial explosive, and drug and Pharmaceuticals.
- b. The trade restrictions of quantitative terms, customs, duties, and tariffs were removed on the movement of goods and services.

- c. The companies had the liberty to decide the size and scale of production along with the price of its products.
- d. The government encouraged foreign direct investment and steps with taken to attract FDI from other countries.
- e. The government also reduced the tax rates on various goods.
- f. The procedure for import and export was simplified.

b. Privatisation: Privatization refers to the transfer of ownership of state-owned enterprises from the public sector to the private sector. It implies a greater role to the private sector undertakings. Privatization was followed in the given manner:

- a. The government sold a part of the equity of the public sector undertaking the and strategic sale of the public sector undertakings. This was called disinvestment.
- b. Many companies were sold off such as Maruti Udyog Limited and modern Foods India.
- c. The government has established the board of Industrial and financial reconstruction for the revival of the sick industries.
- d. The government had given the award of Navratnas to the nine high-performing public sector undertaking. This help to bring about professionalism and to enable them to compete effectively in the market.
- e. The number of industries that will be reserved only for the public sector reduced from 17 to 8. Only railway,

atomic mineral, and atomic energy sectors were reserved for the public sector.

c. Globalization: Globalisation is the process of rapid integration and interdependence of the various economies of the world. The following policies were undertaken in regard to globalization:

a. The government has reduced and eliminated many duties and taxes on the import and export of goods for the promotion of free trade.

b. The government had also reduced many tariffs and customs duties.

c. Many steps were also taken to encourage foreign capital investment such as the introduction of Foreign Exchange Management Act and setting up of Special Economic Zones.

Question 3 : National Digital Library of India (NDL India) is a pilot project initiated by the HRD ministry. It works towards developing a framework of virtual repository of learning resources with a single-window search facility. It provides support to all academic levels including researchers, life-long learners and differentlyabled learners free of cost. State the dimensions of business environment highlighted above.

Solution :

The business environment highlighted are:

1. Technological dimension: 'It works towards developing a framework of virtual repository of learning resources with a single-window search facility.'
2. Social dimension: 'It provides support to all academic levels including researchers, life-long learners and differently-abled learners free of cost. '

Question 4 : State the impact of demonetization on interest rates, private wealth and real estate.

Solution :

Impact of demonetization:

1. Interest rates: Cash transactions declined, Bank deposits increased and Increase in financial savings
2. Private wealth: Declined since some high demonetized notes were not returned
3. Real estate: Decline in prices of property

Long answers questions

Question 1: How would you characterize 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 unctioing. 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: The government of India announced Demonetization of ₹ 500 and ₹ 1,000 currency notes with effect from the midnight of November 8, 2016. As a result, the existing ₹ 500 and ₹ 1,000 currency notes ceased to be legal tender from that date. New currency notes of the denomination of ₹ 500 and ₹ 2,000 were issued by Reserve Bank of India after the announcement. This step resulted in a substantial increase in the awareness about and use of Point of Sale machines, e-wallets, digital cash and other modes of cashless transactions. Also, increased transparency in monetary transactions and disclosure led to a rise in government revenue in the form of tax collection.

- a. Enumerate the dimensions of business environment highlighted above.
- b. State the features of Demonetization.

Solution:

a. Dimensions of business environment highlighted above are:

1. Political dimension: 'The government of India announced Demonetization of ₹ 500 and ₹ 1,000 currency notes with effect from the midnight of November 8, 2016.'
2. Legal dimension: 'As a result, the existing ₹ 500 and ₹ 1,000 currency notes ceased to be legal tender from that date.'
3. Technological dimension: 'The step resulted in a substantial increases in the awareness about and use of Point of Sale machines, e-wallets, digital cash and

other modes of cashless transactions.'

b. Features of Demonetization are:

1. Measure of tax administration- black money holders had to declare the unaccounted wealth and pay taxes at penalty rates
2. Measure to avoid tax evasion- indicating the government will not tolerate tax evasion
3. Measure of channelizing savings into the financial system- by depositing money in banks
4. Create 'cash-less' or 'cash-lite' economy- for increasing financial savings and reducing tax evasion

Question 5: 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 6: What are the essential features of:

- i. Liberalisation,
- ii. Privatization and
- 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.

Privatization: Privatization 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, privatization 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).



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