

ECONOMIC & BUSINESS ENVIRONMENT

Chapter

1	Basics of Demand and Supply and Forms of Market Competition	1
2	National Income Accounting and Related Concepts	22
3	Indian Union Budget	39
4	Indian Financial Markets	51
5	Indian Economy	88
6	Entrepreneurship Scenario	108
7	Business Environment	120
8	Key Government Institutions	136

Lesson 1

**BASICS OF DEMAND
AND
SUPPLY
AND FORMS
OF
MARKET
COMPETITION**

THEORY OF DEMAND AND SUPPLY

Meaning of Demand

Demand is an economic principle referring to a consumer's desire to purchase goods and services and willingness to pay a price for a specific good or service.

Law of Demand

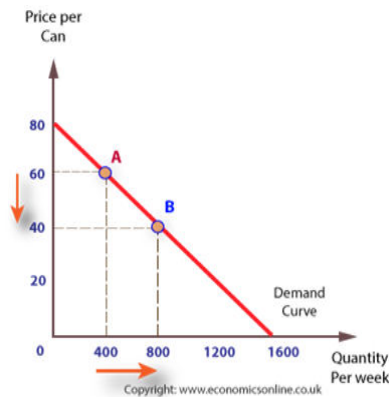
According to the law of demand, other things being equal, if price of a commodity falls, the quantity demanded of it will rise, and if price of the commodity rises, its quantity demanded will decline. It implies that there is an inverse relationship between the price and quantity demanded of a commodity. In other words, other things being equal, quantity demanded will be more at a lower price than at higher price.

The law of demand describes the functional relationship between price and quantity demanded. Among various factors affecting demand, price of a commodity is the most critical factor. Thus, demand of a commodity is mainly determined by the price of commodity.

$$D_x = f(P_x).$$

The law of demand may be understood from the following example:

PRICE PER CAN (INR)	QUANTITY DEMANDED
80	0
70	200
60	400
50	600
40	800
30	1000
20	1200
10	1400
0	1600



Source: *Economics Online*

Thus, it may be observed that with the rise in price per can, the demand for the cans is reducing.

Assumptions of the law of demand

The above stated law of demand is conditional. It is based on certain conditions as given. It is therefore, always stated with the 'other things being equal'. It relates to the change in price variable only, assuming other determinants of demand to be constant. The law of demand is thus, based on the following ceteris paribus assumptions:

1. No Change in Consumer's Income
2. No Change in Consumer's Preferences
3. No Change in the Fashion
4. No Change in the Price of Related Goods
5. No Expectation of Future Price Changes or Shortages
6. No Change in Size, Age Composition and Sex Ratio of the Population
7. No Change in the Range of Goods Available to the Consumers
8. No Change in the Distribution of Income and Wealth of the Community
9. No Change in Government Policy
10. No Change in Weather Conditions

EXCEPTIONS TO THE LAW OF DEMAND

There are few exceptional cases where the law of demand is not applicable, which may be categorised as follows:

Giffen Goods : In the case of certain inferior goods called Giffen goods (named after Sir Robert Giffen), when the prices fall, quite often less quantity will be purchased than before because of the negative income effect and people's increasing preference for a superior commodity with the rise in their real income. Examples of Giffen goods can include bread, rice, and wheat.

Articles of Snob Appeal : Sometimes, certain commodities are demanded just because they happen to be expensive or prestige goods, and have a 'snob appeal'. They satisfy the aristocratic desire to preserve exclusiveness for unique goods.

Speculation : When people speculate about changes in the price of a commodity in the future, they may not act according to the law of demand at the present price, say, when people are convinced that the price of a particular commodity will rise still further, they will not contract their demand with the given price rise: on the contrary, they may purchase more for the purpose of hoarding.

Consumer's Psychological Bias or Illusion : When the consumer is wrongly biased against the quality of the commodity with the price change, he may contract this demand with a fall in price.

Law of Supply

Supply represents how much the market can offer. The quantity supplied refers to the amount of a good producers are willing to supply when receiving a certain price. The supply of a good or service refers to the quantities of that good or service that producers are prepared to offer for sale at a set of prices over a period of time. Supply means a schedule of possible prices and amounts that would be sold at each price. The supply is not the same concept as the stock of something in existence, for example, the stock of commodity X in Delhi means the total quantity of Commodity X in existence at a point of time; whereas, the supply of commodity X in Delhi means the quantity actually being offered for sale, in the market, over a specified period of time.

The law of supply states that a firm will produce and offer to sell greater quantities of a product or service as the price of that product or service rises, other things being equal. There is direct relationship between price and quantity supplied. In this statement, change in price is the cause and change in supply is the effect. Thus, the price rise leads to increase in supply and not otherwise. It may be noted that at higher prices, there is greater incentive to the producers or firms to produce and sell more. Other things include cost of production, change of technology, prices of inputs, level of competition, size of industry, government policy and non-economic factors.

Thus 'Ceteris Paribus'

- (a) With an increase in the price of a good, the producer is willing to offer more quantity in the market for sale.

(b) The quantity supplied is related to the specified time interval over which it is offered.

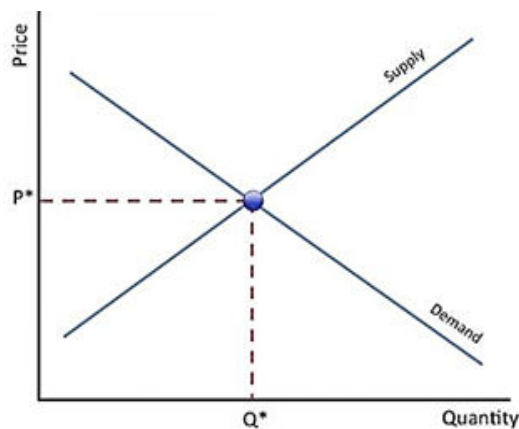
The law of supply is the microeconomic law that states that, all other factors being equal, as the price of a good or service increases, the quantity of goods or services that suppliers offer will increase, and vice versa. The law of supply says that as the price of an item goes up, suppliers will attempt to maximize their profits by increasing the quantity offered for sale.

Assumptions of Law of Supply

The term “other things remaining the same” refers to the following assumptions in the law of supply:

1. No change in the state of technology.
2. No change in the price of factors of production.
3. No change in the number of firms in the market.
4. No change in the goals of the firm.
5. No change in the seller's expectations regarding future prices.
6. No change in the tax and subsidy policy of the products.
7. No change in the price of other goods.

The equilibrium price is the market price where the quantity of goods supplied is equal to the quantity of goods demanded. This is the point at which the demand and supply curves in the market intersect.



Source: Study.com

At equilibrium, there is no shortage or surplus unless a determinant of demand or a determinant of supply changes. If a change in the price of a good or a service creates a shortage, it means that consumers want to buy a higher quantity than the one offered by producers. In this case, demand exceeds supply and consumers are not satisfied. In contrast, if a change in the price of a product or a service creates a surplus, it means that consumers want to buy less quantity than the one offered by producers. In this case, supply exceeds demand and producers need to lower the price of the product or the service to avoid excessive inventory.

Let us take an example to understand the concept.

Price (\$)	Quantity Demanded (kg)	Quantity Supplied (kg)	Surplus (kg)	Shortage (kg)
100	5	50	45	
90	12	41	29	
80	18	35	17	
70	22	28	6	
60	25	25	0	0
50	34	22		12
40	41	18		23
30	47	14		33
20	50	9		41
10	55	5		50

Source: My Accounting Course

In the table above, the quantity demanded is equal to the quantity supplied at the price level of \$60. Therefore, the price of \$60 is the equilibrium price. At any other price level, there is either surplus or shortage. Specifically, for any price that is lower than \$60, the quantity supplied is greater than the quantity demanded, thereby creating a surplus. For any price that is higher than \$60, the quantity demanded is greater than the quantity supplied, thereby creating a shortage.

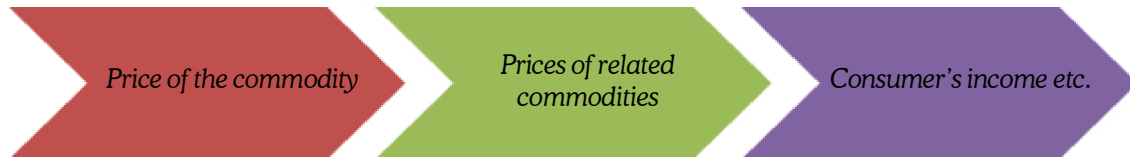
ELASTICITY OF DEMAND

In economics, the demand elasticity (elasticity of demand) refers to how sensitive the demand for a good is to changes in other economic variables, such as prices and consumer income.

Demand elasticity is calculated as the percent change in the quantity demanded divided by a percent change in another economic variable. A higher demand elasticity for an economic variable means that consumers are more responsive to changes in this variable.

“Elasticity of demand is the responsiveness of the quantity demanded of a commodity to changes in

one of the variables on which demand depends. In other words, it is the percentage change in quantity demanded divided by the percentage in one of the variables on which demand depends.” The variables on which demand can depend on are:



There are major three types of elasticity of demand, i.e. Price elasticity; Income elasticity and Cross elasticity. However, this lesson focuses only on price elasticity of demand.

Price Elasticity of Demand

The price elasticity of demand is the response of the quantity demanded to change in the price of a commodity. It is assumed that the consumer's income, tastes, and prices of all other goods are steady. It is measured as a percentage change in the quantity demanded divided by the percentage change in price. Therefore, price elasticity of demand is:

$$E_p = \frac{\text{Percentage Change in Quantity Demanded}}{\text{Percentage Change in Price}}$$

$$\text{Or, } E_p = \frac{\text{Change in Quantity}}{\text{Original Quantity}} \times \frac{\text{Original Price}}{\text{Change in Price}}$$

Types of Price Elasticity of Demand

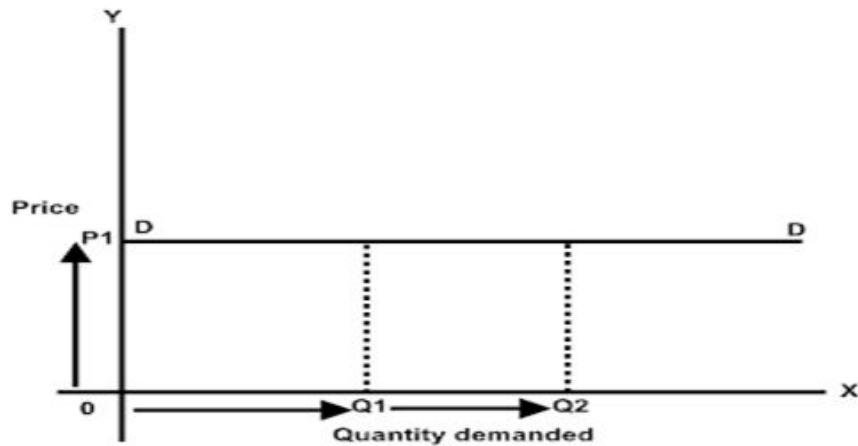
The extent of responsiveness of demand with change in the price is not always the same. The demand for a product can be elastic or inelastic, depending on the rate of change in the demand with respect to change in price of a product.

Elastic demand is the one when the response of demand is greater with a small proportionate change in the price. On the other hand, inelastic demand is the one when there is relatively a less change in the demand with a greater change in the price.

The various forms of price elasticity of demand are as under:

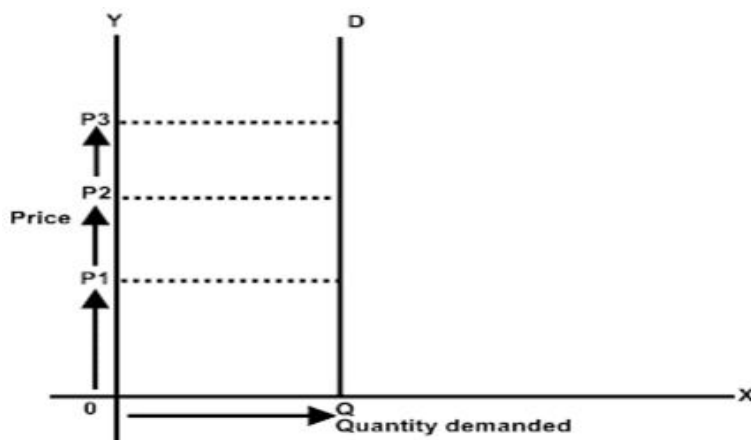
1. *Perfectly Elastic Demand* : When a small change in price of a product causes a major change in its demand, it is said to be perfectly elastic demand. In perfectly elastic demand, a small rise

in price results in fall in demand to zero, while a small fall in price causes increase in demand to infinity. In such a case, the demand is perfectly elastic or $e_p = \infty$.



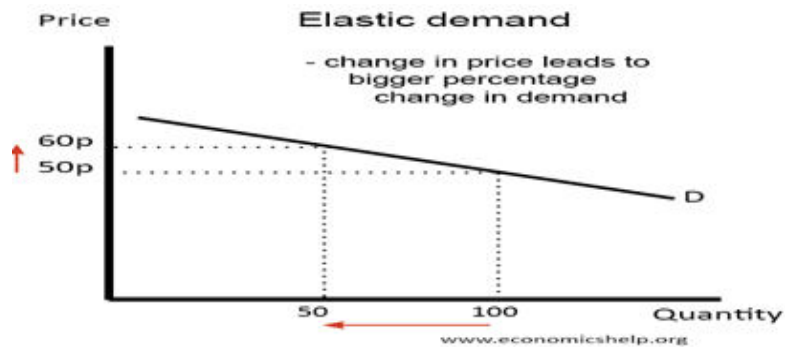
Source: Economics basics

2. *Perfectly Inelastic Demand* : A perfectly inelastic demand is one when there is no change produced in the demand of a product with change in its price. The numerical value for perfectly inelastic demand is zero ($e_p = 0$).



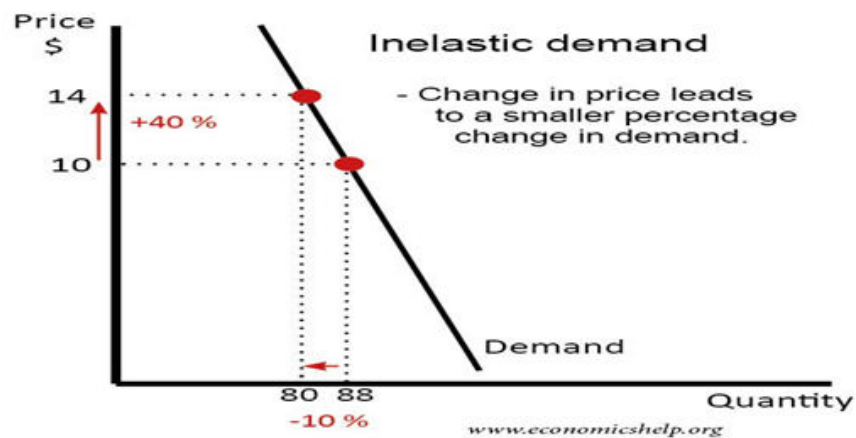
Source: Economics basics

3. *Relatively Elastic Demand* : Relatively elastic demand refers to the demand when the proportionate change produced in demand is greater than the proportionate change in price of a product. The numerical value of relatively elastic demand ranges between one to infinity ($e_p > 1$).



Source: Economics help

4. *Relatively Inelastic Demand*: Relatively inelastic demand is one when the percentage change produced in demand is less than the percentage change in the price of a product. For example, if the price of a product increases by 30% and the demand for the product decreases only by 10%, then the demand would be called relatively inelastic. The numerical value of relatively elastic demand ranges between zero to one ($e_p < 1$).



Source: Economics help

5. *Unitary Elastic Demand* : When the proportionate change in demand produces the same change in the price of the product, the demand is referred as unitary elastic demand. The numerical value for unitary elastic demand is equal to one ($e_p = 1$).



Source: *Economics basics*

A quick recap

Perfectly Elastic Demand ($E_p = \infty$)

Perfectly Inelastic Demand ($E_p = 0$)

Relatively Elastic Demand ($E_p > 1$)

Relatively Inelastic Demand ($E_p < 1$)

Unitary Elastic Demand ($E_p = 1$)

Factors affecting Price Elasticity of Demand

1. *Price Level* : The demand is generally elastic for moderately priced goods but, the demand for very costly and very cheap goods is inelastic. The rich do not bother about the prices of the goods that they buy. Very costly goods are demanded by the rich people and hence their demand is not affected much by change in prices. For example, increase in the price of Toyota car from Rs. 5,00,000 to Rs. 5,20,000 will not make any noticeable difference in its

demand. Similarly, the change in the price of very cheap goods (such as salt) will not have any effect on their demand, for their consumption which is very small and fixed.

2. *Availability of Substitutes* : If a good has close substitutes, the price elasticity of demand for a commodity will be very elastic as some other commodities can be used for it. A small rise in the price of such a commodity will induce consumers to switch their consumption to its substitutes. For example gas, kerosene oil, coal etc. will be used more as fuel if the price of wood increases. On the other hand, the demand of such commodities which have no close substitutes is inelastic, such as salt.
3. *Necessities* : If a good is a necessity, then the demand tends to be inelastic. For example, if the price for drinking water rises, then there is unlikely to be a huge drop in the quantity demanded since drinking water is a necessity.
4. *Time Period* : Over time, a good tends to become more elastic because consumers and businesses have more time to find alternatives or substitutes. For example, if the price of gasoline goes up, over time people will adjust for the change, i.e., they may drive less or use public transportation or form carpools.
5. *Habits* : The demand for addictive or habitual products is usually inelastic. This is because the consumer has no choice but to pay whatever the producer is demanding. For example, if the price for a pack of cigarettes goes up, it will likely not have any effect on demand.
6. *Nature of the Commodities* : The demand for necessities is inelastic and that for comforts and luxuries is elastic. This is so because certain goods which are essential will be demanded at any price, whereas goods meant for luxuries and comforts can be dispensed with easily if they appear to become costlier.
7. *Various Uses* : A commodity which has several uses will have an elastic demand such as milk, wood etc. On the other hand, a commodity having only one or fewer uses will have inelastic demand. The consumer finds it easier to adjust the quantity demanded of a good when it is to be used for satisfying several wants than if it is confined to a single or few uses. For this reason, a multiple-use good tends to have more elastic demand.
8. *Postponing Consumption* : Usually the demand for commodities, the consumption of which can be postponed, is elastic as the prices rise and are expected to fall again. For example, the demand for mp3 is elastic because its use can be postponed for some time if its price goes up, but the demand for rice and wheat is inelastic because their use cannot be postponed when their prices increase.

Income Elasticity of Demand

Income elasticity of demand is the degree of responsiveness of demand to the change in income. Prof. Watson defines it as : "Income elasticity of demand is the rate of change of quantity with respect to changes in the income, other determinants remaining constant." The income elasticity of demand can be measured by the following formula :

$$E_y = \text{Percentage change in quantity demanded} / \text{Percentage change in income}$$

$$\text{Percentage change in quantity demanded} = \frac{\text{New quantity demanded } (\Delta Q)}{\text{Original quantity demanded } (Q)}$$

Percentage change in income = New income (ΔY)/original income (Y)

Symbolically,

$$E_y = \Delta Q/Q \times \Delta Y/Y$$

Income elasticity of demand, thus explains the responsiveness of demand to a change in income. Ordinarily, demand for most goods increases with increase in household's level of income. Demand for inferior goods, however, shows a negative relation to change in income.

Types of Income Elasticity of Demand

Income elasticity of demand can be of five different types : These are tabulated with description below:

<i>S.No.</i>	<i>Numerical Measure of Income elasticity of demand</i>	<i>Verbal description</i>
1.	Negative Demand for a commodity falls as income rises.	The trend is visible in case of inferior goods.
2.	Zero Demand for a commodity does not change as income changes.	This is true in the case of essential goods.
3.	Greater than zero but less than one.	Demand for commodity rises in proportion to a rise in income.
4.	Unity	Demand for commodity rises in the same proportion as rise in income.
5.	Greater than the unity	Demand for commodity rises more than in proportion to rise in income.

Cross Elasticity of Demand

The responsiveness of demand to changes in prices of related commodities is called cross elasticity of demand. Prof. Watson defines it as, "Cross elasticity of demand is the rate of change in quantity associated with a change in the price of related goods." Thus cross elasticity of demand is the responsiveness of demand for commodity X to change in price of commodity Y and is represented as follows :

Symbolically :

Cross Elasticity of Demand E_c

% increase in quantity demanded of A

% increase in price of product B

The relationship between X and Y commodities may be substitutive as in case of tea and coffee or complementary as in the case of ball pens and refills. Main measures of cross elasticity with description are as follows :

1. Cross elasticity = Infinity (Commodity X is nearly a perfect substitute for commodity Y)
2. Cross elasticity = Zero (Commodity X and Y are not related)
3. Cross elasticity = Negative (Commodities X and Y are complementary)

Thus, if E_c approaches infinity, it means that commodity X is nearly a perfect substitute for commodity Y. On the other hand, if E_c approaches Zero it would mean that the two commodities in question are not related at all. E_c shall be negative when commodity Y is complementary to commodity X.

INCREASE AND DECREASE IN DEMAND AND EXPANSION AND CONTRACTION OF DEMAND

Increase in Demand and Decrease in Demand

Changes in demand include an increase or decrease in demand. Due to the change in the price of related goods, the income of consumers, and the preferences of consumers, etc. the demand for a product or service changes.

- (a) *Increase in Demand* : When demand changes not because of price but because of changes in other determinants of demand, it is a case of either increase or decrease in demand. "Increase in demand means more demand at same price".

Increases in demand are shown by a shift to the right in the demand curve. This could be caused by a number of factors, including a rise in income, a rise in the price of a substitute or a fall in the price of a complement.



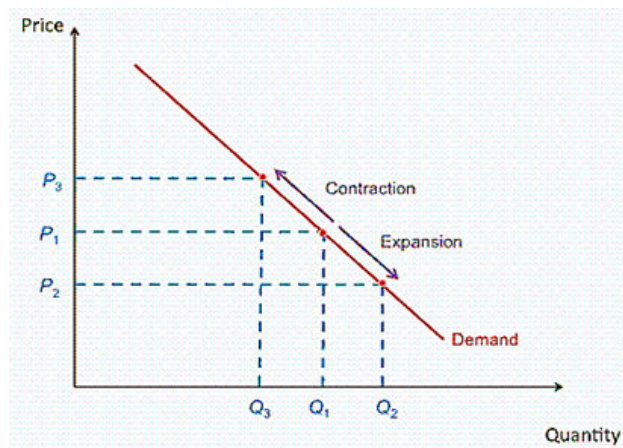
- (b) *Decrease in Demand*: Decrease in demand means, "Less demand at same price". Demand can

decrease and cause a shift to the left of the demand curve for a number of reasons, including a fall in income, assuming a good is a normal good, a fall in the price of a substitute and a rise in the price of a complement.



Expansion and Contraction of Demand

When quantity demanded of a commodity increases as a result of the fall in the price, it is called extension (or expansion) in demand and when the quantity demanded decreases as a result of an increase in the price of the commodity, it is called contraction in demand. The following is the diagrammatical presentation of expansion and contraction of demand:



Source: knowledgate.com

FORMS OF MARKET COMPETITION

A variety of market structures will characterize an economy. Such market structures essentially refer to the degree of competition in a market.

There are other determinants of market structures such as the nature of the goods and products, the number of sellers, number of consumers, the nature of the product or service, economies of scale etc. We will discuss the five basic types of market structures in any economy.

(1) *Perfect Competition*

In a perfect competition market structure, there are a large number of buyers and sellers. All the sellers of the market are small sellers in competition with each other. There is no one big seller with any significant influence on the market. So, all the firms in such a market are price takers.

There are certain assumptions when discussing the perfect competition. This is the reason a perfect competition market is pretty much a theoretical concept. These assumptions are as follows,

- The products on the market are homogeneous, i.e. they are completely identical
- All firms only have the motive of profit maximization
- There is free entry and exit from the market, i.e. there are no barriers
- And there is no concept of consumer preference

(2) *Monopolistic Competition*

This is a more realistic scenario that actually occurs in the real world. In monopolistic competition, there are still a large number of buyers as well as sellers. But they all do not sell homogeneous products. The products are similar but all sellers sell slightly differentiated products.

Now the consumers have the preference of choosing one product over another. The sellers can also charge a marginally higher price since they may enjoy some market power. So, the sellers become the price setters to a certain extent.

For example, the market for cereals is a monopolistic competition. The products are all similar but slightly differentiated in terms of taste and flavours. Another such example is toothpaste.

(3) *Oligopoly*

In an oligopoly, there are only a few firms in the market. While there is no clarity about the number of firms, 3-5 dominant firms are considered the norm. So, in the case of an oligopoly, the buyers are far greater than the sellers.

The firms in this case either compete with another to collaborate together, They use their market influence to set the prices and in turn maximize their profits. So, the consumers become the price takers. In an oligopoly, there are various barriers to entry in the market, and new firms find it difficult to establish themselves.

(4) *Monopoly*

In a monopoly type of market structure, there is only one seller, so a single firm will control the entire market. It can set any price it wishes since it has all the market power. Consumers do not have any alternative and must pay the price set by the seller. Monopolies are extremely undesirable. Here the consumers lose all their power and market forces become irrelevant. However, a pure monopoly is very rare in reality.

(5) *Duopoly*

A duopoly is a kind of oligopoly: a market dominated by a small number of firms. In the case of a duopoly, a particular market or industry is dominated by just two firms (this is in contrast to the more widely-known case of the monopoly when just one company dominates).

In very rare cases, this means they are the only two firms in the entire market (this almost never occurs); in practice, it usually means the two duopolistic firms have a great deal of influence, and their actions, as well as their relationship to each other, powerfully shape their industry. Duopolistic markets are imperfectly competitive, so entry barriers are typically significant for those attempting to enter the market, but there are usually still other, smaller businesses persisting alongside the two dominant firms.

ELASTICITY OF SUPPLY

The elasticity of supply establishes a quantitative relationship between the supply of a commodity and its price. Hence, we can express the numeral change in supply with the change in the price of a commodity using the concept of elasticity. Note that elasticity can also be calculated with respect to the other determinants of supply.

However, the major factor controlling the supply of a commodity is its price. Therefore, we generally talk about the price elasticity of supply. The price elasticity of supply is the ratio of the percentage change in the price to the percentage change in quantity supplied of a commodity.

$$E_s = [\Delta q/q] \times 100 \div [(\Delta p/p) \times 100] = (\Delta q/q) \div (\Delta p/p)$$

Δq = The change in quantity supplied

q = The quantity supplied

Δp = The change in price

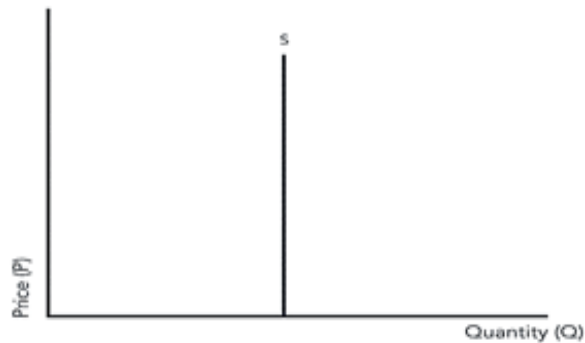
p = The price

Types of Price Elasticity of Supply

1. *Perfectly Inelastic Supply* : A service or commodity has a perfectly inelastic supply if a given quantity of it can be supplied whatever might be the price. The elasticity of supply for such a service or commodity is zero. A perfectly inelastic supply curve is a straight line parallel to the Y-axis. This is representative of the fact that the supply remains the same irrespective of the price.

The supply of exclusive items, like the painting of Mona Lisa, falls into this category. Whatever might be the price on offer, there is no way we can increase its supply.

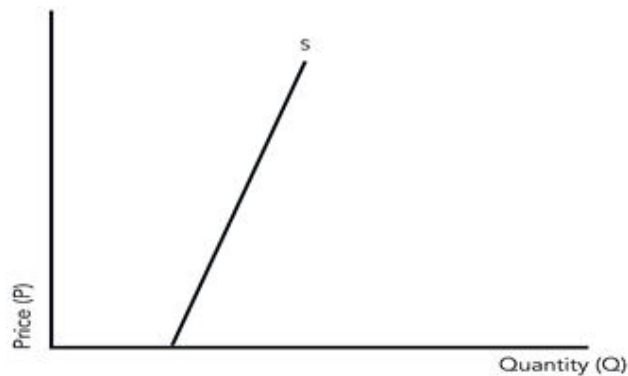
($PES = 0$), The Quantity Supplied doesn't change as the price changes.



Source: *Intelligent Economist*

2. *Relatively Less-Elastic Supply* : When the change in supply is relatively less when compared to the change in price, we say that the commodity has a relatively-less elastic supply. In such a case, the price elasticity of supply assumes a value less than 1.

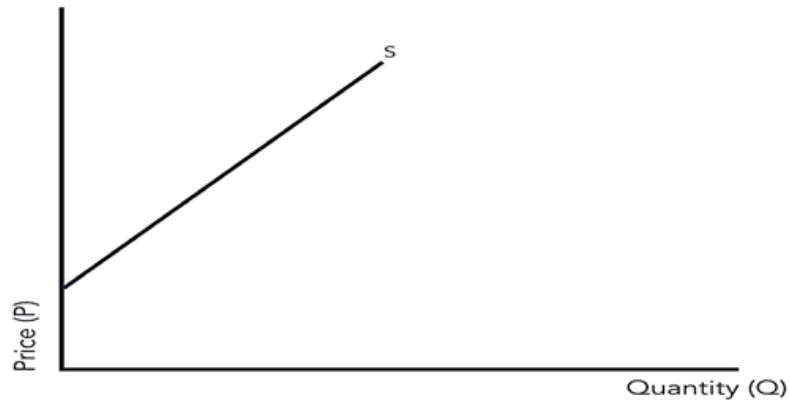
($0 < PES < 1$), Quantity Supplied changes by a lower percentage than a percentage change in price.



Source: *Intelligent Economist*

3. *Relatively Greater-Elastic Supply* : When the change in supply is relatively more when compared to the change in price, we say that the commodity has a relatively greater-elastic supply. In such a case, the price elasticity of supply assumes a value greater than 1.

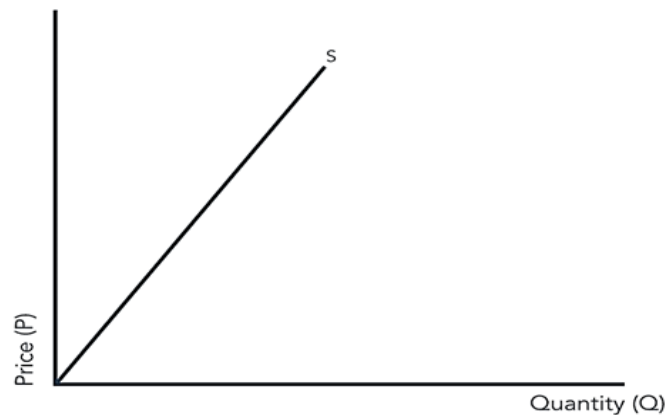
($1 < PES < 8$), The Quantity Supplied changes by a larger percentage than the percentage change in price.



Source: *Intelligent Economist*

4. *Unitary Elastic Supply* : For a commodity with a unit elasticity of supply, the change in quantity supplied of a commodity is exactly equal to the change in its price. In other words, the change in both price and supply of the commodity are proportionately equal to each other. To point out, the elasticity of supply in such a case is equal to one. Further, a unitary elastic supply curve passes through the origin.

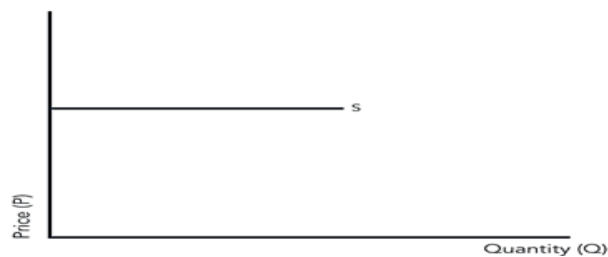
($PES = 1$), Quantity Supplied changes by the same percentage as the change in price.



Source: *Intelligent Economist*

5. *Perfectly Elastic supply* : A commodity with a perfectly elastic supply has an infinite elasticity. In such a case the supply becomes zero with even a slight fall in the price and becomes infinite with a slight rise in price. This is indicative of the fact that the suppliers of such a commodity are willing to supply any quantity of the commodity at a higher price. A perfectly elastic supply curve is a straight line parallel to the X-axis.

($PES = \infty$), Suppliers will be willing and able to supply any amount at a given price but none at a different price.



Source: Intelligent Economist

Factors influencing the elasticity of supply

1. *Price of the Good* : The supply and elasticity of supply of a good depend upon the price of the good. If the price of a good increases or decreases, the quantity supplied of it will also increase or decrease, respectively. This is the law of supply. Also the coefficient of price-elasticity of supply (ES) will depend on the price of the good. ES may be greater than, less than, or equal to one, depending on the price.
2. *Probability that the Price would Change in Future* : If the sellers think that the price of the good will increase (or decrease) in near future, then, at any particular price at present, they would want to decrease (or increase) their supply. In this case, the supply curve for the good would shift to the left (or to the right).
3. *Conditions regarding Cost of Production* : If the cost of production of a good increases (or decreases), i.e., if its cost curve shifts upwards (or downwards), then the quantity supplied of the good would decrease (or increase) at any particular price, i.e., the supply curve would shift to the left (or to the right).
4. *Nature of the Good* : The supply of a good depends upon the nature of the good, e.g., on the perishability and lumpiness of the good. The more the perishability or lumpiness of the good, the more would be its market localised, and, in a localised market, the supply of a good at any particular price would be relatively small.
5. *Length of Time* : If the price of a good rises, then by how much would supply rise, or, how large will be the price-elasticity of supply, would depend on the length of time available for the necessary adjustments (e.g., in the quantities of the factor inputs used) to complete. That is why; the elasticity of supply in the long-period market would be larger than that in the short-period market.

Sample Questions

1. No change in habits, customs and income of consumers is the assumption of which law of economics?
 - a. Law of Demand**
 - b. Law of Supply
 - c. Laws of Production
 - d. Law of Diminishing Marginal Utility

2. A service or commodity has a _____, if a given quantity of it can be supplied whatever might be its price
 - a. Relatively Less-Elastic Supply
 - b. Unitary Elastic Supply
 - c. Perfectly Elastic supply**
 - d. Perfectly Inelastic Supply

3. _____ refers to the market situation in which there is a keen competition, but neither perfect nor pure, among a group of a large number of small producers or suppliers having some degree of monopoly because of the differentiation of their products
 - a. Perfect Competition
 - b. Monopolistic Competition**
 - c. Duopoly
 - d. Oligopoly

4. When demand changes not because of price but because of changes in other determinants of demand, it is a case of _____.
 - a. Either Expansion or Contraction of Demand
 - b. Either Increase or Decrease of Demand**

- c. Either Rise or Fall in Demand
 - d. Either Acceleration or Deceleration in Demand
5. When quantity demanded of a commodity increases as a result of the fall in the price, it is called _____ in demand
- a. Increase in Demand
 - b. Extension in Demand**
 - c. Rise in Demand
 - d. Acceleration in Demand

Lesson 2

**NATIONAL INCOME
ACCOUNTING
AND
RELATED CONCEPTS**

INTRODUCTION

National income is an uncertain term which is used interchangeably with national dividend, national output and national expenditure. On this basis, national income has been defined in a number of ways. In common parlance, national income means the total value of goods and services produced annually in a country.

In other words, the total amount of income accruing to a country from economic activities in a year's time is known as national income. It includes payments made to all resources in the form of wages, interest, rent and profits.

National Income or Net National Income is Gross National Income or Gross National Product less depreciation. It is to be noted that National Income includes Net Factor Income Earned from Abroad also. While computing National Income only finished or final goods are considered as factoring intermediate goods used for manufacturing would amount to double counting. It includes taxes but does not include subsidies.

METHODS TO MEASURE NATIONAL INCOME

There are three methods of measuring national income of a country. They yield the same result. These methods are:

- (1) The Product Method or Value Added Method.
- (2) The Income Method.
- (3) The Expenditure Method

(1) The Product Method : The Product method measures the contribution of each producing enterprise in the domestic territory of the country. This method involves the following steps:

- (a) Identifying the producing enterprise and classifying them into individual sectors according to their activities.
- (b) Estimating net value added by each producing enterprise as well as each industrial sector and adding up the net value added by all the sectors.

Goods and services are counted in gross domestic product (GDP) at their market values. The product approach defines a nation's gross product as that market value of goods and services currently produced within a nation during a one year period of time.

The product approach measuring national income involves adding up the value of all the final goods and services produced in the country during the year. Here we focus on various sectors of the economy and add up all their production during the year. The main sectors whose production value is added up are:

- (i) agriculture (ii) manufacturing (iii) construction (iv) transport and communication (v) banking (vi) administration and defence and (vii) distribution of income.

Precautions for Product Method or Value Added Method

- (i) *Problem of double counting* : When we add up the value of output of various sectors, we should be careful to avoid double counting. This pitfall can be avoided by either counting (the final value of the output or by including the extra value that each firm adds to an item.
- (ii) *Value addition in particular year* : While calculating national income, the values of goods added in the particular year in question are added up. The values which had previously been added to the stocks of raw material and goods have to be ignored. GDP thus includes only those goods, and services that are newly produced within the current period.
- (iii) *Stock appreciation* : Stock appreciation, if any, must be deducted from value added. This is necessary as there is no real increase in output.
- (iv) *Production for self consumption* : The production of goods for self consumption should be counted while measuring national income. In this method, the production of goods for self consumption should be valued at the prevailing market prices.

(2) Expenditure Method : The expenditure approach measures national income as total spending on final goods and services produced within nation during a year. The expenditure approach to measuring national income is to add up all expenditures made for final goods and services at current market prices by households, firms and government during a year. Total aggregate final expenditure on final output thus is the sum of four broad categories of expenditures:

- (i) Consumption (ii) Investment (iii) Government and (iv) Net export.
- (i) *Consumption expenditure (C)* : Consumption expenditure is the largest component of national income. It includes expenditure on all goods and services produced and sold to the final consumer during the year.
- (ii) *Investment expenditure (I)* : Investment is the use of today's resources to expand tomorrow's production or consumption. Investment expenditure is expenditure incurred on by business firms on (a) new plants, (b) adding to the stock of inventories and (c) on newly constructed houses.
- (iii) *Government expenditure (G)* : It is the second largest component of national income. It includes all government expenditure on currently produced goods and services but excludes transfer payments while computing national income.
- (iv) *Net exports (X - M)* : Net exports are defined as total exports minus total imports. National income calculated from the expenditure side is the sum of final consumption expenditure, expenditure by business on plants, government spending and net exports.

Precautions for Expenditure Method

- (i) The expenditure on second hand goods should not be included as they do not contribute to the current year's production of goods.
- (ii) Similarly, expenditure on purchase of old shares and bonds is not included as these also do not represent expenditure on currently produced goods and services.
- (iii) Expenditure on transfer payments by government such as unemployment benefit, old age pensions, interest on public debt should also not be included because no productive service is rendered in exchange by recipients of these payments.

(3) Income Method : Income approach is another alternative way of computing national income, This method seeks to measure national income at the phase of distribution. In the production process of an economy, the factors of production are engaged by the enterprises. They are paid money incomes for their participation in the production. The payments received by the factors and paid by the enterprises are wages, rent, interest and profit. National income thus may be defined as the sum of wages, rent, interest and profit received or occurred to the factors of production in lieu of their services in the production of goods. Briefly, national income is the sum of all income, wages, rents, interest and profit paid to the four factors of production. The four categories of payments are briefly described below:

- (i) *Wages* : It is the largest component of national income. It consists of wages and salaries along with fringe benefits and unemployment insurance.
- (ii) *Rents* : Rents are the income from property received by households.
- (iii) *Interest* : Interest is the income private businesses pay to households who have lent the business money.
- (iv) *Profits*: Profits are normally divided into two categories (a) profits of incorporated businesses and (b) profits of unincorporated businesses (sole proprietorship, partnerships and producers cooperatives).

Precautions for Income Method

While estimating national income through income method, the following precautions should be undertaken.

- (i) Transfer payments such as gifts, donations, scholarships, indirect taxes should not be included in the estimation of national income.
- (ii) Illegal money earned through smuggling and gambling should not be included.
- (iii) Windfall gains such as prizes won, lotteries etc. is not be included in the estimation of national income.

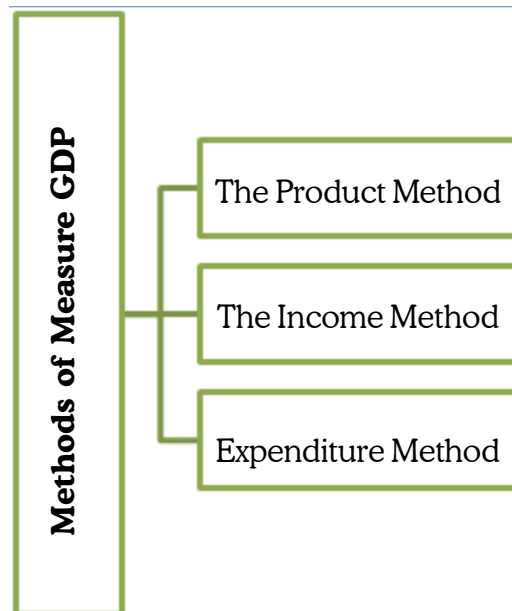
- (iv) Receipts from the sale of financial assets such as shares, bonds should not be included in measuring national income as they are not related to generation of income in the current year production of goods.

KEY CONCEPTS OF NATIONAL INCOME

Gross Domestic Product (GDP)

GDP is the total value of goods and services produced within the country during a year. This is calculated at market prices and is known as GDP at market prices. Dernberg defines GDP at market price as “the market value of the output of final goods and services produced in the domestic territory of a country during an accounting year.”

There are three different ways to measure GDP:



- (a) *The Product Method* : In this method, the value of all goods and services produced in different industries during the year is added up. This is also known as the value added method to GDP or GDP at factor cost by industry of origin. The following items are included in India in this: agriculture and allied services; mining; manufacturing, construction, electricity, gas and water supply; transport, communication and trade; banking and insurance, real estates and ownership of dwellings and business services; and public administration and defence and other services (or government services). In other words, it is the sum of gross value added.

- (b) *The Income Method* : The people of a country who produce GDP during a year receive incomes from their work. Thus GDP by income method is the sum of all factor incomes: Wages and Salaries (compensation of employees) + Rent + Interest + Profit.
- (c) *Expenditure Method* : This method focuses on goods and services produced within the country during one year. GDP by expenditure method includes:
1. Consumer expenditure on services and durable and non-durable goods (C).
 2. Investment in fixed capital such as residential and non-residential building, machinery, and inventories (I).
 3. Government expenditure on final goods and services (G).
 4. Export of goods and services produced by the people of country (X).
 5. Less imports (M). That part of consumption, investment and government expenditure which is spent on imports is subtracted from GDP. Similarly, any imported component, such as raw materials, which is used in the manufacture of export goods, is also excluded.

Thus GDP by expenditure method at market prices = $C + I + G + (X - M)$, where $(X - M)$ is net export which can be positive or negative.

GDP at Factor Cost

GDP at factor cost is the sum of net value added by all producers within the country. Since the net value added gets distributed as income to the owners of factors of production, GDP is the sum of domestic factor incomes and fixed capital consumption (or depreciation).

Thus GDP at Factor Cost = Net value added + Depreciation.

GDP at factor cost includes:

- (a) Compensation of employees i.e., wages, salaries, etc.
- (b) Operating surplus which is the business profit of both incorporated and unincorporated firms [Operating Surplus = Gross Value Added at Factor Cost—Compensation of Employees—Depreciation].
- (c) Mixed Income of Self- employed.

Conceptually, GDP at factor cost and GDP at market price must be identical/This is because the factor cost (payments to factors) of producing goods must equal the final value of goods and services at market prices. However, the market value of goods and services is different from the earnings of the factors of production.

In GDP at market price indirect taxes are included and subsidies by the government are excluded. Therefore, in order to arrive at GDP at factor cost, indirect taxes are subtracted and subsidies are added to GDP at market price.

Thus, $\text{GDP at Factor Cost} = \text{GDP at Market Price} - \text{Indirect Taxes} + \text{Subsidies}$.

- (i) *Net Domestic Product (NDP)* : NDP is the value of net output of the economy during the year. Some of the country's capital equipment wears out or becomes obsolete each year during the production process. The value of this capital consumption is some percentage of gross investment which is deducted from GDP. Thus $\text{Net Domestic Product} = \text{GDP at Factor Cost} - \text{Depreciation}$.
- (ii) *Nominal and Real GDP* : When GDP is measured on the basis of current price, it is called GDP at current prices or nominal GDP. On the other hand, when GDP is calculated on the basis of fixed prices in some year, it is called GDP at constant prices or real GDP.

Nominal GDP is the value of goods and services produced in a year and measured in terms of rupees (money) at current (market) prices. In comparing one year with another, we are faced with the problem that the rupee is not a stable measure of purchasing power. GDP may rise a great deal in a year, not because the economy has been growing rapidly but because of rise in prices (or inflation).

On the contrary, GDP may increase as a result of fall in prices in a year but actually it may be less as compared to the last year. In both 5 cases, GDP does not show the real state of the economy. To rectify the underestimation and overestimation of GDP, we need a measure that adjusts for rising and falling prices.

This can be done by measuring GDP at constant prices which is called real GDP. To find out the real GDP, a base year is chosen when the general price level is normal, i.e., it is neither too high nor too low. The prices are set to 100 (or 1) in the base year.

Now the general price level of the year for which real GDP is to be calculated is related to the base year on the basis of the following formula which is called the deflator index:

$$\text{Real GDP} = \frac{\text{GDP for the Current Year} \times \text{Base Year (100)}}{\text{Current Year Index}}$$

GDP Deflator

GDP deflator is an index of price changes of goods and services included in GDP. It is a price index which is calculated by dividing the nominal GDP in a given year by the real GDP for the same year and multiplying it by 100. Thus,

$$\text{GDP Deflator} = \frac{\text{Nominal (or Current Prices) GDP}}{\text{Real (or Constant Prices) GDP}} \times 100$$

Gross National Product (GNP)

GNP is the total measure of the flow of goods and services at market value resulting from current production during a year in a country, including net income from abroad.

GNP includes four types of final goods and services:

1. Consumers' goods and services to satisfy the immediate wants of the people;
2. Gross private domestic investment in capital goods consisting of fixed capital formation, residential construction and inventories of finished and unfinished goods;
3. Goods and services produced by the government; and
4. Net exports of goods and services, i.e., the difference between value of exports and imports of goods and services, known as net income from abroad.

In this concept of GNP, there are certain factors that have to be taken into consideration:

First, GNP is the measure of money, in which all kinds of goods and services produced in a country during one year are measured in terms of money at current prices and then added together.

Second, in estimating GNP of the economy, the market price of only the final products should be taken into account. Many of the products pass through a number of stages before they are ultimately purchased by consumers.

If those products were counted at every stage, they would be included many a time in the national product. Consequently, the GNP would increase too much. To avoid double counting, therefore, only the final products and not the intermediary goods should be taken into account.

Third, goods and services rendered free of charge are not included in the GNP, because it is not possible to have a correct estimate of their market price. For example, the bringing up of a child by the mother, imparting instructions to his son by a teacher, recitals to his friends by a musician, etc.

Fourth, the transactions which do not arise from the produce of current year or which do not contribute in any way to production are not included in the GNP. The sale and purchase of old goods, and of shares, bonds and assets of existing companies are not included in GNP because these do not make any addition to the national product, and the goods are simply transferred.

Fifth, the payments received under social security, e.g., unemployment insurance allowance, old age pension, and interest on public loans are also not included in GNP, because the recipients do not provide any service in lieu of them. But the depreciation of machines, plants and other capital goods is not deducted from GNP.

Sixth, the profits earned or losses incurred on account of changes in capital assets as a result of fluctuations in market prices are not included in the GNP if they are not responsible for current production or economic activity.

For example, if the price of a house or a piece of land increases due to inflation, the profit earned by selling it will not be a part of GNP. But if, during the current year, a portion of a house is constructed anew, the increase in the value of the house (after subtracting the cost of the newly constructed portion) will be included in the GNP. Similarly, variations in the value of assets, that can be ascertained beforehand and are insured against flood or fire, are not included in the GNP.

Last, the income earned through illegal activities is not included in the GNP. Although the goods sold in the black market are priced and fulfil the needs of the people, but as they are not useful from the social point of view, the income received from their sale and purchase is always excluded from the GNP.

There are two main reasons for this. One, it is not known whether these things were produced during the current year or the preceding years. Two, many of these goods are foreign made and smuggled and hence not included in the GNP.

Three Approaches to GNP

After having discussed the basic constituents of GNP, it is essential to know how it is estimated. Three approaches are employed for this purpose. One, the income method to GNP; two, the expenditure method to GNP and three, the value added method to GNP. Since gross income equals gross expenditure, GNP estimated by all these methods would be the same with appropriate adjustments.

- 1. Income Method to GNP :** The income method to GNP consists of the remuneration paid in terms of money to the factors of production annually in a country.

Thus GNP is the sum total of the following items:

- (a) *Wages and salaries :* Under this head are included all forms of wages and salaries earned through productive activities by workers and entrepreneurs. It includes all sums received or deposited during a year by way of all types of contributions like overtime, commission, provident fund, insurance, etc.
- (b) *Rents :* Total rent includes the rents of land, shop, house, factory, etc. and the estimated rents of all such assets as are used by the owners themselves.
- (c) *Interest :* Under interest comes the income by way of interest received by the individual of a country from different sources. To this is added, the estimated interest on that private capital which is invested and not borrowed by the businessman in his personal business. But the interest received on governmental loans has to be excluded, because it is a mere transfer of national income.
- (d) *Dividends :* Dividends earned by the shareholders from companies are included in the GNP.
- (e) *Undistributed corporate profits :* Profits which are not distributed by companies and are retained by them are included in the GNP.

- (f) *Mixed incomes* : These include profits of unincorporated business, self-employed persons and partnerships. They form part of GNP.
- (g) *Direct taxes* : Taxes levied on individuals, corporations and other businesses are included in the GNP.
- (h) *Indirect taxes* : The government levies a number of indirect taxes, like excise duties and sales tax. These taxes are included in the price of commodities. But revenue from these goes to the government treasury and not to the factors of production. Therefore, the income due to such taxes is added to the GNP.
- (i) *Depreciation* : Every corporation makes allowance for expenditure on wearing out and depreciation of machines, plants and other capital equipment. Since this sum also is not a part of the income received by the factors of production, it is, therefore, also included in the GNP.
- (j) *Net income earned from abroad* : This is the difference between the value of exports of goods and services and the value of imports of goods and services. If this difference is positive, it is added to the GNP and if it is negative, it is deducted from the GNP.

GNP according to the Income Method = Wages and Salaries + Rents + Interest + Dividends + Undistributed Corporate Profits + Mixed Income + Direct Taxes + Indirect Taxes + Depreciation + Net Income from abroad.

- 2. Expenditure Method to GNP** : From the expenditure view point, GNP is the sum total of expenditure incurred on goods and services during one year in a country.

It includes the following items:

- (a) *Private consumption expenditure* : It includes all types of expenditure on personal consumption by the individuals of a country. It comprises expenses on durable goods like watch, bicycle, radio, etc., expenditure on single-used consumers' goods like milk, bread, ghee, clothes, etc., as also the expenditure incurred on services of all kinds like fees for school, doctor, lawyer and transport. All these are taken as final goods.
- (b) *Gross domestic private investment* : Under this comes the expenditure incurred by private enterprise on new investment and on replacement of old capital. It includes expenditure on house construction, factory- buildings, and all types of machinery, plants and capital equipment.

In particular, the increase or decrease in inventory is added to or subtracted from it. The inventory includes produced but unsold manufactured and semi-manufactured goods during the year and the stocks of raw materials, which have to be accounted for in GNP. It does not take into account the financial exchange of shares and stocks because their sale and purchase is not real investment. But depreciation is added.

- (c) *Net foreign investment* : It means the difference between exports and imports or export

surplus. Every country exports to or imports from certain foreign countries. The imported goods are not produced within the country and hence cannot be included in national income, but the exported goods are manufactured within the country. Therefore, the difference of value between exports (X) and imports (M), whether positive or negative, is included in the GNP.

- (d) *Government expenditure on goods and services* : The expenditure incurred by the government on goods and services is a part of the GNP. Central, state or local governments spend a lot on their employees, police and army. To run the offices, the governments have also to spend on contingencies which include paper, pen, pencil and various types of stationery, cloth, furniture, cars, etc.

It also includes the expenditure on government enterprises. But expenditure on transfer payments is not added, because these payments are not made in exchange for goods and services produced during the current year.

Thus GNP according to the Expenditure Method = Private Consumption Expenditure (C) + Gross Domestic Private Investment (I) + Net Foreign Investment (X-M) + Government Expenditure on Goods and Services (G) = $C + I + (X-M) + G$.

- 3. Value Added Method to GNP** : Another method of measuring GNP is by value added. In calculating GNP, the money value of final goods and services produced at current prices during a year is taken into account. This is one of the ways to avoid double counting. But it is difficult to distinguish properly between a final product and an intermediate product.

For instance, raw materials, semi-finished products, fuels and services, etc. are sold as inputs by one industry to the other. They may be final goods for one industry and intermediate for others. So, to avoid duplication, the value of intermediate products used in manufacturing final products must be subtracted from the value of total output of each industry in the economy.

Thus, the difference between the value of material outputs and inputs at each stage of production is called the value added. If all such differences are added up for all industries in the economy, we arrive at the GNP by value added. $\text{GNP by value added} = \text{Gross value added} + \text{net income from abroad}$.

GNP at Market Prices

When we multiply the total output produced in one year by their market prices prevalent during that year in a country, we get the Gross National Product at market prices. Thus GNP at market prices means the gross value of final goods and services produced annually in a country plus net income from abroad.

GNP at Market Prices = GDP at Market Prices + Net Income from Abroad.

GNP at Factor Cost

GNP at factor cost is the sum of the money value of the income produced by and accruing to the various factors of production in one year in a country. It includes all items mentioned above under income method to GNP less indirect taxes.

GNP at market prices always includes indirect taxes levied by the government on goods which raise their prices. But GNP at factor cost is the income which the factors of production receive in return for their services alone. It is the cost of production.

Thus GNP at market prices is always higher than GNP at factor cost. Therefore, in order to arrive at GNP at factor cost, we deduct indirect taxes from GNP at market prices. Again, it often happens that the cost of production of a commodity to the producer is higher than a price of a similar commodity in the market.

In order to protect such producers, the government helps them by granting monetary help in the form of a subsidy equal to the difference between the market price and the cost of production of the commodity. As a result, the price of the commodity to the producer is reduced and equals the market price of similar commodity.

For example if the market price of rice is Rs. 3 per kg but it costs the producers in certain areas Rs. 3.50. The government gives a subsidy of 50 paise per kg to them in order to meet their cost of production. Thus in order to arrive at GNP at factor cost, subsidies are added to GNP at market prices.

$$\text{GNP at Factor Cost} = \text{GNP at Market Prices} - \text{Indirect Taxes} + \text{Subsidies.}$$

Net National Product (NNP)

NNP includes the value of total output of consumption goods and investment goods. But the process of production uses up a certain amount of fixed capital. Some fixed equipment wears out, its other components are damaged or destroyed, and still others are rendered obsolete through technological changes.

All this process is termed depreciation or capital consumption allowance. In order to arrive at NNP, we deduct depreciation from GNP. The word 'net' refers to the exclusion of that part of total output which represents depreciation. So $\text{NNP} = \text{GNP} - \text{Depreciation}$.

NNP at Market Prices

Net National Product at market prices is the net value of final goods and services evaluated at market prices in the course of one year in a country. If we deduct depreciation from GNP at market prices, we get NNP at market prices.

$$\text{NNP at Market Prices} = \text{GNP at Market Prices} - \text{Depreciation.}$$

NNP at Factor Cost

Net National Product at factor cost is the net output evaluated at factor prices. It includes income earned by factors of production through participation in the production process such as wages and salaries, rents, profits, etc. It is also called National Income. This measure differs from NNP at market prices in that indirect taxes are deducted and subsidies are added to NNP at market prices in order to arrive at NNP at factor cost. Thus

$$\begin{aligned} \text{NNP at Factor Cost} &= \text{NNP at Market Prices} - \text{Indirect taxes} + \text{Subsidies} \\ &= \text{GNP at Market Prices} - \text{Depreciation} - \text{Indirect taxes} + \text{Subsidies.} \\ &= \text{National Income.} \end{aligned}$$

Normally, NNP at market prices is higher than NNP at factor cost because indirect taxes exceed government subsidies. However, NNP at market prices can be less than NNP at factor cost when government subsidies exceed indirect taxes.

Domestic Income

Income generated (or earned) by factors of production within the country from its own resources is called domestic income or domestic product.

Domestic income includes:

- (i) Wages and salaries, (ii) rents, including imputed house rents, (iii) interest, (iv) dividends, (v) undistributed corporate profits, including surpluses of public undertakings, (vi) mixed incomes consisting of profits of unincorporated firms, self-employed persons, partnerships, etc., and (vii) direct taxes.

Since domestic income does not include income earned from abroad, it can also be shown as: Domestic Income = National Income - Net income earned from abroad. Thus the difference between domestic income and national income is the net income earned from abroad. If we add net income from abroad to domestic income, we get national income, i.e., National Income = Domestic Income + Net income earned from abroad.

But the net national income earned from abroad may be positive or negative. If exports exceed import, net income earned from abroad is positive. In this case, national income is greater than domestic income. On the other hand, when imports exceed exports, net income earned from abroad is negative and domestic income is greater than national income.

Private Income

Private income is income obtained by private individuals from any source, productive or otherwise, and the retained income of corporations. It can be arrived at from NNP at Factor Cost by making certain additions and deductions.

The additions include transfer payments such as pensions, unemployment allowances, sickness and

other social security benefits, gifts and remittances from abroad, windfall gains from lotteries or from horse racing, and interest on public debt. The deductions include income from government departments as well as surpluses from public undertakings, and employees' contribution to social security schemes like provident funds, life insurance, etc.

$$\text{Private Income} = \text{National Income (or NNP at Factor Cost)} + \text{Transfer Payments} + \text{Interest on Public Debt} - \text{Social Security} - \text{Profits and Surpluses of Public Undertakings.}$$

Personal Income

Personal income is the total income received by the individuals of a country from all sources before payment of direct taxes in one year. Personal income is never equal to the national income, because the former includes the transfer payments whereas they are not included in national income.

Personal income is derived from national income by deducting undistributed corporate profits, profit taxes, and employees' contributions to social security schemes. These three components are excluded from national income because they do not reach individuals.

But business and government transfer payments, and transfer payments from abroad in the form of gifts and remittances, windfall gains, and interest on public debt which are a source of income for individuals are added to national income.

$$\text{Personal Income} = \text{National Income} - \text{Undistributed Corporate Profits} - \text{Profit Taxes} - \text{Social Security Contribution} + \text{Transfer Payments} + \text{Interest on Public Debt.}$$

Personal income differs from private income in that it is less than the latter because it excludes undistributed corporate profits.

$$\text{Personal Income} = \text{Private Income} - \text{Undistributed Corporate Profits} - \text{Profit Taxes}$$

Disposable Income

Disposable income or personal disposable income means the actual income which can be spent on consumption by individuals and families. The whole of the personal income cannot be spent on consumption, because it is the income that accrues before direct taxes have actually been paid. Therefore, in order to obtain disposable income, direct taxes are deducted from personal income. Thus, Disposable Income = Personal Income – Direct Taxes.

But the whole of disposable income is not spent on consumption and a part of it is saved. Therefore, disposable income is divided into consumption expenditure and savings. Thus Disposable Income = Consumption Expenditure + Savings.

If disposable income is to be deduced from national income, we deduct indirect taxes plus subsidies, direct taxes on personal and on business, social security payments, undistributed corporate profits or business savings from it and add transfer payments and net income from abroad to it.

Disposable Income = National Income – Business Savings – Indirect Taxes + Subsidies – Direct Taxes on Persons – Direct Taxes on Business – Social Security Payments + Transfer Payments + Net Income from abroad.

Real Income

Real income is national income expressed in terms of a general level of prices of a particular year taken as base. National income is the value of goods and services produced as expressed in terms of money at current prices. But it does not indicate the real state of the economy.

It is possible that the net national product of goods and services this year might have been less than that of the last year, but owing to an increase in prices, NNP might be higher this year. On the contrary, it is also possible that NNP might have increased but the price level might have fallen, as a result national income would appear to be less than that of the last year. In both the situations, the national income does not depict the real state of the country. To rectify such a mistake, the concept of real income has been evolved.

In order to find out the real income of a country, a particular year is taken as the base year when the general price level is neither too high nor too low and the price level for that year is assumed to be 100. Now the general level of prices of the given year for which the national income (real) is to be determined is assessed in accordance with the prices of the base year. For this purpose the following formula is employed.

Real NNP = NNP for the Current Year x Base Year Index (= 100) / Current Year Index

Per Capita Income

The average income of the people of a country in a particular year is called Per Capita Income for that year. This concept also refers to the measurement of income at current prices and at constant prices. For instance, in order to find out the per capita income for 2018, at current prices, the national income of a country is divided by the population of the country in that year.

$$\text{Per Capita Income for 2018} = \frac{\text{National Income for 2018}}{\text{Population of 2018}}$$

Similarly, for the purpose of arriving at the Real Per Capita Income, this very formula is used.

$$\text{Real Per Capita Income for 2018} = \frac{\text{Real National Income for 2018}}{\text{Population of 2018}}$$

This concept enables us to know the average income and the standard of living of the people. But it is not very reliable, because in every country due to unequal distribution of national income, a major portion of it goes to the richer sections of the society and thus income received by the common man is lower than the per capita income.

Sample Questions

1. _____ means the actual income which can be spent on consumption by individuals and families.
(a) Personal Disposable Income
(b) Net National Income
(c) Gross National Income
(d) Per Capita Income
2. The formula to derive NNP at Factor Cost is:
(a) NNP at Market Prices + Subsidies
(b) NNP at Market Prices – Indirect taxes - Subsidies
(c) NNP at Market Prices + Indirect taxes + Subsidies
(d) NNP at Market Prices – Indirect taxes+ Subsidies
3. _____ is an index of price changes of goods and services included in GDP.
(a) GDP Inflator
(b) GDP deflator
(c) GDP accelerator
(d) GDP decelerator
4. The formula to compute GDP at Factor Cost is:
(a) Net value added - Depreciation
(b) Net value added x Depreciation
(c) Net value added + Depreciation.
(d) Net value added / Depreciation

5. The formula to determine Real GDP is:

(a) Nominal GDP / GDP Deflator x 100

(b) GDP of the Previous Year x Base Year (100) / Current Year Index

(c) GDP of the Current Year / Current Year Index

(d) GDP of the Current Year x Current Year Index

Lesson 3

Indian Union Budget

OVERVIEW OF INDIAN UNION BUDGET

- The first Indian Budget was presented by Mr James Wilson on February 18, 1869 after Indian Budget was introduced on April 7, 1860 by the East India Company.
- The first Budget of Independent India was presented by the then Finance Minister, Mr RK Shanmukham Chetty on November 26, 1947.
- Till 1955, Budget was only printed in English language. However, from 1955-56, budget started getting printed in both languages, Hindi and English.
- In the British Era, the Budget used to be presented at 5 PM. This practice was discontinued in the year 2001 by presenting the Budget at 11 AM.
- Until 2017, the ritual was to present the Budget on the last working day of the February. From last 2 years, Budget is now presented on the first working day of the February.
- Mr KC Neogy and Mr HN Bahuguna were the only two Finance Ministers who did not present any Indian Budget.
- The record of presenting maximum number of Budgets is held by Shri Morarji Desai for presenting 10 Budgets.
- For the first time in 92 years, Union Budget of 2017 merged the Union Budget with the Rail Budget, which was usually presented separately.

KEY TERMINOLOGIES / HEADS COVERED UNDER THE BUDGET

1. Annual Financial Statement

Article 112 of the Constitution requires the government to present to Parliament a statement of estimated receipts and expenditure in respect of every financial year - April 1 to March 31. This statement is the annual financial statement.

The annual financial statement is usually a white 10-page document. It is divided into three parts, consolidated fund, contingency fund and public account. For each of these funds, the government has to present a statement of receipts and expenditure.

2. Consolidated Fund

This is the most important of all government funds. All revenues raised by the government, money borrowed and receipts from loans given by the government flow into the consolidated fund of India. All government expenditure is made from this fund, except for exceptional items met from the Contingency Fund or the Public Account. Importantly, no money can be withdrawn from this fund without the Parliament's approval.

3. Demand For Grants

Demand for Grants is the form in which estimates of expenditure from the Consolidated Fund, included in the annual financial statement and required to be voted upon in the Lok Sabha, are submitted in pursuance of Article 113 of the Constitution.

The demand for grants includes provisions with respect to revenue expenditure, capital expenditure, grants to State and Union Territory governments together with loans and advances. Generally, one demand for grant is presented in respect of each ministry or department. However, for large ministries and departments, more than one demand is presented.

4. Appropriation Bill

Appropriation Bill gives power to the government to withdraw funds from the Consolidated Fund of India for meeting the expenditure during the financial year. Post the discussions on Budget proposals and the Voting on Demand for Grants, the government introduces the Appropriation Bill in the Lok Sabha. It is intended to give authority to the government to withdraw from the Consolidated Fund, the amounts so voted for meeting the expenditure during the financial year.

5. Finance Bill

A Finance Bill is a Money Bill as defined in Article 110 of the Constitution. The proposals of the government for levy of new taxes, modification of the existing tax structure or continuance of the existing tax structure beyond the period approved by Parliament are submitted to Parliament through this bill.

The Finance Bill is accompanied by a Memorandum containing explanations of the provisions included in it. The Finance Bill can be introduced only in Lok Sabha. However, the Rajya Sabha can recommend amendments in the Bill. The bill has to be passed by the Parliament within 75 days of its introduction.

6. Contingency Fund

As the name suggests, any urgent or unforeseen expenditure is met from this fund. The Rs 500-crore fund is at the disposal of the President. Any expenditure incurred from this fund requires a subsequent approval from Parliament and the amount withdrawn is returned to the fund from the consolidated fund.

7. Public Account

This fund is to account for flows for those transactions where the government is merely acting as a banker. For instance, provident funds, small savings and so on. These funds do

not belong to the government. They have to be paid back at some time to their rightful owners. Because of this nature of the fund, expenditure from it are not required to be approved by the Parliament.

For each of these funds the government has to present a statement of receipts and expenditure. It is important to note that all money flowing into these funds is called receipts, the funds received, and not revenue. Revenue in budget context has a specific meaning.

The Constitution requires that the budget has to distinguish between receipts and expenditure on revenue account from other expenditure. So all receipts in, say consolidated fund, are split into Revenue Budget (revenue account) and Capital Budget (capital account), which includes non-revenue receipts and expenditure. For understanding these budgets - Revenue and Capital - it is important to understand revenue receipts, revenue expenditure, capital receipts and capital expenditure.

8. Revenue receipt/Expenditure

All receipts and expenditure that in general do not entail sale or creation of assets are included under the revenue account. On the receipts side, taxes would be the most important revenue receipt. On the expenditure side, anything that does not result in creation of assets is treated as revenue expenditure. Salaries, subsidies and interest payments are good examples of revenue expenditure.

9. Capital receipt/Expenditure

All receipts and expenditure that liquidate or create an asset would in general be under capital account. For instance, if the government sells shares (disinvests) in public sector companies, like it did in the case of Maruti, it is in effect selling an asset. The receipts from the sale would go under capital account. On the other hand, if the government gives someone a loan from which it expects to receive interest, that expenditure would go under capital account. On the other hand, if the government gives someone a loan from which it expects to receive interest, that expenditure would go under the capital account.

In respect of all the funds the government has to prepare a revenue budget (detailing revenue receipts and revenue expenditure) and a capital budget (capital receipts and capital expenditure). Contingency fund is clearly not that important. Public account is important in that it gives a view of select savings and how they are being used, but not that relevant from a budget perspective. The consolidated fund is the key to the budget.

As mentioned in the first part, the government has to present a revenue budget (revenue account) and capital budget (capital account) for all the three funds. The revenue account of the consolidated fund is split into two parts, receipts and disbursements - simply, income and expenditure. Receipts are broadly tax revenue, non-tax revenue and grants-in-aid and contributions.

Preparing a Budget is extremely tedious and a lengthy process. It begins with the Budget Division issuing circular to all ministries, states, UTs, autonomous bodies, departments and the defence forces, who are asked to submit expenditure estimates for the upcoming year. Extensive consultations are held between Union ministries and the Department of Expenditure of the finance ministry once the estimates have been submitted.

In the meantime, the Department of Economic Affairs (DEA) and Department of Revenue meet stakeholders such as farmers, businessmen, FIIs, economists and civil society groups to take their views. Once the pre-Budget meetings are over, a final call on the tax proposals is taken by the finance minister. The proposals are discussed with the Prime Minister before the Budget is finally prepared.

The Budget presentation speech comprises the following parts:

- Annual Financial Statement (AFS)
 - Demand for Grants (DG)
 - Appropriation Bill
 - Finance Bill
- Macro-economic framework for the relevant financial year
 - Medium-Term fiscal policy and a strategy statement
 - Expenditure Profile
 - Expenditure Budget
 - Receipts Budget

REVENUE, CAPITAL AND EXPENDITURE BUDGETS

Revenue Budget

The Revenue Budget records all the revenue receipts and expenditure. If the revenue expense is more than that of receipts, it indicates that there is a revenue deficit. Revenue expenditure is for the normal running of government departments and various services, interest payments on debt, subsidies, etc. Revenue receipts are divided into tax and non-tax revenue. Tax revenues are made up of taxes such as income tax, corporate tax, excise, customs and other duties that the government levies.

In non-tax revenue, the government's sources are interest on loans and dividend on investments like PSUs, fees, and other receipts for services that it renders.

Capital Budget

The Capital Budget part of the Union Budget has accounts for capital payment and receipts of the government. Capital receipts include:

- (i) Loans from the public;
- (ii) Loans from RBI

Capital receipts are loans raised by the government from the public (which are called market loans), borrowings by the government from the Reserve Bank of India and other parties through sale of treasury bills, loans received from foreign bodies and governments, and recoveries of loans granted by the Central government to state and Union Territory governments and other parties.

Capital payments include expenses incurred towards building long term assets and facilities like land, buildings, machinery, etc.

Expenditure Budget

The expenditure budget refers to the estimated expenditure of the government during a given financial year. It shows the capital and revenue disbursements of various ministries/departments and presents it under 'Plan' and Non Plan'. Expenditure Budget provides analysis of various types of expenditure. Demand for grants of the Central government is also a part of the Expenditure Budget.

MAJOR COMPONENTS OF REVENUE AND CAPITAL BUDGET

Revenue Budget

Government receipts which neither create asset nor reduce any liability are called Revenue Receipts. Essentially, these are current income receipts for the government from all sources. Revenue Receipts are further classified into tax revenue and non-tax revenue.

Tax Revenue will include receipts from direct tax which is in the form of income tax is paid to the government. It will also include various indirect taxes like GST and Cess levied and collected by the government on various goods and services.

Non-tax Revenue will include receipts from the government's divestment process which are nothing but the proceeds from the stake sale in various public sector undertakings. Non-tax Revenue will also include the dividend income which the government receives as a shareholder of the various public sector undertakings.

As the name suggests, Revenue Expenditure is also called income statement expenditure. It denotes short-term cost-related assets that are not capitalised. To put it simply, these are the maintenance

expenditure which the government makes towards the assets which it owns in order to keep them functioning. These expenditures are recurring in nature and are incurred by the government regularly.

Revenue Expenditure does not create an asset for the government. For example, payment of salaries or pension as it does not create any asset. However, the amount spent on construction of Metro is not Revenue Expenditure as it leads to the creation of an asset.

Revenue Expenditure also must not decrease the liability for the government. For example, repayment of borrowings is not Revenue Expenditure as it leads to a reduction in liability of the government.

The difference between Revenue Receipt and Revenue Expenditure is known as Revenue Deficit. A Revenue Deficit does not denote an actual loss of revenue for the government but it only means a shortfall in revenue from what was expected by the government.

Capital Budget

Capital Budget is one of the two parts of the government budget. Generally, the budget is divided into revenue budget and capital budget. This classification is made by considering the items that comes under the two budget components. Capital budget is considered to be productive as it shows the investment type activities of the government.



Capital budget consists of capital receipts and payments. The capital receipts are:

- (1) loans raised by Government from public, called market loans, borrowings by Government from Reserve Bank and other parties through sale of Treasury Bills, loans received from foreign Governments and bodies,
- (2) disinvestment receipts and
- (3) recoveries of loans from State and Union Territory Governments and other parties.

Capital expenditure consists of expenditure for acquiring of assets like land, buildings, machinery, equipment, investments in shares, etc., and loans and advances granted by Central Government to State and Union Territory Governments, Government companies, Corporations and other parties.

FISCAL DEFICIT

A fiscal deficit is a shortfall in a government's income compared with its spending. The government that has a fiscal deficit is spending beyond its means.

A fiscal deficit is calculated as a percentage of gross domestic product (GDP), or simply as total dollars spent in excess of income. In either case, the income figure includes only taxes and other revenues and excludes money borrowed to make up the shortfall.

In other words, fiscal deficit is the difference between the total income of the government (total taxes and non-debt capital receipts) and its total expenditure. A fiscal deficit situation occurs when the government's expenditure exceeds its income. This difference is calculated both in absolute terms and also as a percentage of the Gross Domestic Product (GDP) of the country. A recurring high fiscal deficit means that the government has been spending beyond its means.

The government describes fiscal deficit of India as “the excess of total disbursements from the Consolidated Fund of India, excluding repayment of the debt, over total receipts into the Fund (excluding the debt receipts) during a financial year”.

The elements of the fiscal deficits are:

- (a) The revenue deficit, which is the difference between the government's current or revenue expenditure and total current receipts, that is excluding borrowing.
- (b) Capital expenditure.

In order to have a proper understanding on fiscal deficit, it is essential to have a fair idea on government's total income and receipts.

1. *Revenue Receipts*
 - Corporation Tax
 - Income Tax
 - Custom Duties
 - Union Excise Duties
2. *Non-tax Revenues*
 - Interest Receipts
 - Dividends and Profits
 - External Grants
 - Other non-tax revenues
 - Receipts of union territories
3. *Expenditures of the government*
 - Revenue Expenditure

- Capital Expenditure
- Interest Payments
- Grants-in-aid for creation of capital assets

Fiscal Deficit = Total expenditure of the government (capital and revenue expenditure) – Total income of the government (Revenue receipts + recovery of loans + other receipts)

If the total expenditure of the government exceeds its total revenue and non-revenue receipts in a financial year, then that gap is the fiscal deficit for the financial year. The fiscal deficit is usually mentioned as a percentage of GDP. For example, if the gap between the Centre's expenditure and total income is Rs 5 lakh crore and the country's GDP is Rs 200 lakh crore, the fiscal deficit is 2.5% of the GDP.

COMPONENTS / VARIABLES COVERED UNDER FISCAL DEFICIT

From the following exhibit, the various components covered under the fiscal deficit may be understood

(INR Crore)

	Actuals 2017-18	Budgeted 2018-19	Revised 2018-19	Budgeted 2019-20	% change (RE 2018-19 to BE 2019-20)
Revenue Expenditure	18,78,833	21,41,772	21,40,612	24,47,780	14.3%
Capital Expenditure	2,63,140	3,00,441	3,16,623	3,38,569	6.9%
Total Expenditure	21,41,973	24,42,213	24,57,235	27,86,349	13.4%
Revenue Receipts	14,35,233	17,25,738	17,29,682	19,62,761	13.5%
Capital Receipts	1,15,678	92,199	93,155	1,19,828	28.6%
of which:					
Recoveries of Loans	15,633	12,199	13,155	14,828	12.7%
Other receipts (including disinvestments)	1,00,045	80,000	80,000	1,05,000	31.3%
Total Receipts (without borrowings)	15,50,911	18,17,937	18,22,837	20,82,589	14.2%
Revenue Deficit	4,43,600	4,16,034	4,10,930	4,85,019	18.0%
% of GDP	2.6	2.2	2.2	2.3	
Fiscal Deficit	5,91,062	6,24,276	6,34,398	7,03,760	10.9%
% of GDP	3.5	3.3	3.4	3.3	
Primary Deficit	62,110	48,481	46,828	43,289	-7.6%
% of GDP	0.4	0.3	0.2	0.2	

Note: Budgeted estimates (BE) are budget allocations announced at the beginning of each financial

year. Revised Estimates (RE) are estimates of projected amounts of receipts and expenditure until the end of the financial year. Actual amounts are audited accounts of expenditure and receipts in a year.

The fiscal deficit for the year 2017-18 (Actuals) is calculated by deducting Total Receipts of INR 15,50,911 from the Total Expenditure of INR 21,41,973 = INR 5,91,062 Crore.

It is to be noted that fiscal deficit could be financed by borrowing from Reserve Bank of India, which also known as deficit financing or money creation and market borrowing (from money market, that is mainly from banks).

Sample Questions

1. If the revenue expense is more than that of receipts, it indicates that there is a _____.
 - (a) Primary Deficit
 - (b) Fiscal Deficit
 - (c) Monetary Deficit
 - (d) Revenue Deficit**
2. The _____ records all the revenue receipts and expenditure.
 - (a) Capital Budget
 - (b) Cash Budget
 - (c) Revenue Budget**
 - (d) Foreign Exchange Budget
3. Government receipts which neither create asset nor reduce any liability are called _____.
 - (a) Revenue Receipts**
 - (b) Capital Receipts
 - (c) Cash Receipts
 - (d) Financial Receipts
4. Which of the following is not covered under the revenue receipts of Government of India?
 - (a) Corporation Tax
 - (b) Loans from RBI**
 - (c) Income Tax
 - (d) Custom Duties

5. Payment of salaries is covered under which form of government expenditure?

(a) Revenue Expenditure

(b) Capital Expenditure

(c) Planned Expenditure

(d) Unplanned Expenditure

Lesson 4

**Indian
Financial Markets**

OVERVIEW OF INDIAN FINANCIAL ECOSYSTEM

The financial system of an economy is a crucial element for its economic development. It facilitates the flow of funds from the households (savers) to business organisations (investors), thereby assisting in creation of wealth for the nation. Mainly, the financial system of a country is concerned with the following:

- (a) Allocation and mobilisation of savings.
- (b) Provision of funds.
- (c) Facilitating the financial transactions.
- (d) Developing financial markets.
- (e) Provision of legal financial structure.
- (f) Provision of financial and advisory services.

The important features of a financial are-

- (i) It plays an important role in economic development of a country.
- (ii) It encourages both savings and investment
- (iii) It links savers and investors.
- (iv) It assists in capital formation.
- (v) It facilitates expansion of financial markets.

India has a diversified financial sector undergoing rapid expansion, both in terms of strong growth of existing financial services firms and new entities entering the market. The sector comprises commercial banks, insurance companies, non-banking financial companies, co-operatives, pension funds, mutual funds and other smaller financial entities. The banking regulator has allowed new entities such as payments banks to be created recently thereby adding to the types of entities operating in the sector.

In other words, financial services sector consists of the capital markets, insurance sector and non-banking financial companies (NBFCs). India's gross national savings (GDS) as a percentage of Gross Domestic Product (GDP) stood at 30.50 per cent in 2019. The total amount of Initial Public Offerings increased to Rs 84,357 crore (US\$ 13,089 million) by the end of FY18. IPO's reached to US\$ 1.94 billion in FY19 (up to Feb 2019). Ultra High Net Worth Individual (UHNWI) increased to 2,697 in 2018 and the population of UHNWI has grown by 118 per cent from 2013 to 2018.

Noteworthy developments in Indian Financial Ecosystem

- Rising incomes are driving the demand for financial services across income brackets.
- Financial inclusion drive from RBI has expanded the target market to semi-urban and rural areas.
- Investment corpus in Indian insurance sector can rise to US\$ 1 trillion by 2025.
- Credit, insurance and investment penetration is rising in rural areas.
- HNWI (High Networth Individual) participation is growing in the wealth management segment.
- Lower mutual fund penetration of 5–6 per cent reflects latent growth opportunities.
- The Government of India launched India Post Payments Bank (IPPB), to provide every district with one branch which will help increase rural penetration.
- India benefits from a large cross-utilisation of channels to expand reach of financial services.
- Maharashtra has launched its mobile wallet facility allowing transferring of funds from other mobile wallets. Maharashtra is the first state to launch it.
- As of October 2018, the Financial Inclusion Lab has selected 11 fintech innovators with an investment of US\$ 9.5 million promoted by the IIM-Ahmedabad's Bharat Inclusion Initiative (BII) along with JP Morgan, Michael and Susan Dell Foundation, and the Bill and Melinda Gates Foundation.
- Government has approved new banking licenses and increased the FDI limit in the insurance sector.

KEY FACETS AND GROWTH OF FINANCIAL INSTITUTIONS IN INDIA

The significant characteristics of Indian financial system are as under:

1. Plays a pivotal role in accelerating the rate and volume of savings through provision of different financial instruments and efficient mobilisation of savings.
2. It is playing a significant role in increasing the national output by providing funds to corporate customers to expand their business operations.
3. Safeguarding the interests of the investors by ensuring smooth financial transactions through regulatory bodies like, Reserve Bank of India (RBI), Securities and Exchange Board of India (SEBI) etc.

4. Contributes substantially towards the economic development and raising the standard of living of the people.
5. Promotes development of weaker section of the society through rural development banks and cooperative societies.
6. Assist corporate customers to make better financial decisions by offering effective financial and advisory services.
7. Facilitates financial deepening and broadening. Financial deepening refers to increase in financial assets as a percentage of GDP and financial broadening pertains to increasing number of participants in the financial system.

The growth of Indian financial system may be broadly covered for banking, mutual funds and insurance.

(1) Banking Sector

The banking industry handles finances in a country including cash and credit. Banks are the institutional bodies that accept deposits and grant credit to the entities and play a major role in maintaining the economic stature of a country. Given their importance in the economy, banks are kept under strict regulation in most of the countries. In India, the Reserve Bank of India (RBI) is the apex banking institution that regulates the monetary policy in the country.

Banks are classified into classified into four categories –

- (i) Commercial Banks
- (ii) Small Finance Banks
- (iii) Payments Banks
- (iv) Co-operative Banks

A brief description of the aforesaid forms of banks is as under:

- (i) *Commercial Banks* : Commercial Banks can be further classified into public sector banks, private sector banks, foreign banks and Regional Rural Banks (RRB). On the other hand, cooperative banks are classified into urban and rural. Apart from these, a fairly new addition to the structure is payments bank. Commercial Banks are regulated under the Banking Regulation Act, 1949 and their business model is designed to make profit. Their primary function is to accept deposits and grant loans to the general public, corporate and government.

Public sector banks are the nationalised banks and account for more than 75 per cent of the total banking business in the country. Majority of stakes in these banks are held by the government.

Private sector banks are those in which major stake or equity is held by private shareholders. All the banking rules and regulations laid down by the RBI will be applicable on private sector banks as well.

A foreign bank is one that has its headquarters in a foreign country but operates in India as a private entity. These banks are under the obligation to follow the regulations of its home country as well as the country in which they are operating.

Regional Rural Banks (RRBs) are also scheduled commercial banks but they are established with the main objective of providing credit to weaker sections of the society like agricultural labourers, marginal farmers and small enterprises. They usually operate at regional levels in different states of India and may have branches in selected urban areas as well. Other important functions carried out by RRBs include-

- Providing banking and financial services to rural and semi-urban areas.
 - Government operations like disbursement of wages of MGNREGA workers, distribution of pensions, etc.
 - Para-Banking facilities like debit cards, credit cards and locker facilities
- (ii) *Small Finance Banks* : This is a niche banking segment in the country and is aimed to provide financial inclusion to sections of the society that are not served by other banks. The main customers of small finance banks include micro industries, small and marginal farmers, unorganized sector entities and small business units. These are licensed under Section 22 of the Banking Regulation Act, 1949 and are governed by the provisions of RBI Act, 1934 and FEMA.
- (iii) *Payments Bank* : This is a relatively new model of bank in the Indian Banking industry. It was conceptualised by the RBI and is allowed to accept a restricted deposit. they also offer services like ATM cards, debit cards, net-banking and mobile-banking. The following are the payments bank in India:
- India Post Payments Bank
 - Fino Payments Bank
 - Paytm Payments Bank
 - Airtel Payments Banks

Comparison between Traditional Banks and Payment Banks

Features	Traditional Banks	Payment Banks
Accept deposits	Yes	Yes
Pay Interest on Deposits	Yes	Yes
Withdrawal facility for customers	Yes	Yes
Provide loans or involve in lending activities	Yes	No
Issue credit cards	Yes	No
Investment products	Yes	Yes
Maximum Deposit limit	No limit	Rs.1 lakh only per individual customer.

Source: *fintrakk.com*

(iv) *Urban Co-operative Banks* : Urban Co-operative Banks refer to the primary cooperative banks located in urban and semi-urban areas. These banks essentially lent to small borrowers and businesses centered around communities, localities work place groups.

(v) *State Co-operative Banks* : A State Cooperative Bank is a federation of the central cooperative bank which acts as custodian of the cooperative banking structure in the State.

The major developments of Indian banking sector is captured in the following table-

Years	Major Developments
1921	<ul style="list-style-type: none"> • Closed market • State-owned Imperial Bank of India was the only bank existing.
1935	<ul style="list-style-type: none"> • RBI was established as the central bank of country. • Quasi central banking role of Imperial Bank came to an end.
1936-1955	<ul style="list-style-type: none"> • Imperial Bank expanded its network to 480 branches. • In order to increase penetration in rural areas, Imperial Bank was converted into State Bank of India.

- | | |
|--------------|--|
| 1956-2000 | <ul style="list-style-type: none"> • Nationalisation of 14 large commercial banks in 1969 & 6 more banks in 1980. • Entry of private players such as ICICI intensifying the competition. • Gradual technology upgradation in PSU banks . |
| 2000 onwards | <ul style="list-style-type: none"> • In 2003, Kotak Mahindra Finance Ltd received a banking license from RBI and became the first NBFC to be converted into a bank • In 2009, the government removed the Banking Cash Transaction Tax which had been introduced in 2005. |
| 2018 onwards | <ul style="list-style-type: none"> • As per Union Budget 2019-2020, Provision coverage ratio of banks reached highest in 7 years. • As per RBI, as of November 30, 2018, India recorded foreign exchange reserves of approximately US\$ 393.72 billion. |

As of May 29, 2019, there are 20 Public Sector Banks, 22 Private Sector Banks, 44 Foreign Banks, 56 Regional Rural Banks (RRBs), 1542 Urban Co-operative Banks and 94,384 Rural Co-operative Banks. However, after the mergers, the country will have 12 public sector banks including State Bank of India and Bank of Baroda . Bank of India and Central Bank of India will continue to remain independent. It is interesting to note that credit off-take has been surging ahead over the past decade, aided by strong economic growth, rising disposable incomes, increasing consumerism & easier access to credit. During FY07-18, credit off-take grew at a CAGR of 10.94 per cent. As of Q3 FY19, total credit extended surged to Rs 93,751.17 billion (US\$ 1,299.39 billion). Demand has grown for both corporate & retail loans; particularly the services, real estate, consumer durables & agriculture allied sectors have led the growth in credit. Credit to non-food industries increased by 12.3 per cent year-on-year reaching Rs 86,334 billion (US\$ 1.24 trillion) in March 29, 2019.

To capture the rural areas Indian banks are expanding their businesses. According to RBI, Under Financial Inclusion Plan, 598,093 banking outlets were provided in villages as on March 2017. As of September 2018, Ministry of Finance, Government of India launched the Financial Inclusion Index. This index will measure access, usage and quality to financial services.

As of September 2018, Department of Financial Services (DFS), Ministry of Finance and National Informatics Centre (NIC) launched Jan Dhan Darshak as a part of financial inclusion initiative. It is a mobile app to help people locate financial services in India.

The increasingly dynamic business scenario & financial sophistication has increased the need for customised exotic financial products. Banks are developing innovative financial products & advanced risk management methods to capture the market share. Bank of Maharashtra tied up with Cigna TTK, to market their insurance products across India.

With entry of foreign banks, competition in the Indian banking sector has intensified. Banks are increasingly looking at consolidation to derive greater benefits such as enhanced synergy cost take-outs from economies of scale, organisational efficiency & diversification of risks.

(2) Mutual Funds

A mutual fund is an investment security that enables investors to pool their money together into one professionally managed investment. Mutual funds can invest in stocks, bonds, cash or a combination of those assets.

<i>Phases</i>	<i>Major Developments</i>
First Phase (1964-1987)	The Mutual Fund industry in India started in 1963 with formation of UTI in 1963 by an Act of Parliament and functioned under the Regulatory and administrative control of the Reserve Bank of India (RBI). In 1978, UTI was de-linked from the RBI and the Industrial Development Bank of India (IDBI) took over the regulatory and administrative control in place of RBI. Unit Scheme 1964 (US '64) was the first scheme launched by UTI. At the end of 1988, UTI had Rs. 6,700 crores of Assets Under Management (AUM).
Second Phase (1987-1993)	The year 1987 marked the entry of public sector mutual funds set up by Public Sector banks and Life Insurance Corporation of India (LIC) and General Insurance Corporation of India (GIC). SBI Mutual Fund was the first 'non-UTI' mutual fund established in June 1987, followed by Canbank Mutual Fund (Dec. 1987), Punjab National Bank Mutual Fund (Aug. 1989), Indian Bank Mutual Fund (Nov 1989), Bank of India (Jun 1990), Bank of Baroda Mutual Fund (Oct. 1992). LIC established its mutual fund in June 1989, while GIC had set up its mutual fund in December 1990. At the end of 1993, the MF industry had assets under management of Rs. 47,004 crores.
Third Phase (1993-2003)	The Indian securities market gained greater importance with the establishment of SEBI in April 1992 to protect the interests of the investors in securities market and to promote the development of, and to regulate, the securities market. In the year 1993, the first set of SEBI Mutual Fund Regulations came into being for all mutual funds, except UTI. The erstwhile Kothari Pioneer (now merged with Franklin Templeton MF) was the first private sector MF registered in July 1993. With the entry of private sector funds in 1993, a new era began in the Indian MF industry, giving the Indian investors a wider choice

of MF products. The initial SEBI MF Regulations were revised and replaced in 1996 with a comprehensive set of regulations, viz., SEBI (Mutual Fund) Regulations, 1996 which is currently applicable.

The number of MFs increased over the years, with many foreign sponsors setting up mutual funds in India. Also the MF industry witnessed several mergers and acquisitions during this phase. As at the end of January 2003, there were 33 MFs with total AUM of Rs. 1,21,805 crores, out of which UTI alone had AUM of Rs. 44,541 crores.

Fourth Phase (Since February 2003 – April 2014)

In February 2003, following the repeal of the Unit Trust of India Act 1963, UTI was bifurcated into two separate entities, viz., the Specified Undertaking of the Unit Trust of India (SUUTI) and UTI Mutual Fund which functions under the SEBI MF Regulations. With the bifurcation of the erstwhile UTI and several mergers taking place among different private sector funds, the MF industry entered its fourth phase of consolidation.

Following the global melt-down in the year 2009, securities markets all over the world had tanked and so was the case in India. Most investors who had entered the capital market during the peak, had lost money and their faith in MF products was shaken greatly. The abolition of Entry Load by SEBI, coupled with the after-effects of the global financial crisis, deepened the adverse impact on the Indian MF Industry, which struggled to recover and remodel itself for over two years, in an attempt to maintain its economic viability which is evident from the sluggish growth in MF Industry AUM between 2010 to 2013.

Fifth (Current Phase)-
Since May 2014

Taking cognisance of the lack of penetration of MFs, especially in tier II and tier III cities, and the need for greater alignment of the interest of various stakeholders, SEBI introduced several progressive measures in September 2012 to "re-energize" the Indian Mutual Fund industry and increase MFs' penetration.

In due course, the measures did succeed in reversing the negative trend that had set in after the global melt-down and improved significantly after the new Government was formed at the Center.

Since May 2014, the Industry has witnessed steady inflows and increase in the AUM as well as the number of investor folios (accounts).

The Industry's AUM crossed the milestone of Rs. 10 Trillion (Rs. 10 Lakh Crore) for the first time as on 31st May 2014 and in a short span of two years the AUM size has crossed Rs. 15 lakh crore in July 2016.

The overall size of the Indian MF Industry has grown from Rs. 3.26 trillion as on 31st March 2007 to Rs. 15.63 trillion as on 31st August 2016, the highest AUM ever and a five-fold increase in a span of less than 10 years !!

In fact, the MF Industry has more doubled its AUM in the last 4 years from Rs. 5.87 trillion as on 31st March, 2012 to Rs. 12.33 trillion as on 31st March, 2016 and further grown to Rs. 15.63 trillion as on 31st August 2016.

The no. of investor folios has gone up from 3.95 crore folios as on 31-03-2014 to 4.98 crore as on 31-08-2016.

On an average 3.38 lakh new folios are added every month in the last 2 years since Jun 2014.

The growth in the size of the Industry has been possible due to the twin effects of the regulatory measures taken by SEBI in re-energising the MF Industry in September 2012 and the support from mutual fund distributors in expanding the retail base.

MF Distributors have been providing the much needed last mile connect with investors, particularly in smaller towns and this is not limited to just enabling investors to invest in appropriate schemes, but also in helping investors stay on course through bouts of market volatility and thus experience the benefit of investing in mutual funds.

In fact, even though FY 2015-16 was not a very good year for the Indian securities market, the MF Industry witnessed steady positive net inflows month after month, even when the FIIs were pulling out in a big way. This was largely because of the 'hand-holding' of the investors by the MF distributors and convincing them to stay invested and/or invest at lower NAVs when the market had fallen.

MF distributors have also had a major role in popularising Systematic Investment Plans (SIP) over the years. In April 2016, the no. of SIP accounts has crossed 1 crore mark and currently each month retail investors contribute around Rs. 3,500 crore via SIPs.

(3) Insurance Sector

The insurance industry of India consists of 57 insurance companies of which 24 are in life insurance business and 33 are non-life insurers. Among the life insurers, Life Insurance Corporation (LIC) is the sole public sector company. Apart from that, among the non-life insurers there are six public sector insurers. In addition to these, there is sole national re-insurer, namely, General Insurance Corporation of India (GIC Re). Other stakeholders in Indian Insurance market include agents (individual and corporate), brokers, surveyors and third party administrators servicing health insurance claims.

Market Size

Government's policy of insuring the uninsured has gradually pushed insurance penetration in the country and proliferation of insurance schemes.

Gross premiums written in India reached Rs 5.53 trillion (US\$ 94.48 billion) in FY18, with Rs 4.58 trillion (US\$ 71.1 billion) from life insurance and Rs 1.51 trillion (US\$ 23.38 billion) from non-life insurance. Overall insurance penetration (premiums as % of GDP) in India reached 3.69 per cent in 2017 from 2.71 per cent in 2001.

In FY19 (up to October 2018), premium from new life insurance business increased 3.66 per cent year-on-year to Rs 1.09 trillion (US\$ 15.46 billion). In FY19 (up to October 2018), gross direct premiums of non-life insurers reached Rs 962.05 billion (US\$ 13.71 billion), showing a year-on-year growth rate of 12.40 per cent.

Government Initiatives

The Government of India has taken a number of initiatives to boost the insurance industry. Some of them are as follows:

- In September 2018, National Health Protection Scheme was launched under Ayushman Bharat to provide coverage of up to Rs 500,000 (US\$ 7,723) to more than 100 million vulnerable families. The scheme is expected to increase penetration of health insurance in India from 34 per cent to 50 per cent.
- Over 47.9 million farmers were benefitted under Pradhan Mantri Fasal Bima Yojana (PMFBY) in 2017-18.
- The Insurance Regulatory and Development Authority of India (IRDAI) plans to issue redesigned initial public offering (IPO) guidelines for insurance companies in India, which are to looking to divest equity through the IPO route.
- IRDAI has allowed insurers to invest up to 10 per cent in additional tier 1 (AT1) bonds that are issued by banks to augment their tier 1 capital, in order to expand the pool of eligible investors for the banks.

Major Events in the Journey of Indian Insurance Sector

Years	Major Events
1956-72	All life insurance companies were nationalised to form LIC in 1956 to increase penetration and protect policy holders from mismanagement. The non-life insurance business was nationalised to form GIC in 1972.
1993-99	Malhotra Committee recommended opening up the insurance sector to private players. IRDA, LIC and GIC Acts were passed in 1999, making IRDA the statutory regulatory body for insurance and ending the monopoly of LIC and GIC.
2000-2014	Post liberalisation, the insurance industry recorded significant growth; the number of private players increased to 46 in 2017.
2015	In 2015, Government introduced Pradhan Mantri Suraksha Bima Yojna and Pradhan Mantri Jeevan Jyoti Bima Yojana. Government introduced Atal Pension Yojana and Health insurance in 2015.
2017 onwards	National Health Protection Scheme was proposed to be launched under Ayushman Bharat, as per Union Budget 2018-19. Insurance companies raised more than US\$ 6 billion from public issues in 2017.

Notable Trends

- (i) New distribution channels like bancassurance, online distribution and NBFCs have widened the reach and reduced costs.
- (ii) Firms have tied up with local NGOs to target lucrative rural markets.
- (iii) In October 2018, Indian e-commerce major Flipkart entered the insurance space in partnership with Bajaj Allianz to offer mobile insurance.
- (iv) Amazon India is also expected to enter the insurance market as an agent.
- (v) In September 2018, India Post Payments Bank (IPPB) also partnered with Bajaj Allianz to distribute their products.
- (vi) Over the years, share of private sector in life insurance segment has grown from around 2 per cent in FY03 to 31.8 per cent in FY19 (up to September 2018).

- (vii) In the non-life insurance segment, share of private sector increased to 55.70 per cent in FY20 (up to April 2019) from 14.5 per cent in FY04.
- (viii) The life insurance sector has witnessed the launch of innovative products such as Unit Linked Insurance Plans (ULIPs).
- (ix) Other traditional products have also been customised to meet specific needs of Indian consumers.
- (x) In September 2018, HDFC Ergo launched 'E@Secure' a cyber insurance policy for individuals.
- (xi) Large insurers continue to expand, focusing on cost rationalisation and aligning business models to realise reported Embedded Value (EV), and generate value from future business rather than focus on present profits.
- (xii) In January 2019, online insurance distribution platform, Turtlemint raised US\$ 25 million in funding.
- (xiii) As of November 2018, HDFC Ergo is in advanced talks to acquire Apollo Munich Health Insurance at a valuation of around Rs 2,600 crore (US\$ 370.05 million).

PUBLIC AND PRIVATE SECTOR BANKS

Public Sector Banks

The banking sector was developed during the British era. British East India Company set up three banks: Bank of Bengal (1809); Bank of Bombay (1840) and Bank of Madras (1843). These three banks were later merged and called Imperial Bank, which was taken over by State Bank of India (SBI) in 1955. The Reserve Bank of India was established in 1935, followed by the Punjab National Bank, Bank of India, Canara Bank and Indian Bank.

July 19, 1969 was an important date in the history of Indian banking. As it is on this date that 14 major scheduled commercial banks having a deposit of more than INR 50 crore were nationalized. The 14 banks were- Central Bank of India, Bank of Maharashtra, Dena Bank, Punjab National Bank, Syndicate Bank, Canara Bank, Indian Overseas Bank, Indian Bank, Bank of Baroda, Union Bank, Allahabad Bank, United Bank of India, UCO Bank and Bank of India.

Subsequently, some private banks were observed to suffer from governance problems. Further, there was a need to address the need of credit delivery in greater measure. In the second wave of nationalization six banks, i.e. Andhra Bank, Corporation Bank, New Bank of India, Oriental Bank of Commerce, Punjab and Sind Bank and Vijaya Bank — with deposit liabilities of ₹200 crore and above were nationalised in April 1980. With the nationalisation of these six banks, the number of public sector banks (PSBs), including State Bank of India and its associate banks, rose to 28 in April 1980.

PSBs have played a significant role in the development of the country over the last five decades. They have rapidly expanded their branch network, extended credit to crucial segments such as large

industry, MSMEs, agriculture, trade and retail, and participated wholeheartedly in the government's financial inclusion efforts.

Despite the opening up of the sector to private entities in the early 1990s, PSBs remain formidable players. This is underscored by the fact that their market share in overall bank credit and overall bank deposits was at 63.2 per cent and 66.9 per cent respectively at the end of FY18.

Though their market share has come down over the years, PSBs may regain some or most of it. They are now through with the recognition of bad loans, and are taking efforts to recover them. Further, they have tightened the loan origination process and put in place a monitoring mechanism to ensure that new loans don't go off-kilter. Moreover, the government is continuously pumping in capital to nurse them back to health and pushing for consolidation.

While some PSBs (such as SBI, PNB and Canara Bank) are lumbering giants, they did not balk when it was time to adapt to changes in the financial system and customer requirements, embracing retail banking and technology with gusto.

A recent drastic initiative of Government of India is going to change the scenario of public sector banks. As a banking reform measure, 10 public sector banks will be merged into four entities. This would take the number of banks in the country from 27 in 2017 to 12.

These bank mergers, and the ones already carried out, will lead to the creation of big banks with an enhanced capacity to give credit. These big banks, would also be able to compete globally and increase their operational efficiency by reducing their cost of lending.

The banks have been chosen for mergers on the basis of ensuring that there is no disruption in the banking services, and that the banks should benefit from increased CASA [current account savings account] and greater reach.

The largest of the mergers announced is that of Punjab National Bank with Oriental Bank of Commerce and United Bank. The amalgamated entity — to be called Punjab National Bank — will become the second-largest public sector bank in India, after the State Bank of India. It will also become the second-largest bank in India in terms of its branch network, with a combined total of 11,437 branches.

The second merger announced was that of Canara Bank and Syndicate Bank, which would render the merged entity the fourth-largest public sector bank. The merger also has the potential to lead to large cost reductions due to network overlaps. Further, the similar business cultures of the two banks would also facilitate a smooth transition.

The fourth merger announced is of Indian Bank and Allahabad Bank. This, too, would lead to a doubling of the size of the business and would also lead to a huge potential for scaling up due to the complementary networks of the two banks.

Private Sector Banks

Private Sector Banks refer to those banks where most of the capital is in private hands. In India, there

are two types of private sector banks viz. Old Private Sector Banks and New Private Sector Banks. Old private sector banks are those which existed in India at the time of nationalization of major banks but were not nationalized due to their small size or some other reason. After the banking reforms, these banks got license to continue and have existed in India along with new private banks and government banks.

Old Private Banks

At present, there are 12 old private sector banks in India as follows:

1. Catholic Syrian Bank
2. City Union Bank
3. Dhanlaxmi Bank
4. Federal Bank
5. Jammu and Kashmir Bank
6. Karnataka Bank
7. Karur Vysya Bank
8. Lakshmi Vilas Bank
9. Nainital Bank
10. Ratnakar Bank
11. South Indian Bank
12. Tamilnad Mercantile Bank

Among the above, Nainital Bank is a subsidiary of the Bank of Baroda, which has 98.57% stake in it.

New Private Sector Banks

The new private sector banks were incorporated as per the revised guidelines issued by the RBI regarding the entry of private sector banks in 1993. At present, there are nine new private sector banks as follows:

1. Axis Bank
2. Development Credit Bank (DCB Bank Ltd)
3. HDFC Bank

4. ICICI Bank
5. IndusInd Bank
6. Kotak Mahindra Bank
7. Yes Bank
8. IDFC
9. Bandhan Bank of Bandhan Financial Services.

Note: All the old and new banks listed above are scheduled commercial banks.

Small Private Banks in India

Small private banks are financial institutions that have the license to offer fundamental banking services by accepting deposits and lending. The aim of these banks is to provide financial inclusion to those sections of the economy which is not served by other banks like small business units, small and marginal farmers, micro and small industries and the unorganized sector. The list of small private banks in India are as under:

1. Ujjivan small finance bank.
2. Jana small finance bank.
3. Equitas small finance bank.
4. AU small finance bank.
5. Capital small finance bank.
6. Fincare small finance bank.
7. ESAF small finance bank.
8. North East small finance bank.
9. Suryoday small finance bank.
10. Utkarsh small finance bank.

Almost every reform is born out of a crisis. So is the case with Indian economic reforms. The Balance of Payments crisis in 1991 forced the government to begin dismantling the licence permit raj. As Manmohan Singh began setting up framework for fiscal reforms under Prime Minister Narasimha Rao's direction, Rangarajan as Governor began erecting a new monetary structure.

Although RBI had the mandate to issue new banking licences, it did not until 1994 when the dust over the financial crisis settled. It was also the time when the markets were rocked by frauds in the nonbanking finance companies segment with CRB Financial being the prime example. It was a providential escape for the RBI which was about to give a banking licence to CRB as well.

Institutions such as IDBI, ICICI, HDFC and UTI were given licences. Others who managed were Centurion Bank, Bank of Punjab, Times Bank, Global Trust Bank and IndusInd Bank of the Hindujas. Barring IndusInd, all the others are merged into another bank.

Global Trust Bank, was the first one to blow up among the new-age banks in the midst of a scandal. It raised questions about RBI's judgement. But the central bank was quick enough to identify problems and merge it with Oriental Bank of Commerce in 2004.

Centurion Bank of Punjab and Times Bank merged with HDFC Bank. IDBI Bank NSE 5.70 %, which merged with parent Industrial Development Bank of India, is a standing example of how not to run an institution.

INDUSTRIAL FINANCE CORPORATION OF INDIA AND SMALL INDUSTRIES DEVELOPMENT BANK OF INDIA

(a) Industrial Development Corporation of India

At the time of independence in 1947, the Indian Capital Markets were relatively less developed. The demand for capital was growing rapidly, however there was a dearth of providers of capital. The commercial banks that existed were not equipped well enough to provide for long term capital needs in any significant manner. Against this backdrop and to bridge the demand supply gap for capital needs of the economy, the Government of India established The Industrial Finance Corporation of India (IFCI) on July 1, 1948 by way of an IFC Act 1948.

IFCI was the first Development Financial Institution of India set up to propel economic growth through development of infrastructure and industry. Since then, IFCI has contributed significantly to the economy through its incessant support to projects in all the three spheres of growth & development – manufacturing, infrastructure & services and agriculture allied sectors. The Liberalisation of the Indian Economy in 1991 made significant changes in the Indian Capital Markets & Financial System. To aid raising of funds directly through capital markets, the constitution of IFCI was changed from a statutory corporation to a company under the Indian Companies Act, 1956. Subsequently, the name of the company was changed to 'IFCI Limited' with effect from October 1999.

Since its inception 70 years back, IFCI has witnessed and sustained all business economic cycles. IFCI has been able to maintain the financial sustainability with the consistent support and cooperation of all its stakeholders and particularly the Government of India. In addition to its core competence in long term lending to industrial and infrastructure sectors, IFCI is also enhancing its organizational value through optimising value of core and non-core assets & investments. Over the years, IFCI played a pivotal role in establishment of various

institutes (including some of its subsidiaries & associates) - that are respected in their fields today, namely Stock Holding Corporation of India Ltd (SHCIL), National Stock Exchange Ltd (NSE), LIC Housing Finance Ltd, Tourism Finance Corporation of India Ltd (TFCI), Management Development Institute (MDI), ICRA Ltd, among many others. With the changes in the markets over a period of time a few of the subsidiaries were divested and currently IFCI Group has the following subsidiaries – Stock Holding Corporation of India Ltd, IFCI Venture Capital Fund Ltd, IFCI Factors Ltd, IFCI Infrastructure Development Ltd, IFCI Financial Services Ltd, MPCON, Management Development Institute and Institute of Leadership Development.

IFCI Products

The products of IFCI may be categorised under the following:

1. **Loan Products:** IFCI Ltd., established as the Industrial Finance Corporation of India (IFCI) on July 1, 1948, was the first Development Financial Institution in the country, setup to cater to the long-term finance needs of the industrial sector. Since its inception, IFCI has been a catalyst in creating a robust industrial base for the country through modernization of Indian industry, export promotion, import substitution, nurturing sunrise industries etc. through commercially viable and market-friendly initiatives.

In order to continue serving the needs of the Industry and society, IFCI offers the following products broadly categorized into three segments – Project Finance, Corporate Finance & Structured Finance spreading across industries, services and Agro based sectors.

2. **Project Finance :** IFCI's team of professionals with in-depth understanding of the sectoral dynamics, has the ability to provide customized financial solutions to meet the growing & diversified requirement for different levels of the projects – greenfield projects, brownfield, diversification and modernisation of existing projects in infrastructure and manufacturing sectors.

The various sectors covered under Project Finance are Power including Renewable energy, Telecommunications, Roads, Oil & gas, Ports, Airports, Basic Metals, Chemicals, Pharmaceuticals, Electronics, Textiles, Real Estate, Smart Cities & Urban Infrastructure etc.

3. **Corporate Finance :** IFCI caters to the varied needs of diverse set of customers ranging across small, mid and large corporates. IFCI offers financial solutions in areas of corporate finance through Balance Sheet Funding, Loan Against Shares, Lease Rental Discounting, Promoter Funding, Long Term Working Capital requirements, Capital Expenditure and regular Maintenance Capex.

IFCI also offers a Short Term Loan product (tenure upto 1 year) to meet various business requirements including bridge financing and short term working capital requirements.

4. **Syndication & Advisory :** IFCI has taken an initiative to provide customized corporate advisory services and facilitating the financial re-engineering of various corporate houses

and companies. We assimilate the inputs gathered from our vast and rich experience of project appraisal, documentation, syndication, product design in providing a customized comprehensive end to end financial solution for Corporates. We further carry out debt and equity syndication and advisory services for our client companies.

In the area of providing customized corporate advisory services, IFCI has been able to secure new assignments relating to financial/investment appraisal, business reengineering and advisory activities.

5. *Structured Products* : IFCI also provides financing solutions to its clients through Structured Debt/Mezzanine products and assists in providing optimal financing solutions for various requirements such as sponsor financing, acquisition financing, pre-IPO financing and Off-Balance Sheet Structured Solutions amongst others.

(b) Small Industries Development Bank of India (SIDBI)

Small Industries Development Bank of India (SIDBI) set up on 2nd April 1990 under an Act of Indian Parliament, acts as the Principal Financial Institution for Promotion, Financing and Development of the Micro, Small and Medium Enterprise (MSME) sector as well as for co-ordination of functions of institutions engaged in similar activities.

SIDBI's initiatives have remained aligned to the national goals of poverty alleviation, employment generation, kindling entrepreneurship and fostering competitiveness in MSME sector.

Some of SIDBI's key initiatives over more than the past 25 years of tirelessly promoting the growth of MSMEs, include-

- (i) Providing a cumulative assistance of around INR 5.40 lakh crore channelized into MSME segment.
- (ii) Directly impacting over 360 lakh persons/enterprises through its branch network of around 80 offices spread across the country as well as through the network of banks / institutions (having more than 1.25 lakh branches) across the country.
- (iii) Extending loans, equity and quasi-equity aggregating to INR 13,689 crore benefiting 356 lakh disadvantaged people, mostly women, through its Micro Finance operations.
- (iv) Deepening its outreach by nurturing and evolving more than 100 MFIs who have emerged as strong and viable financial intermediaries serving the unserved.
- (v) Supporting more than 1.16 lakh budding and existing entrepreneurs by infusing skills and reskilling initiatives.
- (vi) Facilitating Institutions Building by adopting a SIDBI Plus approach and creating its Subsidiary and Associate Institutions for providing impetus to the growth of MSME ecosystem.

- vii) Developing a passionate pool of 1000+ professionals with 22% women and 40% belonging to SC/ST and OBCs category, for serving to the needs of the dynamic and consistently evolving MSME Sector.

Key Milestones in the Journey of SIDBI

<i>Years</i>	<i>Milestones Achieved</i>
1990	Setting up of SIDBI
1994	Foundation of Microfinance laid
1995	Technology Bureau for Small Enterprise (TBSE) was set up which converted into India SME Technology Services
1999	Setting up of SIDBI Venture Capital Limited
2000	Setting up of Credit Guarantee Fund Trust for Micro & Small Enterprise (CGTMSE)
2005	Setting up of SMERA Ratings Ltd.
2008	Birth of India SME Asset Reconstruction Company Ltd. (ISARC)
2015	Set up MUDRA
2016	Trade Recievables Discounting System (TReDS)
2017	Launched Certified Credit Counsellor (CCC)
2018	Launch MSME Pulse and CriSidEx

Regional Rural Banks (RRBs) are Indian Scheduled Commercial Banks (Government Banks) operating at regional level in different States of India. They have been created with a view of serving primarily the rural areas of India with basic banking and financial services. However, RRBs may have branches set up for urban operations and their area of operation may include urban areas too.

The area of operation of RRBs is limited to the area as notified by Government of India covering one or more districts in the State. RRBs also perform a variety of different functions. RRBs perform various functions in following heads:

- (a) Providing banking facilities to rural and semi-urban areas.

- (b) Carrying out government operations like disbursement of wages of MGNREGA workers, distribution of pensions etc.
- (c) Providing Para-Banking facilities like locker facilities, debit and credit cards, mobile banking, internet banking, UPI etc.
- (d) Small financial banks.

REGIONAL RURAL BANKS (RRBs)

Regional Rural Banks were established under the provisions of an Ordinance passed on 26th September, 1975 and the RRB Act 1976 to provide sufficient banking and credit facility for agriculture and other rural sectors. As a result Five Regional Rural Banks were set up on 2nd October, 1975, Gandhi Jayanti. These were set up on the recommendations of The Narshimham committee Working Group[1] during the tenure of Indira Gandhi's Government with a view to include rural areas into economic mainstream since that time about 70% of the Indian Population was of Rural Orientation. The development process of RRBs started on 2nd October, 1975, Gandhi Jayanti with the forming of the first RRB, the Prathama Bank, Head Office at Moradabad (U.P.) with authorised capital of Rs 5 crore at its starting. As on 2nd October, 1975 Out of the remaining four RRBs in the country one was Set up at Malda in West Bengal under the name of Gour Gramin Bank, which was the first RRB in the Eastern Region of India.

The current structure of RRBs is that Central Government owns 50% , Sponsorship Bank holds 35% and State Government holds 15%.

India is eyeing a mega revamp of its regional rural banks (RRBs) and the plan includes consolidation of these lenders for better operational efficiencies in line with the government's big rural focus.

The plan that the finance ministry is drawing up also envisages RRBs adopting differentiated banking strategies, such as targeting specific sectors, for a strong regional connect. Some RRBs will be merged with their sponsoring banks. There are 56 operational RRBs & the roadmap is to bring them down to 38 or below.

COOPERATIVE BANKS

Cooperative bank is an institution established on the cooperative basis and dealing in ordinary banking business. Like other banks, the cooperative banks are founded by collecting funds through shares, accept deposits and grant loans.

The cooperative banks, however, differ from joint stock banks in the following manner:

1. Cooperative banks issue shares of unlimited liability, while the joint stock banks issue shares of limited liability.
2. In a cooperative bank, one shareholder has one vote whatever the number of shares he may hold. In a joint stock bank, the voting right of a shareholder is determined by the number of shares he possesses.

3. Cooperative banks are generally concerned with the rural credit and provide financial assistance for agricultural and rural activities. Joint stock companies are primarily concerned with the credit requirements of trade and industry.
4. Cooperative banking in India is federal in structure. Primary credit societies are at the lowest rung. Then, there are central cooperative banks at the district level and state cooperative banks at the state level. Joint stock banks do not have such a federal structure.
5. Cooperative credit societies are located in the villages spread over entire country. Joint stock banks and their branches mainly concentrate in the urban areas, particularly in the big cities.

History of Cooperative Banking in India

Cooperative movement in India was started primarily for dealing with the problem of rural credit. The history of Indian cooperative banking started with the passing of Cooperative Societies Act in 1904. The objective of this Act was to establish cooperative credit societies “to encourage thrift, self-help and cooperation among agriculturists, artisans and persons of limited means.”

Many cooperative credit societies were set up under this Act. The Cooperative Societies Act, 1912 recognised the need for establishing new organisations for supervision, auditing and supply of cooperative credit. These organisations were- (a) A union, consisting of primary societies; (b) the central banks; and (c) provincial banks.

Although beginning has been made in the direction of establishing cooperative societies and extending cooperative credit, but the progress remained unsatisfactory in the pre-independence period. Even after being in operation for half a century, the cooperative credit formed only 3.1 per cent of the total rural credit in 1951-52.

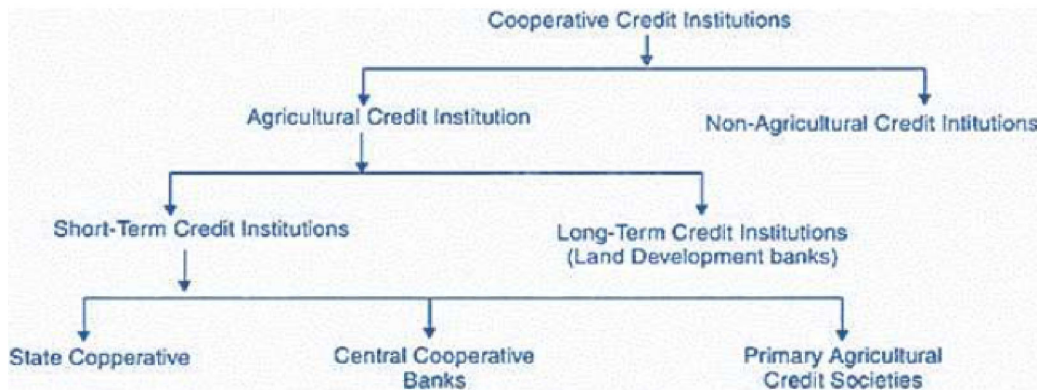
Structure of Cooperative Banking

There are different types of cooperative credit institutions working in India. These institutions can be classified into two broad categories- agricultural and non-agricultural. Agricultural credit institutions dominate the entire cooperative credit structure.

Agricultural credit institutions are further divided into short-term agricultural credit institutions and long-term agricultural credit institutions.

The short-term agricultural credit institutions which cater to the short-term financial needs of agriculturists have three-tier federal structure- (a) at the apex, there is the state cooperative bank in each state; (b) at the district level, there are central cooperative banks; (c) at the village level, there are primary agricultural credit societies. Long-term agricultural credit is provided by the land development banks.

The whole structure of cooperative credit institutions is shown in the chart given.



Source: Economics discussions

There are 4 types of co-operative banks in India:

1. **Central Co-Operative Banks** :These banks are organized and operated at the district level and can be of two types:
 - (a) Co-operative Banking Union
 - (b) Mixed control Co-operative Bank

In the first, the members of the bank are the co-operative societies only. However, in the second, the members can be co-operative societies as well as individuals. The central co-operative banks lend money mainly to the affiliated primary societies with typical loan tenure lending between 1 to 3 years.

2. **State Co-Operative Banks** : These banks are organized and operated at the district level and rest at the top of the hierarchy in the co-operative credit structure. With the help of State Co-operative Banks (SCBs), the RBI funds the co-operative institutions. These banks also get loans at an interest rate of 1% to 2% lower than the standard bank rate.
3. **Primary Co-Operative Banks** : These offer credit services in the urban and semi-urban regions. Thus, they are not considered as agricultural credit societies.

Primary Co-Operative Banks receive concessional refinance service from RBI and IDBI from time to time for them to offer housing loans and other types of loans that can be used by small businesses.

4. *Land Development Banks* : The land development banks are divided into three tiers which are primary, state, and central. These offer credit services to the farmers for developmental purposes. They used to be regulated by the RBI as well as the state governments. However, this responsibility was recently transferred to the National Bank for Agricultural and Rural Development (NABARD).

NON-BANKING FINANCE COMPANIES (NBFCs)

A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act, 1956 engaged in the business of loans and advances, acquisition of shares/stocks/bonds/debentures/securities issued by Government or local authority or other marketable securities of a like nature, leasing, hire-purchase, insurance business, chit business but does not include any institution whose principal business is that of agriculture activity, industrial activity, purchase or sale of any goods (other than securities) or providing any services and sale/purchase/construction of immovable property. A non-banking institution which is a company and has principal business of receiving deposits under any scheme or arrangement in one lump sum or in installments by way of contributions or in any other manner, is also a non-banking financial company (Residuary non-banking company).

NBFCs lend and make investments and hence their activities are akin to that of banks; however there are a few differences as given below:

- i. NBFC cannot accept demand deposits;
- ii. NBFCs do not form part of the payment and settlement system and cannot issue cheques drawn on itself;
- iii. Deposit insurance facility of Deposit Insurance and Credit Guarantee Corporation is not available to depositors of NBFCs, unlike in case of banks.

Different types of NBFCs

NBFCs are categorized a) in terms of the type of liabilities into Deposit and Non-Deposit accepting NBFCs, b) non deposit taking NBFCs by their size into systemically important and other non-deposit holding companies (NBFC-NDSI and NBFC-ND) and c) by the kind of activity they conduct. Within this broad categorization the different types of NBFCs are as follows:

- (i) *Asset Finance Company (AFC)* : An AFC is a company which is a financial institution carrying on as its principal business the financing of physical assets supporting productive/economic activity, such as automobiles, tractors, lathe machines, generator sets, earth moving and material handling equipments, moving on own power and general purpose industrial machines. Principal business for this purpose is defined as aggregate of financing real/physical assets supporting economic activity and income arising therefrom is not less than 60% of its total assets and total income respectively.
- (ii) *Investment Company (IC)* : IC means any company which is a financial institution carrying on as its principal business the acquisition of securities.

- (iii) *Loan Company (LC)* : LC means any company which is a financial institution carrying on as its principal business the providing of finance whether by making loans or advances or otherwise for any activity other than its own but does not include an Asset Finance Company.
- (iv) *Infrastructure Finance Company (IFC)* : IFC is a non-banking finance company a) which deploys at least 75 per cent of its total assets in infrastructure loans, b) has a minimum Net Owned Funds of Rs. 300 crore, c) has a minimum credit rating of 'A 'or equivalent d) and a CRAR of 15%.
- (v) *Systemically Important Core Investment Company (CIC-ND-SI)* : CIC-ND-SI is an NBFC carrying on the business of acquisition of shares and securities which satisfies the following conditions:-
 - (a) it holds not less than 90% of its Total Assets in the form of investment in equity shares, preference shares, debt or loans in group companies;
 - (b) its investments in the equity shares (including instruments compulsorily convertible into equity shares within a period not exceeding 10 years from the date of issue) in group companies constitutes not less than 60% of its Total Assets;
 - (c) it does not trade in its investments in shares, debt or loans in group companies except through block sale for the purpose of dilution or disinvestment;
 - (d) it does not carry on any other financial activity referred to in Section 45I(c) and 45I(f) of the RBI act, 1934 except investment in bank deposits, money market instruments, government securities, loans to and investments in debt issuances of group companies or guarantees issued on behalf of group companies.
 - (e) Its asset size is Rs. 100 crore or above and
 - (f) It accepts public funds
- (vi) *Infrastructure Debt Fund : Non-Banking Financial Company (IDF-NBFC)* : IDF-NBFC is a company registered as NBFC to facilitate the flow of long term debt into infrastructure projects. IDF-NBFC raise resources through issue of Rupee or Dollar denominated bonds of minimum 5 year maturity. Only Infrastructure Finance Companies (IFC) can sponsor IDF-NBFCs.
- (vii) *Non-Banking Financial Company - Micro Finance Institution (NBFC-MFI)* : NBFC-MFI is a non-deposit taking NBFC having not less than 85% of its assets in the nature of qualifying assets which satisfy the following criteria:
 - a. loan disbursed by an NBFC-MFI to a borrower with a rural household annual income not exceeding Rs. 1,00,000 or urban and semi-urban household income not exceeding Rs. 1,60,000;
 - b. loan amount does not exceed Rs. 50,000 in the first cycle and Rs. 1,00,000 in subsequent cycles;
 - c. total indebtedness of the borrower does not exceed Rs. 1,00,000;
 - d. tenure of the loan not to be less than 24 months for loan amount in excess of Rs. 15,000 with prepayment without penalty;

- e. loan to be extended without collateral;
 - f. aggregate amount of loans, given for income generation, is not less than 50 per cent of the total loans given by the MFIs;
 - g. loan is repayable on weekly, fortnightly or monthly instalments at the choice of the borrower
- (viii) *Non-Banking Financial Company – Factors (NBFC-Factors)* : NBFC-Factor is a non-deposit taking NBFC engaged in the principal business of factoring. The financial assets in the factoring business should constitute at least 50 percent of its total assets and its income derived from factoring business should not be less than 50 percent of its gross income.
- (ix) *Mortgage Guarantee Companies (MGC)* - MGC are financial institutions for which at least 90% of the business turnover is mortgage guarantee business or at least 90% of the gross income is from mortgage guarantee business and net owned fund is Rs. 100 crore.
- (x) NBFC- Non-Operative Financial Holding Company (NOFHC) is financial institution through which promoter / promoter groups will be permitted to set up a new bank. It's a wholly-owned Non-Operative Financial Holding Company (NOFHC) which will hold the bank as well as all other financial services companies regulated by RBI or other financial sector regulators, to the extent permissible under the applicable regulatory prescriptions.

BASICS OF CAPITAL MARKET : TYPES OF SHARES AND DEBENTURES

The history of the capital market in India dates back to the eighteenth century when East India Company securities were traded in the country. Until the end of the nineteenth century, securities trading was unorganized and the main trading centres were Bombay(now Mumbai) and Calcutta (now Kolkata). Of the two, Bombay was the chief trading centre wherein bank shares were the major trading stock. During the American Civil War (1860-61). Bombay was an important source of supply for cotton. Hence, trading activities flourished during the period, resulting in a boom in share prices. This boom, the first in the history of the Indian capital market, lasted for a half a decade. The first joint stock company was established on 1850. The bubble burst on July 1, 1865, when there was tremendous slump in share prices.

Trading was at that time limited to a dozen brokers, their trading place was under a banyan tree in front of the Town Hall in Bombay. These stockbrokers organized an informal association in 1875- Native Shares and Stock Brokers Association. Bombay. The stock exchanges in Calcutta and Ahmedabad, also industrial and trading centres; came up later. The Bombay Stock Exchange was recognized in May 1927 under the Bombay Securities Contracts Control Act, 1925.

Indian remained largely inactive till the 1970s. Partial liberalisation of the economy and pro-capital market policies during the 1980s infused some life into the markets, but it was only the economic liberalisation of the 1990s that provided a lasting impetus. Today, segments of India's capital markets are comparable with counterparts in many of the advanced economies in terms of efficiency (price discovery), tradability (low impact cost), resilience (co-movement of rates across product classes and yield curves), and stability. In particular, their ability to withstand several periods of stress, notably the Asian financial crisis in 1997-98, the global financial crisis in 2007-09 and the "taper tantrum" episode in 2013, is a sign of their increasing maturity.

Types of Shares and Debentures

Types of Shares

Equity share capital

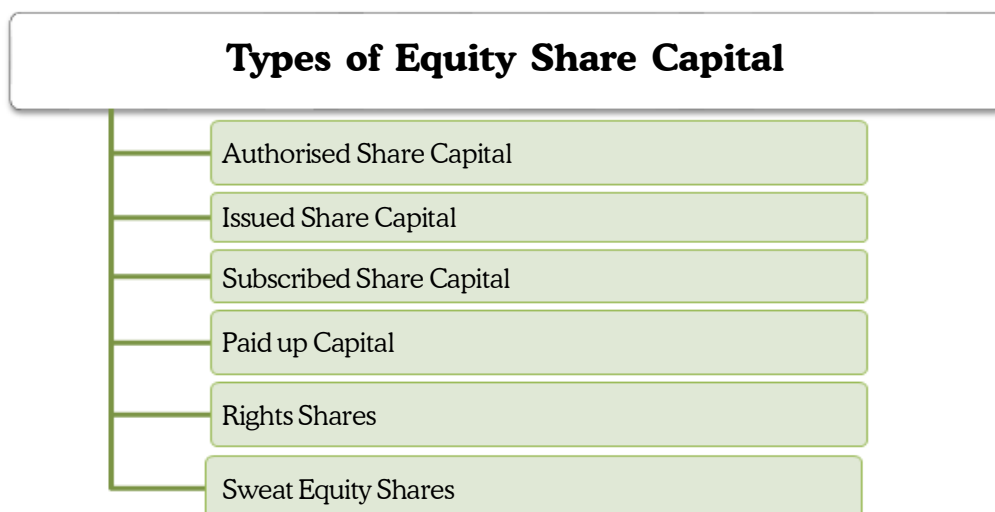
Equity shares, also known as ordinary shares or common shares represent the owners' capital in a company. The holders of these shares are the real owners of the company. They have a control over the working of the company. Equity shareholders are paid dividend after paying it to the preference shareholders. The rate of dividend on these shares depends upon the profits of the company. They may be paid a higher rate of dividend or they may not get anything.

Equity share is a main source of finance for any company giving investors rights to vote, share profits and claim on assets. Various types of equity share capital are authorized, issued, subscribed, paid up, rights, bonus, sweat equity etc. The expression of the value of equity shares are in terms of face value or par value, issue price, book value, market value, intrinsic value, stock market value etc.

Normally, a company is started with equity finance as its first source of capital from the owners or promoters of that company. After a certain level of growth, there is a requirement for more capital for further growth. The company then finds an investor in the form of friends, relatives, venture capitalists, mutual funds, or any such small group of investors and issue fresh equity shares to these investors.

A point comes where the company reaches a very big level and requires huge capital investment for business growth. Initial Public Offer (IPO) is the offer of shares which the company makes to the general public for the first time. And Follow on Public Offer (FPO) is more such offers in future to the public.

Types of Equity Share Capital / Shares

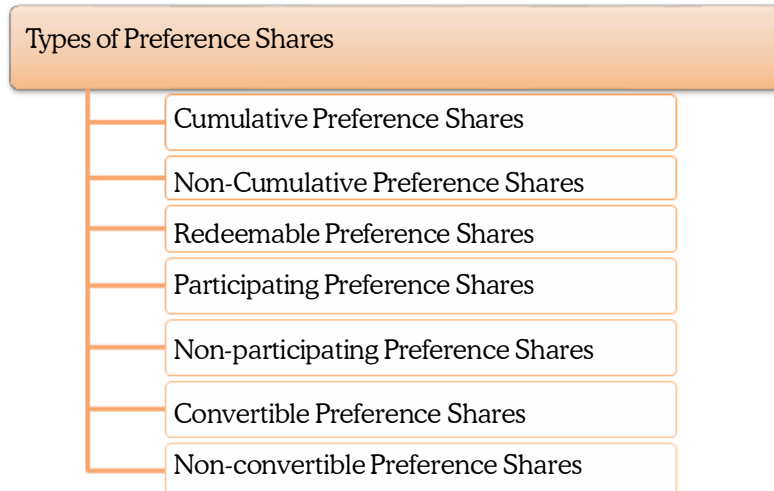


1. *Authorised Share Capital* : It is the maximum amount of capital which a company can issue. The companies can increase it from time to time. However, for that we need to comply with some formalities also have to pay some fees to the legal bodies.
2. *Issued Share Capital* : It is that part of authorized capital which the company offers to the investors.
3. *Subscribed Share Capital* : It is that part of issued capital which an investor accepts and agrees upon.
4. *Paid up Capital* : It is the part of the subscribed capital, which the investors pay. Normally, all companies accept complete money in one shot and therefore issued, subscribed and paid capital becomes one and the same. Conceptually, paid-up capital is the amount of money which a company actually invests in the business.
5. *Rights Shares* : These shares are those which a company issues to its existing shareholders. The company issues such kind of shares in order to protect the ownership rights of the existing investors.
6. *Sweat Equity Shares* : Sweat equity shares are issued to exceptional employees or directors of the company for their exceptional job in terms of providing know-how or intellectual property rights to the company.

Preference Share Capital

Preference shares, more commonly referred to as preferred stock, are shares of a company's stock with dividends that are paid out to shareholders before common stock dividends are issued. If the company enters bankruptcy, preferred stock holders are entitled to be paid from company assets before common stockholders. Most preference shares have a fixed dividend, while common stocks generally do not. Preferred stock shareholders also typically do not hold any voting rights, but common shareholders usually do.

Types of Preference Shares



1. *Cumulative Preference Shares* : Preference dividend is payable if the company earns adequate profit. However, cumulative preference shares carry additional features which allow the preference shareholders to claim unpaid dividends of the years in which dividend could not be paid due to insufficient profit.
2. *Non-Cumulative Preference Shares* : The holders of non-cumulative preference shares will get preference dividend if the company earns sufficient profit but they do not have the right to claim unpaid dividend which could not be paid due to insufficient profit.
3. *Redeemable Preference Shares* : Redeemable preference shares are those shares which are redeemed or repaid after the expiry of a stipulated period.
4. *Participating Preference Shares* : Participating preference shareholders are entitled to share the surplus profit and surplus assets of the company in addition to preference dividend.
5. *Non-participating Preference Shares* : Non-participating preference shareholders are not entitled to share surplus profit and surplus assets like participating preference shareholders.
6. *Convertible Preference Shares* : The holders of convertible preference shares are given an option to convert whole or part of their holding into equity shares after a specific period of time.
7. *Non-convertible Preference Shares* : The holders of non-convertible preference shares do not have the option to convert their holding into equity shares i.e. they remain as preference share till their redemption.

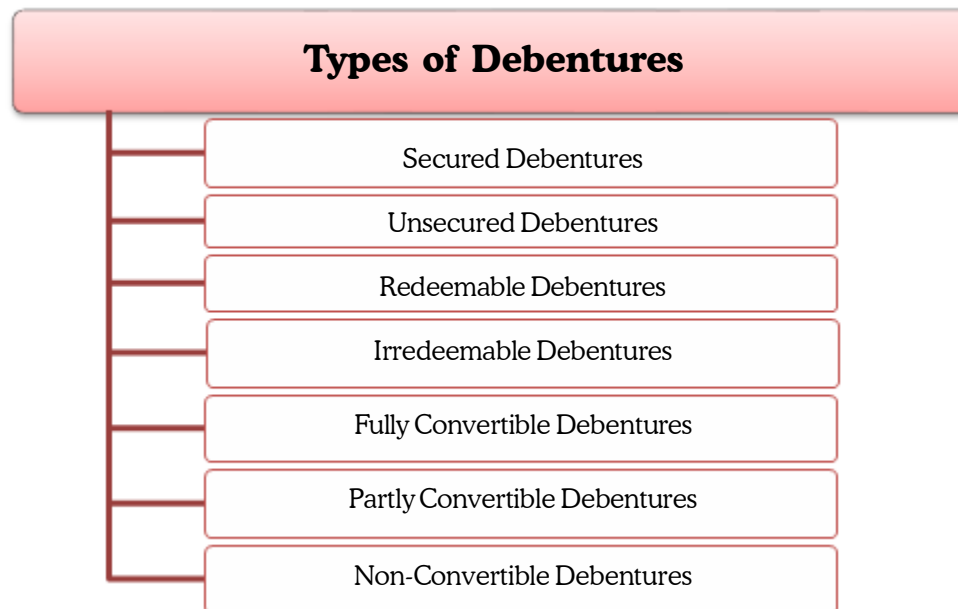
DEBENTURES

A company may raise long-term finance through public borrowings. These loans are raised by the issue of debentures. "A debenture is a document under the company's seal which provides for the payment of principal sum and interest thereon at regular intervals, which is usually secured by a fixed or floating charge on the company's property or undertaking and which acknowledges a loan to the company".

A debenture holder is a creditor of the company. A fixed rate of interest is paid on debentures. The interest on debentures is a charge on the profit and loss account of the company. The debentures are generally given a floating charge over the assets of the company. When the debentures are secured, they are paid on priority in comparison to all other creditors.

Types of Debentures

- *Secured Debentures* : These are debentures that are secured against an asset/assets of the company. This means a charge is created on such an asset in case of default in repayment of such debentures. So in case, the company does not have enough funds to repay such debentures, the said asset will be sold to pay such a loan. The charge may be fixed, i.e. against a specific assets/assets or floating, i.e. against all assets of the firm.



- *Unsecured Debentures* : These are not secured by any charge against the assets of the company, neither fixed nor floating. Normally such kinds of debentures are not issued by companies in India.
- *Redeemable Debentures* : These debentures are payable at the expiry of their term. Which means at the end of a specified period they are payable, either in the lump sum or in installments over a time period. Such debentures can be redeemable at par, premium or at a discount.
- *Irredeemable Debentures* : Such debentures are perpetual in nature. There is no fixed date at which they become payable. They are redeemable when the company goes into the liquidation process. Or they can be redeemable after an unspecified long time interval.
- *Fully Convertible Debentures* : These shares can be converted to equity shares at the option of the debenture holder. So if he wishes then after a specified time interval all his shares will be converted to equity shares and he will become a shareholder.
- *Partly Convertible Debentures* : Here the holders of such debentures are given the option to partially convert their debentures to shares. If he opts for the conversion, he will be both a creditor and a shareholder of the company.
- *Non-Convertible Debentures* : As the name suggests such debentures do not have an option to be converted to shares or any kind of equity. These debentures will remain so till their maturity, no conversion will take place. These are the most common type of debentures.

Bearer Debentures are those which are payable to the bearer thereof. These can be transferred merely by delivery. Interest is paid to the person who produces the interest coupon attached to such debentures.

Registered Debentures are those which are payable to the persons who appear in the Register of Debenture holders. These can be transferred only by executing a transfer deed. Interest is paid to the registered holder.

FINANCIAL ASSISTANCE SCENARIO FOR SMALL AND MEDIUM ENTERPRISES AND START-UPS

1. Financial Assistance Scenario for Small and Medium Enterprises in India

There are various schemes launched by Ministry of Micro, Small & Medium Enterprises, and Government of India for providing financial assistance to SME sector. However, in this section we would restrict our discussion to certain selected schemes.

(a) *Scheme of Fund for Regeneration of Traditional Industries (SFURTI)*

Related Scheme	Scheme of Fund for Regeneration of Traditional Industries (SFURTI).
Description	The objectives of the scheme is to organize the traditional industries and artisans into clusters to make them competitive and provide support for their long term sustainability, sustained employment, to enhance marketability of products of such clusters, to equip traditional artisans of the associated clusters with the improved skills, to make provision for common facilities and improved tools and equipments for artisans, to strengthen the cluster governance systems with the active participation of the stakeholders, and to build up innovated and traditional skills, improved technologies, advanced processes, market intelligence and new models of public-private partnerships, so as to gradually replicate similar models of cluster-based regenerated traditional industries
Nature of assistance	The financial assistance provided for any specific project shall be subject to a maximum of Rs 8 (eight) crore to support Soft, Hard and Thematic interventions.
Who can apply?	Non-Government organizations (NGOs), institutions of the Central and State Governments and semi-Government institutions, field functionaries of State and Central Govt., Panchayati Raj institutions (PRIs), Private sector by forming cluster specific SPVs, Corporates and corporate Responsibility (CSR) foundations with expertise to undertake cluster development

(b) A Scheme for Promotion of Innovation, Rural Industries and Entrepreneurship (ASPIRE)-

Objectives of the Scheme:

- (i) Create new jobs and reduce unemployment
- (ii) Promote entrepreneurship culture in India
- (iii) Grassroots economic development at district level
- (iv) Facilitate innovative business solution for un-met social needs
- (v) Promote innovation to further strengthen the competitiveness of MSME sector.

Nature of Assistance - 80 Livelihood business incubators (2014-2016) to be set up by NSIC, KVIC or Coir Board or any other Institution/agency of GoI/State Govt. on its own or by any of the agency/Scheme for promotion of Innovation, Entrepreneurship and Agro-Industry organisation of the M/o MSME, one-time grant of 100% of cost of Plant & Machinery other than the land and infrastructure or an amount up to Rs.100 lakhs whichever is less to be provided

In case of incubation centres to be set up under PPP mode with NSIC, KVIC or Coir Board or any other Institution/agency of GoI/State Govt., one- time grant of 50% of cost of Plant & Machinery other than the land and infrastructure or Rs.50.00 lakhs, whichever is less to be provided

Assistance towards the training cost of incubates will be met out of the ATI scheme of the Ministry as far as possible for both centres.

(c) *Entrepreneurship and Skill Development Programme (ESDP)*

Related Scheme	Entrepreneurship Skill Development Programme (ESDP)
Description	Entrepreneurship Development Programmes are being organized regularly to nurture the talent of youth by enlightening them on various aspects of industrial activity required for setting up MSEs. These EDPs are generally conducted in ITIs , Polytechnics and other technical institutions, where skill is available to motivate them towards self-employment.
Nature of assistance	20 % of the total targeted of ESDPs are conducted exclusively for weaker sections of the society i.e. (SC/ST/women and PH) with a stipend of Rs.500/- per month per candidate under the Promotional Package for (Micro, Small Enterprises) MSEs. No fee is charged from the candidates under these programmes.
Who can apply?	These programmes are conducted by MSME-DIs of Ministry

- (d) *Schemes of National Small Industries Corporation (NSIC)* - The schemes of National Small Industries Corporation are as under:

Single Point Registration - The Government is the single largest buyer of a variety of goods. With a view to increase the share of purchases from the small-scale sector, the Government Stores Purchase Programme was launched in 1955-56. NSIC registers Micro & small Enterprises (MSEs) under Single Point Registration scheme (SPRS) for participation in Government Purchases.

2. Financial Assistance for Start-Ups

There are numerous schemes launched by Government of India for financing start-ups. However, this section covers only three finance schemes i.e. (a) The Venture Capital Assistance Scheme; (b) Support for International Patent Protection in Electronics & Information Technology (SIP-EIT) and (c) Stand-Up India for Financing SC/ST and/or Women Entrepreneurs.

- (a) *The Venture Capital Assistance Scheme*: This scheme is run by Ministry of Agriculture and Farmers welfare. Venture Capital Assistance is financial support in the form of an interest free loan provided by SFAC to qualifying projects to meet shortfall in the capital requirement for implementation of the project.



The benefits of the Venture Capital Assistance Scheme are as under:

- (i) Help in assisting agripreneurs to make investments in setting up agribusiness projects through financial participation.
- (ii) Provides financial support for preparation of bankable Detailed Project Reports (DPRs) through Project Development Facility (PDF).

Eligibility Criteria (Who can apply)-

Farmers

Producer Groups

Partnership/Proprietary Firms

Self Help Groups

Companies

Agripreneurs

Units in agriexport zones

Agriculture graduates Individually or in groups for setting up agribusiness projects.

- (b) *Support for International Patent Protection in Electronics & Information Technology (SIP-EIT)*: This scheme is managed by Ministry of Electronics & Information Technology.

SIP-EIT is a scheme to provide financial support to MSMEs and Technology Start-up units for international patent filing to encourage innovation and recognize the value and capabilities of global IP along with capturing growth opportunities in ICTE sector.

Eligibility Criteria :

1. The Applicant should be registered under the MSME Development Act 2006 of Government of India as amended from time to time as a MSME unit as per the criteria for such registration(the applicant would be required to furnish the proof of such registration).
 2. The applicant should be a registered company under the Companies Act of Government of India and should fulfil the investment limits in plant and machinery or equipment as defined in the MSME Development Act 2006 of Government of India as amended from time to time(this criteria will be ascertained from the proof of such registration and last audited balance sheet of the applicant)
 3. The applicant should be a registered STP Unit and should fulfil the investment limits in plant and machinery or equipment as defined in the MSME Development Act 2006 of Government of India as amended from time to time(this criteria will be ascertained from the proof of such registration and last audited balance sheet of the applicant).
 4. The applicant should be a technology incubation enterprise or a startup located in an incubation centre/ park and registered as a company (a certification from the incubation centre/ park in this case is mandatory) and should fulfil the investment limits in plant and machinery or equipment as defined in the MSME Development Act 2006 of Government of India as amended from time to time(this criteria will be ascertained from the proof of such registration and last audited balance sheet of the applicant).
- (c) *Stand-Up India for Financing SC/ST and/or Women Entrepreneurs* : This scheme is managed by Small Industries Development Bank of India (SIDBI). Stand Up India Scheme facilitate

bank loans between 10 lakh and 1 crore to atleast one scheduled caste (SC) or Scehduled Tribe, borrower and atleast one women per bank branch for setting up a greenfield enterprise. This enterprise may be in manufacturing, services or the trading sector. In case of non-individual enterprises at least 51% of the shareholding and controlling stake should be held by either an SC/ST or Woman entrepreneur.

Eligibility

1. SC/ST and/or women entrepreneurs; above 18 years of age
2. Loans under the scheme is available for only greenfield project. GreenField signifies, in this context, the first time venture of the benefeciary in the manufacturing or services or trading sector
3. In case of non-individual enterprises,51% of the shareholding and controlling stakes should be held by either SC/ST and/or Women Entrepreneur
4. Borrower should not be in default to any bank or financial institution

Sample Questions

1. Which of the following is not covered under the Commercial banks?
 - (a) Public sector banks
 - (b) Private sector banks
 - (c) Foreign banks
 - (d) Reserve Bank of India**
2. Which is the first NBFC to be converted into a bank?
 - (a) Kotak Mahindra Finance Ltd.**
 - (b) Muthoot Finance
 - (c) Bajaj Allianz
 - (d) GE Capital
3. In September 2018, which insurance company launched 'E@Secure' a cyber insurance policy for individuals?
 - (a) ICICI Lombard
 - (b) HDFC Ergo**
 - (c) LIC
 - (d) IFFCO Tokio
4. In which year Mutual Fund industry started in India?
 - (a) 1940
 - (b) 1973
 - (c) 1963**
 - (d) 1979

5. Which of the following manages Stand-Up India for Financing SC/ST and/or Women Entrepreneur scheme?

(a) Small Industries Development Bank of India (SIDBI)

(b) Industrial Finance Corporation of India (IFCI)

(c) State Bank of India

(d) HDFC

Lesson 5

Indian Economy

PRIMARY (AGRICULTURE AND ALLIED ACTIVITIES)

Agriculture is the primary source of livelihood for about 58 per cent of India's population. Gross Value Added by agriculture, forestry and fishing is estimated at Rs 18.53 trillion (US\$ 271.00 billion) in FY18.

The Indian food industry is poised for huge growth, increasing its contribution to world food trade every year due to its immense potential for value addition, particularly within the food processing industry. The Indian food and grocery market is the world's sixth largest, with retail contributing 70 per cent of the sales. The Indian food processing industry accounts for 32 per cent of the country's total food market, one of the largest industries in India and is ranked fifth in terms of production, consumption, export and expected growth. It contributes around 8.80 and 8.39 per cent of Gross Value Added (GVA) in Manufacturing and Agriculture respectively, 13 per cent of India's exports and six per cent of total industrial investment.

Major Investments

According to the Department for Promotion of Industry and Internal Trade (DPIIT), the Indian food processing industry has cumulatively attracted Foreign Direct Investment (FDI) equity inflow of about US\$ 9.08 billion between April 2000 and March 2019.

Some major investments and developments in agriculture are as follows:

- Investments worth Rs 8,500 crore (US\$ 1.19 billion) have been announced in India for ethanol production.
- The first mega food park in Rajasthan was inaugurated in March 2018.
- Agrifood start-ups in India received funding of US\$ 1.66 billion between 2013-17 in 558 deals.
- In 2017, agriculture sector in India witnessed 18 M&A deals worth US\$ 251 million.

Major Government Initiatives

Some of the recent major government initiatives in the sector are as follows:

- Prime Minister of India, launched the Pradhan Mantri Kisan Samman Nidhi Yojana (PM-Kisan) and transferred Rs 2,021 crore (US\$ 284.48 million) to the bank accounts of more than 10 million beneficiaries on February 24, 2019.
- The Government of India has come out with the Transport and Marketing Assistance (TMA) scheme to provide financial assistance for transport and marketing of agriculture products in order to boost agriculture exports.
- The Agriculture Export Policy, 2018 was approved by Government of India in December 2018. The new policy aims to increase India's agricultural exports to US\$ 60 billion by 2022 and US\$ 100 billion in the next few years with a stable trade policy regime.

- In September 2018, the Government of India announced Rs 15,053 crore (US\$ 2.25 billion) procurement policy named 'Pradhan Mantri Annadata Aay SanraksHan Abhiyan' (PM-AASHA), under which states can decide the compensation scheme and can also partner with private agencies to ensure fair prices for farmers in the country.
- In September 2018, the Cabinet Committee on Economic Affairs (CCEA) approved a Rs 5,500 crore (US\$ 820.41 million) assistance package for the sugar industry in India.
- The Government of India is going to provide Rs 2,000 crore (US\$ 306.29 million) for computerisation of Primary Agricultural Credit Society (PACS) to ensure cooperatives are benefitted through digital technology.
- With an aim to boost innovation and entrepreneurship in agriculture, the Government of India is introducing a new AGRI-UDAAN programme to mentor start-ups and to enable them to connect with potential investors.
- The Government of India has launched the Pradhan Mantri Krishi Sinchai Yojana (PMKSY) with an investment of Rs 50,000 crore (US\$ 7.7 billion) aimed at development of irrigation sources for providing a permanent solution from drought.
- The Government of India plans to triple the capacity of food processing sector in India from the current 10 per cent of agriculture produce and has also committed Rs 6,000 crore (US\$ 936.38 billion) as investments for mega food parks in the country, as a part of the Scheme for Agro-Marine Processing and Development of Agro-Processing Clusters (SAMPADA).
- The Government of India has allowed 100 per cent FDI in marketing of food products and in food product e-commerce under the automatic route.

SECONDARY (MANUFACTURING)

Manufacturing has emerged as one of the high growth sectors in India. Prime Minister of India, Mr Narendra Modi, had launched the 'Make in India' program to place India on the world map as a manufacturing hub and give global recognition to the Indian economy. India is expected to become the fifth largest manufacturing country in the world by the end of year 2020.

Major Investments

With the help of Make in India drive, India is on the path of becoming the hub for hi-tech manufacturing as global giants such as GE, Siemens, HTC, Toshiba, and Boeing have either set up or are in process of setting up manufacturing plants in India, attracted by India's market of more than a billion consumers and increasing purchasing power.

Cumulative Foreign Direct Investment (FDI) in India's manufacturing sector reached US\$ 76.82 billion during April 2000-June 2018.

India has become one of the most attractive destinations for investments in the manufacturing sector. Some of the major investments and developments in this sector in the recent past are:

- As of December 2018, premium smartphone maker OnePlus is anticipating that India will become its largest Research and Development (R&D) base within the next three years.
- India's manufacturing PMI stood at 51.7 in May 2019. Also companies start to spend more on hiring and anticipate good growth in future prospects.
- As of October 2018, Filatex India, a polymer manufacturer, is planning to undertake forward integration by setting up a fabric manufacturing and processing unit.
- As of August 2018, IISC's Society of Innovation and Development (SID) and WIPRO 3D are collaborating to produce India's first industrial scale 3D printing machine.
- For its Commercial Vehicles, Ashok Leyland is utilising machine learning algorithms and its newly created telematics unit to improve the performance of the vehicle, driver and so on.

Major Government Initiatives

The Government of India has taken several initiatives to promote a healthy environment for the growth of manufacturing sector in the country. Some of the notable initiatives and developments are:

- In October 2018, the Government of India released the draft National Policy on Electronics (NPE) which has envisaged creation of a US\$ 400 billion electronics manufacturing industry in the country by 2025.
- In September 2018, the Government of India exempted 35 machine parts from basic custom duty in order to boost mobile handset production in the country.
- Government of India is in the process of coming up with a new industrial policy which envisions development of a globally competitive Indian industry. As of December 2018, the policy has been sent to the Union Cabinet for approval.
- In Union Budget 2018-19, the Government of India reduced the income tax rate to 25 per cent for all companies having a turnover of up to Rs 250 crore (US\$ 38.75 million).
- Under the Mid-Term Review of Foreign Trade Policy (2015-20), the Government of India increased export incentives available to labour intensive MSME sectors by 2 per cent.
- The Government of India has launched a phased manufacturing programme (PMP) aimed at adding more smartphone components under the Make in India initiative thereby giving a push to the domestic manufacturing of mobile handsets.
- The Government of India is in talks with stakeholders to further ease foreign direct investment (FDI) in defence under the automatic route to 51 per cent from the current 49 per cent, in order to give a boost to the Make in India initiative and to generate employment.

- The Ministry of Defence, Government of India, approved the “Strategic Partnership” model which will enable private companies to tie up with foreign players for manufacturing submarines, fighter jets, helicopters and armoured vehicles.
- The Union Cabinet has approved the Modified Special Incentive Package Scheme (M-SIPS) in which, proposals will be accepted till December 2018 or up to an incentive commitment limit of Rs 10,000 crore (US\$ 1.5 billion).

Way Forward

India is an attractive hub for foreign investments in the manufacturing sector. Several mobile phone, luxury and automobile brands, among others, have set up or are looking to establish their manufacturing bases in the country.

The manufacturing sector of India has the potential to reach US\$ 1 trillion by 2025 and India is expected to rank amongst the top three growth economies and manufacturing destination of the world by the year 2020. The implementation of the Goods and Services Tax (GST) will make India a common market with a GDP of US\$ 2.5 trillion along with a population of 1.32 billion people, which will be a big draw for investors.

With impetus on developing industrial corridors and smart cities, the government aims to ensure holistic development of the nation. The corridors would further assist in integrating, monitoring and developing a conducive environment for the industrial development and will promote advance practices in manufacturing.

TERTIARY (SERVICES)

The services sector is a key driver of India’s economic growth. Nikkei India Services Purchasing Managers’ Index (PMI) stood at 53.8 in May 2019, indicating an expansion but fall in June 2019 to 49.6. Strong overseas demand and new export business opportunities helps to boost total sale in country.

Services exports are a key driver of India’s growth and India ranked as the eighth largest exporter of commercial services in the world in 2017. India is currently the second largest telecommunication market and has the 2nd highest number of internet users in the world.

Major Government Initiatives

1. *Services Exports from India Scheme (SEIS)*
 - (a) SEIS is aimed at promoting export of services from India by providing duty scrip credit for eligible export.
 - (b) Under this scheme, a reward of 3 to 5 per cent of net foreign exchange earned is given for Mode 1 and Mode 2 services.

- (c) In the Mid-term review of FTP 2015-20, SEIS incentives to notified services were increased by 2 per cent.

2. *National Digital Communications Policy 2018*

The National Digital Communications Policy 2018 envisages three missions:

- (a) Connect India: Creating Robust Digital Communications Infrastructure.
- (b) Propel India: Enabling Next Generation Technologies and Services through Investments, Innovation and IPR generation.
- (c) Secure India: Ensuring Sovereignty, Safety and Security of Digital Communications.

3. *National Tourism Policy 2015*

- (a) Formulation of National Tourism Policy 2015 that would encourage the citizens of India to explore their own country as well as position the country as a 'Must See' destination for global travellers.

4. *National Health Policy 2017*

- (a) The Union Cabinet, Government of India, has approved the National Health Policy 2017, which will provide the policy framework for achieving universal health coverage and delivering quality health care services to all at an affordable cost.

5. *National Education Policy, 2016*

- (a) The new 2016 National Education Policy (NEP) considers education as an utmost important parameter in the country. The 2016 NEP majorly focuses on quality of education as well as innovation and research in the sector.

6. *FDI Policy*

- (a) 100 per cent FDI is allowed under automatic route in scheduled air transport service, regional air transport service and domestic scheduled passenger airline.
- (b) Approval of 100 per cent FDI in aviation for foreign carriers.
- (c) 100 per cent FDI is allowed under the automatic route in tourism and hospitality, subject to applicable regulations and laws.
- (d) The Government of India allowed 100 per cent FDI in the education sector through the automatic route since 2002.
- (e) For the healthcare sector, 100 per cent FDI is allowed under the automatic route for

greenfield projects and for brownfield project investments, up to 100 per cent FDI is permitted under the government route.

- (f) FDI cap in the telecom sector has been increased to 100 per cent from 74 per cent; out of 100 per cent, 49 per cent will be done through automatic route and the rest will be done through the FIPB approval route.
- (g) Government has allowed 100 per cent FDI in the railway sector for approved list of projects.
- (h) FDI limit for insurance companies has been raised from 26 per cent to 49 per cent and 100 per cent for insurance intermediates.

Note: Since the topics, Current scenario of agriculture and allied activities in India and Current scenario of services sector in India have been already covered under Primary (Agriculture and allied activities); Secondary (Manufacturing) and Tertiary (Services), in view of this, they have not been explained separately.

AGRICULTURAL AND INDUSTRIAL POLICIES OF INDIA

(A) Agricultural Policies

The agricultural development policies during five year plans are as under:

- (1) *Five-year plan (1951-56)* : The highest priority was accorded to increase of agricultural production. Nearly one third or 31 per cent of total plan funds were allocated to agriculture sector. River valley projects were taken up. Irrigational facilities and fertilizer plants were established. Consequently, production of food-grains increased by 36 per cent in a short span of five years.
- (2) *Second five-year plan (1956-61)* : It focused on industrial growth and only 20 per cent of plan allocation was devoted to agriculture. Still food-grains production exceeded the target due to extension of irrigation facilities and use of chemical fertilizers.
- (3) *Third Five Years Plan (1961-66)* : The priorities were on self-sufficiency in food grains, meeting the raw material needs of industries and increase in ex-ports. During this period, Green Revolution programme was started on a small scale. But this plan failed to meet the target due to Chinese aggression (1962), Indo-Pak war (1965) and severe and prolonged drought during 1965-66. There were a great crisis of food that forced the Prime Minister L. B. Shastri to appeal to people to observe fast once a week. During next three annual plans (1966-69) agriculture recorded 6-9 per cent annual growth under the impact of Green Revolution. The production of food grain touched 94 million tonnes.
- (4) *Fourth Five Years Plan (1969-74)* : It aimed at 5 per cent annual growth in food grains. High Yielding Variety (HYV) of seeds, fertilizer use, new agriculture techniques and irrigation facilities provided to expand area of Green Revolution. The production of wheat increased sharply

but growth in rice, oilseeds and coarse grains were nominal resulting in only 3 per cent annual growth against the target of 5 per cent.

- (5) *Fifth Five Years Plan (1974-79)* : It emphasised on self-sufficiency in food production and poverty eradication. Stress was laid on the extension of irrigation, expansion in cultivated area under HYV seeds and grant of loans and subsidies to farmers. Dry farming was propagated. This plan achieved its target successfully with 4.6 per cent growth. Almost all food grains except pulses witnessed increase in production.
- (6) *Sixth Five Years Plan (1980-85)* : It emphasised on land reforms, use of HYV seeds, chemical fertilisers and groundwater resources and improving post harvest technology as well as marketing and storage facilities. The annual growth rate was 6 per cent, highest ever during plan periods. The food-grain production reached 152 million tonnes.
- (7) *Seventh Five Year Plan (1985-90)* : During this period, the highest growth in foodgrain, pulses and coarse cereals was recorded showing over all annual growth rate of 4 per cent. The areas of Green Revolution were expanded during the period.
- (8) *Eight Five Year Plan (1992-97)* : This witnessed a tendency of stagnation in foodgrain production while oilseed registered a rapid growth.
- (9) *Ninth Five Year Plan (1997-02)* : The ninth five year plan witnessed a mixed success. There were fluctuations in the foodgrain production. During this plan period National Agricultural Policy, 2000, was framed and several measures were announced including, watershed management, development of horticulture, agricultural credits and insurance scheme for crops.
- (10) *Tenth Five Year Plan (2002-07)* : In the Tenth Plan (2002-2007) focus was placed on (i) sustainable management of water and land resources, (ii) development of rural infrastructure to support agriculture, (iii) dissemination of agriculture technology, (iv) credit flow to agriculture sector, and (v) agricultural marketing reforms. The New Agricultural Policy The Government of India has announced (28th July 2000) a new National Agricultural policy, 2000, in the light of changes arising out of economic liberalization and globalization.

The main aims of the policy were:

- (i) achieving more than 4 per cent per annum growth rate in agriculture sector,
- (ii) growth based on efficient use of resources and conservation of soil, water and biodiversity,
- (iii) growth with equity in region and among the farmers,
- (iv) growth that caters to domestic market and maximizes benefits from exports of agricultural products and
- (v) technologically, environmentally and economically sustainable growth.

- (11) *Eleventh Five Year Plan (2007-12)* : The 11th Five Year Plan (2007–12) emphasised 'Inclusive growth' to achieve a target growth of 4 per cent per annum in GDP from agriculture and allied services. Globally, studies indicate that a higher GDP in agriculture is more effective in alleviating poverty in comparison with higher GDP in other sectors.

To achieve 'Inclusive growth', the 11th plan aimed at the following:

- (i) Improving accessibility of technology to farmers to increase production and ensure optimum use of natural resources.
- (ii) Attracting higher public investments and ensuring efficacy of such investments.
- (iii) Promoting diversification for higher value crops and livestock.
- (iv) Addressing issues pertaining to food security.
- (v) Decentralising decision making to come up with customised solutions to specific local problems and to improve the accessibility of land, credit, skills and scale to the poor.

One of the major accomplishment of Eleventh Five Year Plan was launching of National Food Security Mission (NFSM) launched in 2007 and introduction of Rashtriya Krishi Vikas Yojana (RKVY) in financial year 2008.

National Food Security Mission (NFSM) : In 2007, the Government of India launched the National Food Security Mission (NFSM) initiative to improve the country's overall crop production, especially that of rice, wheat and pulses. The primary objective of NFSM is to introduce technological components that include farm machines/implements as well as improved variants of seeds, soil ameliorants, plant nutrients and plant protection measures.

The government aimed to increase production of rice, wheat and pulses by 10 million tons, eight million tons and two million tons, respectively, by end 2012. It had allocated Rs 4,883 crore (US\$ 915.7 million) to NFSM, of which Rs 3,381 crore (US\$ 634 million) was spent until 31 March 2011. Through NFSM, 25 million tonnes of additional food grain was produced in the 11th Five Year Plan.

The following are the major achievements of the initiative:

- (i) Implemented in about 312 districts, spread across 17 states.
- (ii) Wheat production increased from 71.3 million tons in FY07 (terminal year of 10th plan) to 80.3 million tons in FY10.
- (iii) Rice production increased from 89.4 million tons in FY07 to 99.2 million tons in FY09; however, it declined to 87.6 million tons in FY10.
- (iv) Pulse production increased from 13.6 million tons in FY07 to 14.7 million tons in FY10.
- (v) Different districts were able to increase the food basket of the country.

Rashtriya Krishi Vikas Yojana (RKVY): In FY08, the government introduced Rashtriya Krishi Vikas Yojana (RKVY), with an outlay of Rs 25,000 crore (US\$ 4.7 billion), to encourage states to increase public investment in agriculture and allied services. The programme enables adoption of national priorities as sub schemes, thereby providing flexibility in project selection and implementation to state governments. Various sub schemes under RKVY are as follows:

- (a) Green revolution in the Eastern region.
 - (b) Combining development of 60,000 pulses villages in rain fed areas.
 - (c) Encouraging the use of palm oil.
 - (d) Initiative on vegetable clusters.
 - (e) Nutri cereals.
 - (f) National Mission for Protein Supplements initiative.
 - (g) Accelerated Fodder Development Programme.
 - (h) Rain fed Area Development Programme.
 - (i) Saffron Mission.
- (12) *Twelfth Five Year Plan (2012-17)* : Agriculture sector grew by an average 1.6 percent per annum in first four years as against the targeted 4 percent annual growth due to lower production. However, Government of India took several steps for increasing investment in agriculture sector such as enhanced institutional credit to farmers, promotion of scientific warehousing infrastructure for increasing shelf life of agriculture produce, setting up of agri-tech infrastructure fund for making farming competitive and profitable, developing commercial organic farming.

(B) Industrial Policies

Industrial policy is a statement of objectives to be achieved in the area of industrial development and the measures to be adopted towards achieving these objectives. The industrial policy thus formally indicates the spheres of activity of the public and the private sectors. It lays down rules and procedures that would govern the growth and pattern of industrial activity.

(1) Industrial Policy Resolution 1948

After having attained independence, the Government of India declared its first Industrial Policy on 6th April, 1948.

Salient Features of Industrial Policy, 1948

Under this policy, the large industries were classified in four categories viz. Strategic Industries, Basic / Key industries, Important Industries and other industries which respectively referred

to Public Sector; Public-cum-Private Sector; Controlled Private Sector and Private & Cooperative sector.

- (i) *Strategic Industries (Public Sector)* : This category included three industries in which Central Government had monopoly. These included Arms and ammunitions; Atomic energy and Rail transport.
- (ii) *Basic / Key Industries (Public-cum-Private Sector)* : Six industries viz. coal, Iron and Steel, Aircraft manufacturing, Ship-building, Manufacture of telephone, telegraph and wireless apparatus, and Mineral oil were designated as “Key Industries” or “Basic Industries”. It was decided that the new industries in this category will henceforth only be set-up by the Central Government. However, the existing private sector enterprises were allowed to continue.
- (iii) *Important Industries (Controlled Private Sector)* : Eighteen industries were kept in the “Important Industries” category. Such important industries included heavy chemicals, sugar, cotton textile and woollen industry, cement, paper, salt, machine tools, fertiliser, rubber, air and sea transport, motor, tractor, electricity etc. These industries will continue to remain under private sector however, the central government, in consultation with the state government, will have general control over them.
- (iv) *Other Industries (Private and Co-operative Sector)* : All other industries which were not included in the above mentioned three categories were left open for the private sector. However, government could impose controls on these industries also if any of them was not working satisfactorily.

2. The Industries (Development and Regulation) Act, 1951

Industries (Development and Regulation) Act, 1951 was passed by parliament in Oct, 1951 to control and regulate industrial development in the country. Its objectives were:

- The regulation of industrial investment and production according to planned priorities and targets
- The protection of small entrepreneurs against the competition from larger industries
- Prevention of monopoly and concentration of ownership industries
- Balanced regional development with the view to reduce the disparity level of development of different regions of the country

Provisions of the Act

The act laid down two provisions:

- *Restrictive provisions* : Under this category, all the measures were designed to curb the unfair practices adopted by industries
 - o Registration and licensing of industrial undertakings

- o Enquiry of listed industries
- o Cancellation of registration license
- *Reformative provisions*
 - o Direct regulation and control by government
 - o Control on price, distribution and supply
 - o Constructive measures

3. Industry Policy Resolution (IPR), 1956

Industrial Policy Resolution, 1956 replaced the IPR, 1948. It stressed on:

- Speeding up the pace of industrialization, particularly heavy industries.
- Expansion of public sector and growth of co-operative sector.
- State to take up the responsibility of setting up new industrial set up and development of transport facilities.
- Prevent private monopolies and concentration of economic process in hands of few number of individuals.

4. New Industrial Policy of India, 1991

The new Industrial Policy was announced in July, 1991 in the midst of severe economic instability in the country. The objective of the policy was to raise efficiency and accelerate economic growth.

Features of New Industrial Policy

1. Strengthening of Private Sector
 - Abolition of licensing system for large number of industries
 - Greater role of private sector envisaged
 - Contraction in field of operations for public sector
2. Dismantling of controls
3. Dispersing Industries
 - Policy to shift industries away from big congested cities to rural and backward areas

- Incentives were brought to attract industries to village and backward regions
- Favoured agro-based industries near the farming areas

Limiting role of public sector

- Policy pointed out the grey area which were not fit for PSUs and needs to be vacated by them

Liberalization of foreign investments

- Foreign investment in the form of FDI allowed up to 50% with automatic approval
- Foreign investment in export promotion activities

Foreign technology had been made easy by allowing automatic approvals for technology related agreements

Promotion of Small Scale Industries (SSI)

- It ensured adequate supply of credit these industries based on their needs
- To enable modernization and technical up gradation, the policy allows equity participation by other non-SSI undertakings in SSI sector
- Limited partnership was allowed to enhance the supply of risk capital to the SSI sector
- It ensured the speedy payment towards the sale of products by SSI sector

Domestic Regulatory Reforms

- Reduced the number of reserve industries
- Security and Industries of strategic concern were reserved for public sector.

Abolition of Industrial Licensing : It abolished industrial licensing system for all industries except few such as security and strategic concerns, social concerns, related to safety and manufacture of hazardous industries.

BALANCE OF PAYMENTS

The balance of payments (BOP) is the method countries use to monitor all international monetary transactions at a specific period. Usually, the BOP is calculated every quarter and every calendar year. All trades conducted by both the private and public sectors are accounted for in the BOP to determine how much money is going in and out of a country. If a country has received money, this is known as a credit, and if a country has paid or given money, the transaction is counted as a debit.

Theoretically, the BOP should be zero, meaning that assets (credits) and liabilities (debits) should

balance, but in practice, this is rarely the case. Thus, the BOP can tell the observer if a country has a deficit or a surplus and from which part of the economy the discrepancies are stemming. A country's trade balance equals the value of its exports minus its imports.

The formula is $X - M = TB$, where:

X = Exports

M = Imports

TB = Trade Balance

With reference to India, the components of Balance of Payments (BOP) are as under:

Major Items of India's Balance of Payments	
	<i>(US\$ Billion)</i>
A. Current Account	
1. Goods	
Of which:	
POL	
2. Services	
3. Primary Income	
4. Secondary Income	
B. Capital Account and Financial Account	
Of which:	
Change in Reserves (Increase (-)/Decrease (+))	
C. Errors & Omissions (-) (A+B)	
P: Preliminary; PR: Partially Revised	

Source : RBI

FAVOURABLE AND UNFAVOURABLE BALANCE OF TRADE

The balance of trade or Net Exports is the difference between the monetary value of exports and imports of output in an economy over a certain period of time. It is the relationship between a nation's imports and exports. A favorable balance of trade is known as a trade surplus and consists of exporting more than is imported; an unfavorable balance of trade is known as a trade deficit or, informally, a trade gap.

1. Favourable Balance of Trade

When there is an excess of exports over imports, it is called favourable balance of trade. In 1976-77 in India the imports were of value of INR 5073 crore while exports were of value of INR 5142 crore. Thus, balance of trade was +INR 69 crore. Further, it assists in strengthening the economy of a country.

2. Unfavourable Balance of Trade

When there is excess of imports over exports, it is called an unfavourable balance of trade. In India in 1982-83 imports were of value INR 14,047 crore while exports were of value of INR 8,637 crore. Balance of trade was INR -5410 crore. Further, it create problems for an economy.

Recent scenario of India's Balance of Trade

India's trade deficit narrowed to USD 13.45 billion in August 2019 from USD 17.92 billion in the same month last year and below market expectations of USD 13.60 billion. Merchandise exports fell 6.05 percent to USD 26.13 billion, due mainly to a 12.29 percent slump in sales of gems and jewellery. Meanwhile, major commodity groups posted positive growth: iron ore (356.66 percent); electronic goods (45.89 percent); spices (35.35 percent); marine products (5.28 percent); and mica, coal & other ores, minerals (2.24 percent). Meanwhile, imports tumbled 13.45 percent to USD 39.58 billion as purchases fell for coal, coke & briquettes (-23.75 percent), organic & inorganic chemicals (-14.95 percent), petroleum, crude & products (-8.90 percent), machinery, electrical & non-electrical (-8.80 percent) and electronic goods (-4.12 percent). Considering April-August 2019-20, the trade deficit narrowed to USD 72.85 billion from USD 83.19 billion in the same period of the previous fiscal year. Balance of Trade in India averaged -2645.81 USD Million from 1957 until 2019, reaching an all time high of 258.90 USD Million in March of 1977 and a record low of -20210.90 USD Million in October of 2012.

FOREIGN INVESTMENTS IN INDIA - TYPES AND FLOWS

Any investment that is made in India with the source of funding that is from outside of India is a foreign investment. By this definition, the investments that are made by Foreign Corporates, Foreign Nationals, as well as Non-Resident Indians would fall into the category of Foreign Investment.

Types of Foreign Investments

Funds from foreign country could be invested in shares, properties, ownership / management or collaboration. Based on this, Foreign Investments are classified as below.



Details on each of the foreign investment type can be found below:

Foreign Direct Investment (FDI)

FDI is an investment made by a company or individual who us an entity in one country, in the form of controlling ownership in business interests in another country. FDI could be in the form of either establishing business operations or by entering into joint ventures by mergers and acquisitions, building new facilities etc.

Foreign Portfolio Investment (FPI)

Foreign Portfolio Investment (FPI) is an investment by foreign entities and non-residents in Indian securities including shares, government bonds, corporate bonds, convertible securities, infrastructure securities etc. The intention is to ensure a controlling interest in India at an investment that is lower than FDI, with flexibility for entry and exit.

Foreign Institutional Investment (FII)

Foreign Institutional Investment (FPI) is an investment by foreign entities in securities, real property and other investment assets. Investors include mutual fund companies, hedge fund companies etc. The intention is not to take controlling interest, but to diversify portfolio ensuring hedging and to gain high returns with quick entry and exit.

Differences between FDI and FII

BASIS FOR COMPARISON	FDI	FII
Meaning	When a company situated in one country makes an investment in a company situated abroad, it is known as FDI.	FII is when foreign companies make investments in the stock market of a country.
Entry and Exit	Difficult	Easy
What it brings?	Long term capital	Long/Short term capital
Transfer of	Funds, resources, technology, strategies, know-how etc.	Funds only
Economic Growth	Yes	No
Consequences	Increase in country's Gross Domestic Product (GDP)	Increase in capital of the country
Target	Specific Company	No such target, investment flows into the financial market
Control over a company	Yes	No

Source: keydifferences.com

Difference between FDI and FPI

<i>BASIS FOR COMPARISON</i>	<i>FDI</i>	<i>FPI</i>
Meaning	FDI refers to the investment made by the foreign investors to obtain a substantial interest in the enterprise located in a different country.	When an international investor, invests in the passive holdings of an enterprise of another country, i.e. investment in the financial asset, it is known as FPI.
Role of investors	Active	Passive
Degree of control	High	Very less
Term	Long term	Short term
Management of Projects	Efficient	Comparatively less efficient
Investment in	Physical assets	Financial assets
Entry and exit	Difficult	Relatively easy
Results in	Transfer of funds, technology and other resources	Capital inflows

Source: keydifferences.com

Sample Questions

1. In which year The Industries (Development and Regulation) Act came into force ?
(a) 1952
(b) 1971
(c) 1983
(d) 1996
2. When there is an excess of exports over imports, it is called _____.
(a) Favourable balance of trade
(b) Unfavourable balance of trade
(c) Favourable Fiscal Deficit
(d) Unfavourable Fiscal Deficit
3. _____ is an investment made by a company or individual who us an entity in one country, in the form of controlling ownership in business interests in another country.
(a) Foreign Portfolio Investment
(b) Foreign Institutional Investment
(c) Foreign Direct Investment
(d) Foreign Grants
4. What does RKVY stands for?
(a) Rashtriya Krishi Vikas Yojana
(b) Rashtriya Kamgaar Vikas Yojana
(c) Rashtriya Kendra Vikas Yojana
(d) Rashtriya Krishi Vishesh Yojana

5. What was the term of Twelfth Five Year Plan of India?
- (a) 2002-07
 - (b) 1990-95
 - (c) 1995-2000
 - (d) 2012-17**

Lesson 6

**Entrepreneurship
Scenario**

GOVERNMENT INITIATIVES TO FOSTER ENTREPRENEURSHIP

Initiatives taken by the Government of India to strengthen entrepreneurship in India are as under:

1. **Make in India** : Businesses from across the globe, and not merely the Americas, consider Make in India as a breakthrough policy of the new India. The 'Make in India' programme was launched in September 2014 soon after the Modi Government came to power.

As a national programme, the Make in India initiatives is aimed at transforming India into a global manufacturing hub, and contained a raft of proposals to attract investments from both local and foreign corporate houses in 25 key areas it has identified, such as:

- (a) Automobiles
- (b) Chemicals
- (c) Information Technology
- (d) Pharmaceuticals
- (e) Textiles
- (f) Aviation
- (g) Leather
- (h) Tourism
- (i) Hospitality
- (j) Wellness
- (k) Railways
- (l) Infrastructure

With this scheme, the government has increased the FDI limit in various industries to attract foreign investment and participation

It has established an investor facilitation centre to assist foreign businesses locate partners and sites, while a slew of measures have been initiated for domestic companies, which were revealed after Modi Government unveiled the 'Stand Up India' initiative in his Independence Day address in 2015.

2. **Stand Up India** : The Stand up India scheme aims at promoting entrepreneurship among women and scheduled castes and tribes. The scheme is anchored by Department of Financial Services (DFS), Ministry of Finance, Government of India.

Stand-Up India Scheme facilitates bank loans between Rs 10 lakh and Rs 1 Crore to at least one Scheduled Caste (SC) or Scheduled Tribe (ST) borrower and at least one woman borrower per bank branch for setting up a Greenfield enterprise. This enterprise may be in manufacturing, services or the trading sector. In case of non-individual enterprises at least 51% of the shareholding and controlling stake should be held by either an SC/ST or woman entrepreneur.

Eligibility

- SC/ST and/or woman entrepreneurs, above 18 years of age.
- Loans under the scheme are available for only green field project. Green field signifies, in this context, the first time venture of the beneficiary in the manufacturing or services or trading sector.
- In case of non-individual enterprises, 51% of the shareholding and controlling stake should be held by either SC/ST and/or Women Entrepreneur.
- Borrower should not be in default to any bank/financial institution.

Loan details

- *Nature of Loan* - Composite loan (inclusive of term loan and working capital) between 10 lakh and upto 100 lakh.
- *Purpose of Loan* - For setting up a new enterprise in manufacturing, trading or services sector by SC/ST/Women entrepreneur.
- *Size of Loan* - Composite loan of 75% of the project cost inclusive of term loan and working capital. The stipulation of the loan being expected to cover 75% of the project cost would not apply if the borrower's contribution along with convergence support from any other schemes exceeds 25% of the project cost.
- *Interest Rate* - The rate of interest would be lowest applicable rate of the bank for that category (rating category) not to exceed (base rate (MCLR) + 3%+ tenor premium).
- *Security* - Besides primary security, the loan may be secured by collateral security or guarantee of Credit Guarantee Fund Scheme for Stand-Up India Loans (CGFSIL) as decided by the banks.
- *Repayment* - The loan is repayable in 7 years with a maximum moratorium period of 18 months.
- *Working Capital* - For withdrawal of Working capital upto 10 lakh, the same may be sanctioned by way of overdraft. Rupay debit card to be issued for convenience of the borrower. Working capital limit above 10 lakh to be sanctioned by way of Cash Credit limit.

- **Margin Money** - The Scheme envisages 25% margin money which can be provided in convergence with eligible Central / State schemes. While such schemes can be drawn upon for availing admissible subsidies or for meeting margin money requirements, in all cases, the borrower shall be required to bring in minimum of 10% of the project cost as own contribution.

3. Startup India : Startup India Scheme is an initiative by the Government of India for generation of employment and wealth creation. The goal of Startup India is the development and innovation of products and services and increasing the employment rate in India. Benefits of Start-up India Scheme is Simplification of Work, Finance support, Government tenders, Networking opportunities. Startup India was launched by Prime Minister Shri. Narendra Modi on 16th January 2016.

Benefits of Startup India

- (a) **Financial benefits** - Most of the start-ups are patent based. It means they produce or provide unique goods or services. In order to register their patents, they have to incur a heavy cost which is known as the Patent Cost.

Under this scheme, the government provides 80% rebate on the patent costs. Moreover, the process of patent registration and related is faster for them. Also, the government pays the fees of the facilitator to obtain the patent.

- (b) **Income Tax Benefits** - Start-ups enjoy a good amount of benefits under the Income Tax head. The government exempts their 3 years income tax post the incorporation year. But they can avail it only after getting a certificate from the Inter-Ministerial Board. Also, they can claim exemption from tax on Capital Gains if they invest money in specified funds.
- (c) **Registration Benefits** - Everyone believes that incorporation and registration of business are far more difficult than running it. It is because of the long and complex steps of registration. Under the Start-up India scheme, an application is there to facilitate registration. A single meeting is arranged to at the Start-up India hub. Also, there is a single doubt and problem-solving window for them.
- (d) **Government Tenders** - Everyone seeks to acquire Government tenders because of high payments and large projects. But it is not easy to acquire the government tenders. Under this scheme, the start-ups get priority in getting government tenders. Also, they are not required to have any prior experience.
- (e) **Huge Networking Opportunities** - Networking Opportunities means the opportunity to meet with various startup stakeholders at a particular place and time. The government provides this opportunity by conducting 2 startups fests annually (both at domestic as well as the international level). Startup India scheme also provides Intellectual Property awareness workshop and awareness.

Registration of the Start-up can be done only from following types of companies-

1. Partnership Firm
2. Limited Liability Partnership Firm
3. Private Limited Company.

4. Skill India

The contents on National Skill Development Corporation to be included at the end of the contents covered under the aforesaid point.

National Skill Development Corporation

National Skill Development Corporation (NSDC) is a not-for-profit public limited company incorporated on July 31, 2008 under section 25 of the Companies Act, 1956 (corresponding to section 8 of the Companies Act, 2013). NSDC was set up by Ministry of Finance as Public Private Partnership (PPP) model. The Government of India through Ministry of Skill Development & Entrepreneurship (MSDE) holds 49% of the share capital of NSDC, while the private sector has the balance 51% of the share capital.

NSDC aims to promote skill development by catalyzing creation of large, quality and for-profit vocational institutions. Further, the organisation provides funding to build scalable and profitable vocational training initiatives. Its mandate is also to enable support system which focuses on quality assurance, information systems and train the trainer academies either directly or through partnerships. NSDC acts as a catalyst in skill development by providing funding to enterprises, companies and organizations that provide skill training. It also develops appropriate models to enhance, support and coordinate private sector initiatives. The differentiated focus on 21 sectors under NSDC's purview and its understanding of their viability will make every sector attractive to private investment.

The details of various schemes and initiatives are provided below-

- (a) *Pradhan Mantri Kaushal Kendra* : Vocational training needs to be made aspirational to transform India into the skill capital of the world. In line with the same, Ministry of Skill Development and Entrepreneurship (MSDE) intends to establish visible and aspirational Model Training Centres (MTCs) in every district of the country. NSDC is the implementation agency for the project.

The model training centres envisage to:

- Create benchmark institutions that demonstrate aspirational value for competency-based skill development training.
- Focus on elements of quality, sustainability and Connection with stakeholders in skills delivery process.

- Transform from a Mandate-driven footloose model to a sustainable institutional model.

Funding Support

Capital Expenditure

NSDC will provide a concessional secured loan funding per centre, up to 75% of the project investment, to cover expenditure only related to:

- Training infrastructure including purchase of plant, machinery & equipment
- Training aid and other associated items
- Civil work including setting up prefabricated structures and retrofit existing structures

Operations Support

The sustainability of the centres will be assured against dedicated training numbers under Pradhan Mantri Kaushal Vikas Yojna (PMKVY) or its successor schemes (any other scheme under MSDE or NSDC). Each PMKK will be assured a training mandate for three years, under the PMKVY scheme, as per common norms, subject to capacity and utilization of the centre.

- (b) *International Skill Training* : A country's ability and potential for growth is determined by the size of its youth population. Youth today need to be harnessed, motivated, skilled and streamlined to bring rapid progress for a country.

India has the relative advantage at present over other countries in terms of distribution of youth population even when compared to large, fast growing Asian economies such as China and Indonesia, the two major countries other than India which determine the demographic features of Asia.

Skill Development and Entrepreneurship: Policy

Recognizing the imperative need for skill development, National Skill Development Policy was formulated in 2009. Given the vast paradigm shift in the skilling and entrepreneurship ecosystem in the country and the experience gained through implementation of various skill development programmes, a need was felt to revisit the existing policy to align the policy framework with the emerging trends in the national and international milieu. Accordingly, Government framed the National Policy for Skill Development and Entrepreneurship 2015. The primary objective of this policy was to meet the challenge of skilling at scale with speed, standard (quality) and sustainability.

Pre-Departure Orientation Training (PDOT)

Given the need to orient potential migrant workers with regards to language, culture, do's and don'ts in the destination country, the emigration process and welfare measures,

PDOT program has been launched. Ministry of External Affairs (MEA) in collaboration with Ministry of Skill Development and Entrepreneurship (MSDE) is conducting the PDOT program. NSDC is the implementing agency for this program.

A longer variant of PDOT i.e. 160 hours was offered at all IISCs which consisted of country orientation, language and digital literacy.

A shorter variant of PDOT program i.e. 1 Day (ongoing) is offered to all migrant workers who are likely to depart soon and register for the training through registered recruitment agents.

PDOT program is delivered by trainers who have undergone Training of Trainers (ToT) program organized by MEA. So far, 52 trainers from existing IISCs and NSDC Training Partners have undergone the PDOT (ToT).

- c) *Technical Intern Training Program* : The program promotes international collaboration through the transfer of skills, technology, and knowledge among the participating countries thereby, contributing towards the human resource development. It offers training to the workers for a specific period (3 – 5 years) in Japan's industrial society.

The objective is to ensure that the most competent youth is selected and sent to Japan to participate in TITP.

Ministry of Skill Development & Entrepreneurship (MSDE), Government of India and the Ministry of Justice, Ministry of Foreign Affairs and Ministry of Health, Labour and Welfare of Japan signed a Memorandum of Cooperation initiating the Technical Intern Training Program (TITP) in India in October 2017.

5. Investment in physical infrastructure

India's infrastructure development has not kept pace with economic growth as it continues to be beleaguered by perennial problems. To name a few, these challenges revolve around poor project management practices, financing and regulation. The rising demand for infrastructure facilities, rapid growth in urbanisation, bulging of the middle class and an increasing working-age population would engender substantial increase in infrastructure investments during the next few years.

Sustained investment in infrastructure is one of the key imperatives for turning the "Make in India" vision into reality. Achieving a manufacturing-led transformation would necessitate addressing the bottlenecks across infrastructure.

The Government has started taking initiatives in this direction and rewards are being witnessed. To start with, public spending on infrastructure such as roads, railways, irrigation and urban infrastructure has received a significant fillip in the Budget. Many bottlenecks facing infrastructure projects have been eased, particularly in the area of procedurally complex environmental rules. The execution of planned infrastructure in a timely and high quality

manner would provide the necessary boost to the manufacturing sector and help India realise her true potential in manufacturing.

Significant pick-up in infrastructure investments can be expected in the coming years given the various initiatives taken by the Government to address the infrastructure bottlenecks. The Government strategy to increase investment in infrastructure through a combination of public investment and public private partnership indicates an increased thrust on the sector. The Government has also emphasized the need for stepping up the scale and scope of private investment in infrastructure by allowing 100% FDI in some areas of railway infrastructure and by easing of FDI rules in construction. Development of smart cities is likely to bridge the gap in infrastructure development in the country.

Given the renewed emphasis on infrastructure sector by boosting infrastructure financing coupled with initiatives to enhance physical infrastructure such as roads, railways, urban infrastructure, the investment in physical infrastructure is expected to increase sharply. According to D&B's estimates, physical infrastructure investment is expected to surge to 10.4% of GDP by FY25 from around 7.5% (Estimated) of GDP in FY15. Resolution of policy bottlenecks such as land acquisition and improvement in demand conditions would also stoke private infrastructure investment.

NEED FOR ENTREPRENEURSHIP IN INDIA

The entrepreneurs are considered 'change agents' in the process of industrial and economic development of an economy. The premium mobile role that entrepreneurs play in promoting industrial and economic development of an economy is well adduced across the countries.

In a sense, entrepreneurs are the 'spark plugs' who transform the economic scene of an economy. The developed countries have more entrepreneurial development as compared to underdeveloped countries.

Thus, the need for entrepreneurs in India may be captured in the following points:

1. Entrepreneurs promote capital formation by mobilising the idle saving of the people.
2. They create immediate and large-scale employment by establishing small-scale enterprises. Thus, they reduce the unemployment problem in the country, i.e., the root cause of all socio-economic problems.
3. They promote balanced regional development by establishing small-scale enterprises in rural, remote and less developed regions.
4. They help reduce the concentration of economic power.
5. They promote the equitable redistribution of wealth, income and even political power in the interest of the country.
6. They encourage effective resource mobilization of capital and skill which might otherwise remain unutilized and idle.

7. They, by establishing industries, induce backward and forward linkages which stimulate the process of economic development in the country.
8. Last but no means the least; they also promote country's export business, i.e. an important ingredient to economic development.

BOTTLENECKS IN ENTREPRENEURIAL GROWTH

1. Inefficient time management

Most entrepreneurs think on infinite time scales, as though they have plenty of time to achieve their goals. Time is the most valuable resource, yet most entrepreneurial leaders don't use it effectively. It is very important to analyze the business flow metrics and identify time-wasting processes. Comparing the performance with industry standards to find out the problem areas in a major challenge. Leveraging technology tools such as automation and machine learning wherever possible is very important in contemporary times.

McKinsey & Co. reported that the next era of supply chain management will hinge on autonomous vehicles and a network of smart programs that can optimize efficiency. Organisational efficiency can be increased by implementing software solutions that break through bottlenecks and boost productivity.

2. Lack of money

Inadequate funds – Less funding and the resources obtained by these funds -- can hinder expansion. When it comes to resolving bottlenecks, money matters a lot. It helps in the purchase of a software programs and hire consultants who reduce the obstacles to growth and profitability. As the company expands, there is a need to scale up the technology, invest in sales enablement and direct resources to a number of other critical areas. Money is needed to achieve all of that.

Fortunately, there are a number of capital sources out there. In addition to venture capital funding, one can apply for a loan backed by the Small Business Administration. Loans repaid in less than seven years typically incur a less than 10 percent interest rate, and these loans can be used to purchase new technology or building your team with supply chain experts.

3. Too much noise

Building and running a start-up can become too complex when the entrepreneur is trying to cut through the noise generated through social media, marketing, apps and vendors. It's enough to make entrepreneurs think they need to chase down the "next big thing" and clamour for the media limelight.

But limelight doesn't guarantee success. Many companies that drew huge amounts of press and venture funding have ultimately failed. The better path is to focus on the work and trust that attention will come. Put out a great product, and be rigorous about clearing ones path to growth. The accolades will follow, but they matter only if one can scale and thrive sustainably.

4. A small (or nonexistent) network

Being a first-time entrepreneur, with a near-nonexistent industry, developing contacts is one of the biggest challenges to overcome. A strong network is crucial to a company's growth. But strong networks aren't built through viral campaigns or flashy marketing. They develop over years through resilience, relationship-building and cultivation of a community around the idea. In Japan and China, sustainable strong networks are an integral part of the value chain and supply chain.

To build a supportive network around one's own business, the type of reach an entrepreneurship wants to have is critical. Is the brand primarily local? Thereafter, a blueprint needs to be put down, roots have to be made, through partnerships and sponsorships with influencers in the region.

If the entrepreneur wants to have global appeal, there is a need to attend conferences and reach out internationally to learn how to move into other markets. The entrepreneur must become relevant to the rest of the world.

5. Growing too much too soon

With the objective of growing production, the problems also compound at the same rate. Figuring out how to scale requires frequent testing and a willingness to pivot -- the entrepreneur doesn't want to miss out on strategic opportunities. For instance, there's nothing wrong with starting small and growing slowly. It's better to take that approach than to overinvest in a lackluster strategy. One needs to pay attention and switch gears when that's needed.

When Groupon, a US based start-up started the concept of online couponing in 2008, it was a tremendous hit. But Groupon focused too much on customer acquisition and not enough on customer retention. So when the company rushed to scale, it hadn't dealt with its preexisting issues. Within months of filing its IPO in 2011, Groupon's share price plunged from \$20 to \$9.

As common as these issues are, startup founders are actually the biggest bottlenecks in their own businesses. They believe they have to do everything themselves, and they try to charge through problems on their way to growth. Hence, there is a strong need to create strong internal bonds and decentralisation systems.

Sample Questions

1. According to a/ an _____, 300 mn youth will enter the labour force by 2025.
 - (a) Reserve Bank of India Report
 - (b) Central Statistical Office Report
 - (c) World Bank Report
 - (d) Indian Labour Report**
2. The Stand up India scheme is managed by which of the following ministry?
 - (a) Ministry of Finance**
 - (b) Ministry of Human Resource Development
 - (c) Ministry of Statistics and Programme Implementation
 - (d) Ministry of Labour
3. “Most entrepreneurs think on infinite time scales, as though they have eons to achieve their goals”. The mentioned phrase relates to which of the following bottleneck?
 - (a) Growing too much too soon
 - (b) A small (or nonexistent) network
 - (c) Too much noise
 - (d) Inefficient time management**
4. ‘Make in India’ programme that was launched in _____.
 - (a) September 2015
 - (b) September 2017
 - (c) September 2014**
 - (d) September 2018

5. Registration of the Start-up cannot be done for which of the following type of company?
- (a) Partnership Firm
 - (b) Limited Liability Partnership Firm
 - (c) Private Limited Company.
 - (d) Public Limited Company**

Lesson 7

Business Environment

OVERVIEW OF BUSINESS ENVIRONMENT

Business organization has to interact and transact with its environment. Hence, both the business and environment are totally interrelated and mutually interdependent. Business environment refers to those aspects of the surroundings business enterprise, which affect or influence its operations and determine its effectiveness.

According to Keith Davis, “Business environment is the aggregate of all conditions, events and influence that surrounds and affect it”.

According to Andrews, “The environment of a company as the pattern of all external influences that affect its life and development”.

The business environment is always changing and is uncertain. It is because of dynamism of environment. As it is already said that the business environment is the sum of all the factors outside the control of management of a company, the factor, which are constantly changing, and they carry with them both opportunities and risks or uncertainties which can, make or mark the future of business.

Business environment encompasses all those factors that affect a company’s operations and includes customers, competitors, stakeholders, suppliers, industry trends, regulations other government activities, social and economic factors and technological developments. Thus, business environment refers to the external environment and includes all factors outside the firm, which lead to opportunities and threats of a firm.

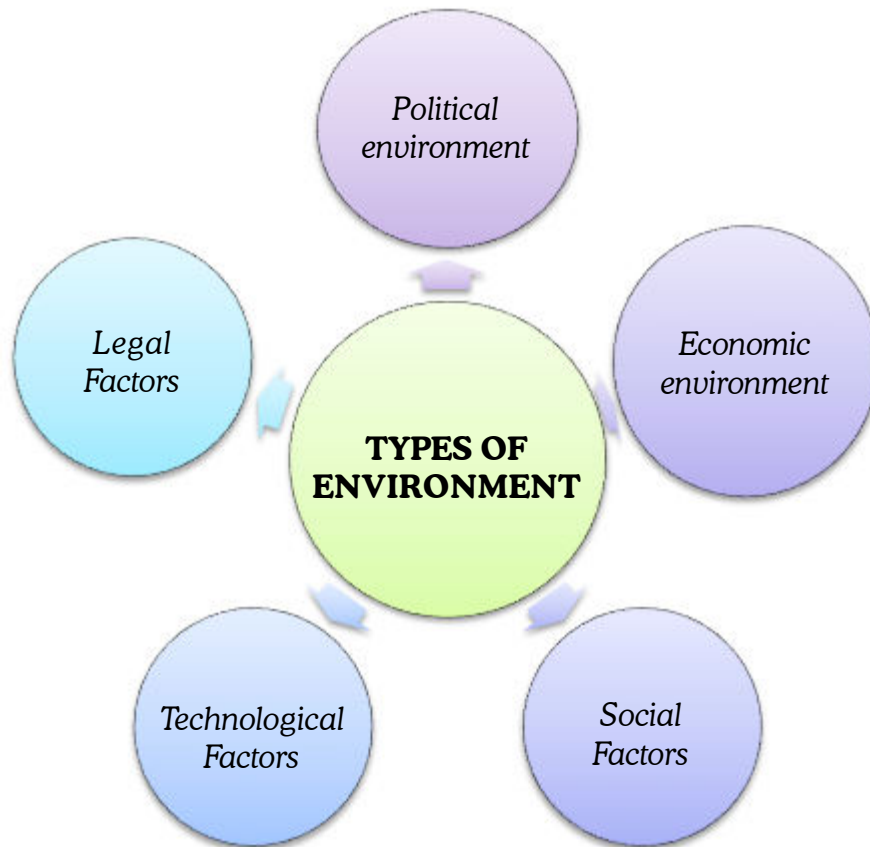
FEATURES AND FACTORS INFLUENCING BUSINESS ENVIRONMENT

The main features of business environment are:

1. *All the external forces* : Business Environment includes all the forces, institutions and factors which directly or indirectly affect the Business Organizations.
2. *Specific and general forces* : Business environment includes specific forces such as investors, customers, competitors and suppliers. Non-human or general forces are Social, Legal, Technological, Political, etc. which affect the Business indirectly.
3. *Inter-relation* : All the forces and factors of Business Environment are inter-related to each other. For example with inclination of youth towards western culture, the demand for fast food is increasing.
4. *Uncertainty* : It is very difficult to predict the changes of Business Environment. As environment is changing very fast for example in IT, fashion industry frequent and fast changes are taking place.
5. *Dynamic* : Business environment is highly flexible and keep changing. It is not static or rigid that is why it is essential to monitor and scan the business environment continuously.

6. *Complex* : It is very difficult to understand the impact of Business environment on the companies. Although it is easy to scan the environment but it is very difficult to know how these changes will influence Business decisions. Some-time change may be minor but it might have large impact. For example, a change in government policy to increase the tax rate by 5% may affect the income of company by large amount.
7. *Relativity* : The impact of Business environment may differ from company to company or country to country. For example, when consumer organisation CES published the report of finding pesticides in cold drinks, resulted in decrease in sale of cold drinks, on the other hand it increased the sale of juice and other drinks.

TYPES OF ENVIRONMENT



- 1. Political environment :** The political environment affects the economic environment of businesses. Legislators at the local, state and federal levels may provide incentives or tax breaks to companies or they can impose regulations that restrict business transactions. In the latter case, for example, if a political body states that a company must include a certain chemical in its product, the cost of the product differs. The company passes those costs on to the customer in the form of higher prices. The customer must determine whether he wants to purchase that product. If he does not purchase the product, then the company does not receive the revenue. If a large number of customers decide not to purchase the product, the company may need to lay off employees.
- 2. Economic environment :** The larger economic environment of a society is a factor that can affect a company's business environment. During a recession, consumers spend less on optional items such as cars and appliances. As a result, the business environment suffers. On the other hand, if the economic environment is one of prosperity, consumers are more likely to spend money, not just on necessities, but larger items as well.
- 3. Social Factors :** Social factors that affect the economic environment of a business are the cultural influences of the time. For example, a fashion designer that creates bell bottom, striped pants will not succeed in an environment where straight-leg, solid colored pants are desired. A social environment that tends to be more conservative will not support styles that appear to be trendy. The fashion designer's business will suffer if he does not change the clothing style. The same would apply to the manufacturers that produce and stores that sell these wares.
- 4. Technological Factors :** Innovation and technology affect business environments. As technology advances, a business is forced to keep pace. For example, when computers were first invented, they were the size of a room. Users were forced to employ punch cards to perform basic functions. Today, computers that are much more powerful can fit into the palm of a hand. Businesses that do not keep up with technology risk increased costs of production and higher prices. If the company's cost to produce a product or service outpaces competitors, the company may soon find itself out of business.
- 5. Legal Factors :** Often, a business will need to change how it operates for legal reasons. This is often done when a company's lawyers anticipate a change in legislation, or it may be due to lawsuits, already filed or anticipated. For example, if a part in a machine is found to be defective, the company may need to issue a recall. If other companies in the same industry are being sued over something like a data breach of confidential information, a business may need to change how information is collected and stored.

EASE OF DOING BUSINESS INDEX BY WORLD BANK FOR INDIA

In the World Bank's latest Doing Business Report (DBR, 2019), India has recorded a jump of 23 positions against its rank of 100 in 2017 to be placed now at 77th rank among 190 countries assessed by the World Bank. India's leap of 23 ranks in the Ease of Doing Business ranking is significant considering that last year India had improved its rank by 30 places, a rare feat for any large and diverse country of

the size of India. As a result of continued efforts by the Government, India has improved its rank by 53 positions in last two years and 65 positions in last four years.

The Doing Business assessment provides objective measures of business regulations and their enforcement across 190 economies on ten parameters affecting a business through its life cycle. The DBR ranks countries on the basis of Distance to Frontier (DTF), a score that shows the gap of an economy to the global best practice. This year, India's DTF score improved to 67.23 from 60.76 in the previous year.

India has improved its rank in 6 out of 10 indicators and has moved closer to international best practices (Distance to Frontier score) on 7 out of the 10 indicators. But, the most dramatic improvements have been registered in the indicators related to 'Construction Permits' and 'Trading across Borders'. In grant of construction permits, India's rank improved from 181 in 2017 to 52 in 2018, an improvement of 129 ranks in a single year. In 'Trading across Borders', India's rank improved by 66 positions moving from 146 in 2017 to 80 in 2018. The changes in six indicators where India improved its rank are as follows:

S. No.	Indicator	2017	2018	Change
1	Construction Permits	181	52	+129
2	Trading Across Borders	146	80	+66
3	Starting a Business	156	137	+19
4	Getting Credit	29	22	+7
5	Getting Electricity	29	24	+5
6	Enforcing Contracts	164	163	+1
	Overall rank	100	77	+23

The important features of India's performance are:

- The World Bank has recognized India as one of the top improvers for the year.
- This is the second consecutive year for which India has been recognized as one of the top improvers.
- India is the first BRICS and South Asian country to be recognized as top improvers in consecutive years.
- India has recorded the highest improvement in two years by any large country since 2011 in the Doing business assessment by improving its rank by 53 positions.

- As a result of continued performance, India is now placed at first position among South Asian countries as against 6th in 2014.

Indicator wise highlights of India's performance are:

A. Construction Permits

- Procedures reduced from 37 to 20 in Mumbai and from 24 to 16 in Delhi
- Time reduced from 128.5 to 99 days in Mumbai and from 157.5 to 91 days in Delhi
- Building quality control index improved from 12 to 14 in Mumbai and 11 to 14 in Delhi
- Cost of obtaining construction permits reduced from 23.2 percent to 5.4 percent
- DTF score improved from 38.80 to 73.81

B. Trading Across Borders

- Changes in time and cost are as follows:

Delhi	Import				Export			
	Documentary Compliance		Border Compliance		Documentary Compliance		Border Compliance	
	Time (hrs.)	Cost (\$)	Time (hrs.)	Cost (\$)	Time (hrs.)	Cost (\$)	Time (hrs.)	Cost (\$)
2017	58	140	262	550	21	90	125	413
2018	25	100	92	323	6	80	77	253

Mumbai	Import				Export			
	Documentary Compliance		Border Compliance		Documentary Compliance		Border Compliance	
	Time (hrs.)	Cost (\$)	Time (hrs.)	Cost (\$)	Time (hrs.)	Cost (\$)	Time (hrs.)	Cost (\$)
2017	65	129	267	536	58	94	85	348
2018	35	100	102	340	24	75	54	250

Source: pib.gov.in

- Robust Risk Management System has reduced inspections significantly
- e-Sanchit allows traders to file all documents electronically
- Time and cost to export reduced through the introduction of electronic self-sealing of container at the factory

C. Starting a Business

- a. Procedures reduced from 11 to 10 in Delhi and 12 to 10 in Mumbai
- b. Time reduced from 30 to 16 days in Delhi and 29.5 to 17 days in Mumbai
- c. PAN, TAN, DIN now merged with SPICe making it a single form for company incorporation
- d. No requirement of inspection for registration under Shops & Establishment in Mumbai
- e. Distance to Frontier improved from 75.40 to 80.96

D. Access to Credit

- a. Rank improved from 29 to 22
- b. DTF improved from 75 to 80
- c. Strength of legal rights index improved from 8 to 9
- d. Secured creditors will now be repaid first during business liquidation hence given priority over other claims

E. Access to Electricity

- a. Procedures reduced from 5 to 3 in Delhi and 5 to 4 in Mumbai
- b. DTF improved from 85.21 to 89.15

Improvement has taken place due to the commitment of the Government to carry out comprehensive and complex reforms, supported by the bureaucracy which has changed its mindset from a regulator to a facilitator. The Government has undertaken an extensive exercise of stakeholder consultations to understand challenges of the industry, government process re-engineering to provide simplified and streamlined processes to create a more conducive business environment in the country. As a result of continued efforts, India's rank has improved as follows:

<i>Year</i>	<i>2014</i>	<i>2016</i>	<i>2017</i>	<i>2018</i>
Overall rank	142	130	100	77
DTF	53.97	56.05	60.76	67.23

The eight indicators in which India has improved its rank over last four years:

S. No.	Indicator	2014	2018	Change
1	Construction Permits	184	52	+132
2	Getting Electricity	137	24	+113
3	Trading across Borders	126	80	+46
4	Paying Taxes	156	121	+35
5	Resolving Insolvency	137	108	+29
6	Enforcing Contracts	186	163	+23
7	Starting a Business	158	137	+21
8	Getting Credit	36	22	+14

Source: pib.gov.in

EASE OF DOING BUSINESS INDEX BY DEPARTMENT FOR PROMOTION OF INDUSTRY AND INTERNAL TRADE (DPIIT) FOR STATES

Department for Promotion of Industry and Internal Trade (DPIIT), in coordination with Central Ministries/Departments and Governments of States/Union Territories (UTs), has taken several reform measures with an aim to improve regulatory environment and facilitate doing business in India. The details of action taken in this regard are given below:

A. World Bank's Ease of Doing Business Assessment

The World Bank released the Doing Business Report (DBR), 2019 on 31st October, 2018. India ranks 77 among 190 countries assessed by the Doing Business Team. India has leapt 23 ranks over its rank of 100 in the DBR 2018. The DBR is an assessment of 190 economies and covers 10 indicators which span the lifecycle of a business. The indicator wise rank of India in World Bank's DBR 2019 is as follows:

S. No.	Indicator	Rank
1.	Starting a Business	137
2.	Dealing with Construction Permits	52
3.	Getting Electricity	24

4.	Registering Property	166
5.	Getting Credit	22
6.	Protecting Minority Investors	7
7.	Paying Taxes	121
8.	Trading Across Borders	80
9.	Enforcing Contracts	163
10.	Resolving Insolvency	108
	Overall	77

Some of the major indicator wise reforms undertaken by the Government towards easing the business environment in the country are as under:

(i) Starting A Business

- a. The minimum capital requirement for public and private company has been eliminated under the Companies (Amendment) Act, 2015.
- b. Introduced a single form SPICe (Simplified Proforma for Incorporating Company electronically) by merging five different applications in it i.e. Name reservation, Company incorporation, Director Identification Number (DIN), Permanent Account Number (PAN) and the Tax Deduction/Collection Account Number (TAN).
- c. Introduced an e-form AGILE (Application for registration of the Goods and Services Tax Identification Number (GSTIN), Employees' State Insurance Corporation (ESIC) registration plus Employees' Provident Fund Organization (EPFO) registration). Any applicant, if he wants to register for any of these bodies, can fill in e-form AGILE and get registration at the time of company incorporation itself. This form enables a user to apply for GST, EPF and ESI registration with the SPICe form.
- d. Launch of a new and simplified web based service i.e. R.U.N. (Reserve Unique Name) for reserving a name. This has also removed the requirement to use a Digital Signature Certificate (DSC) during name reservation.
- e. Incorporation fee reduced to zero for companies with authorized capital up to INR 15 lakhs
- f. The requirement to issue a physical PAN card has been eliminated. Additionally, PAN and TAN are mentioned in the Certificate of Incorporation (CoI) which is considered as a sufficient proof for PAN and TAN.

- g. Online and common registration for EPFO & ESIC is provided on ShramSuvidha Portal.
- h. Registrations under Mumbai Shops & Establishments Act are provided in real time without any cost and any inspection
- i. Eliminated the requirement of bank account details for GST registration

(ii) Dealing with Construction Permits:

- a. An online single window system has been introduced in Delhi (By Municipal Corporations in Delhi) and Mumbai (By Municipal Corporation of Greater Mumbai) integrating internal and external departments, removing requirement of visiting them individually.
- b. Unified building bye-laws 2016 have been introduced in Delhi.
- c. Deemed approvals have been introduced in Delhi, if approvals are not granted within defined timelines.
- d. Risk based classification of buildings has been introduced for fast tracking building plan approval, inspection and grant of occupancy-cum-completion certificate.
- e. Requirement of submitting notarized certificates or affidavits for building plan approval has been replaced with e-undertaking in Delhi.
- f. Multiple inspections at completion stage have been replaced by single joint inspection in Delhi.
- g. Road cutting and restoration for water and sewer connections have been simplified.

(iii) Getting Electricity

- a. Procedures for internal wiring inspection by the Electrical Inspectorate (in Delhi) have been eliminated.
- b. In Delhi, service line charges have been capped to INR 25,000/- in electrified areas for Low Tension loads up to 150 KW.
- c. Time taken by the utility to carry out external connection works has been reduced in Delhi.

(iv) Getting Credit

- a. Secured creditors are paid first during business liquidation, and hence have priority over other claims such as labour and tax.

(v) Paying Taxes

- a. 17 indirect Central and State taxes have been replaced with a single indirect tax, Goods and Service Tax (GST), for the entire country. The previous sales taxes including the

central sales tax, CENVAT, state VAT and the service tax have been merged into the GST. Unification of these taxes will reduce the cascading effect of taxes and make taxes paid on inputs creditable to a higher percentage.

- b. Corporate income tax has been reduced from 30% to 25% for companies with a turnover up to INR 250 crore.
- c. Electronic System for payment of Social Security Contributions has been introduced enabling easier return payment.
- d. Making payment of EPF has been made mandatory electronically.
- e. Administrative charges on The Employees' Provident Funds Scheme, 1952 (EPFS) have been reduced in March 2017 from 0.85% to 0.65% of the monthly pay. The Employees' Deposit Linked Insurance (EDLI) administrative charges of 0.01% have been removed.

(vi) Trading Across Borders

- a. Time and cost to export and import has been reduced through various initiatives, including the implementation of electronic sealing of containers, upgradation of port infrastructure and allowing electronic submission of supporting documents with digital signatures.
- b. Enhancement of risk-based inspections for both imports and exports, whereby only about 5% of goods are physically inspected.
- c. Advance Bill of Entry has been adopted which allows importers to start the process of customs clearance before the arrival of the vessel.
- d. Equipment on the NhavaSheva Port in Mumbai has been upgraded by adding 15 new Rubber Tyre Gantry Cranes. The Phase 1 of the Fourth Container Terminal at the Jawaharlal Nehru Port Trust, with an additional annual capacity of 2,400,000 TEUs, was completed in February 2018.
- e. The new container terminal, Adani CMA Mundra Terminal Private Limited has been fully operational since June 2017, with an additional annual capacity of 1,300,000 TEUs.
- f. e-Sanchit, an online application system, under the Single Window Interface for Trade (SWIFT) has been implemented. It allows traders to submit all supporting documents electronically with digital signatures.

(vii) Enforcing Contracts

- a. National Judicial Data Grid has been introduced which makes it possible to generate case measurement report on local courts.
- b. The Commercial Courts Act 2015 has been amended to reduce the pecuniary jurisdiction

of commercial courts from INR 1 crore to INR 3 lakhs to establish commercial courts at the District Level. This will help in speedier disposal of commercial disputes and reduce pendency.

(viii) Resolving Insolvency

- a. Insolvency and Bankruptcy Code 2016 has been adopted that introduced a reorganization procedure for corporate debtors and facilitated continuation of the debtors' business during insolvency proceedings.
- b. Professional institutions have been established for effective handling of restructuring and insolvency proceedings.
- c. Time-bound resolution process is done under the IBC and liquidation is the last resort.
- d. Section 42 of the Insolvency & Bankruptcy Code 2016 has been amended to provide that a creditor has the right to object to decisions of the liquidator accepting or rejecting claims against the debtor brought by the creditor itself and by any other creditor.

B. Implementation of Business Reforms by States/UTs

1. The Department spearheaded a dynamic reform exercise that commenced in 2014 to rank all the States/UTs in the country based on implementation of designated reform parameters.
2. The aim of this exercise is to create a conducive business environment by streamlining regulatory structures and creating an investor-friendly business climate by cutting down red tape.
3. DPIIT also developed an online portal, which can be accessed at <http://eodb.dipp.gov.in>, wherein all the reforms implemented are accessible for public viewing. The portal also gives dynamic ranking which updates, as and when, any of the reform points are recognized and approved.
4. In 2017, the reform exercise was updated to 372 action points with additions introduced such as Central Inspection system, Trade License, Registration under Legal Metrology, and Registration of Partnership Firms & Societies.
5. Initiatives taken by DPIIT for the reform process:
 - i. A nationwide workshop was held on 29th July, 2017 to discuss the relevance and importance of implementing reforms. The all-day conference witnessed an active involvement of almost 100 participants from 26 States/UTs. The workshop witnessed sharing of the best practices by States/UTs
 - ii. A unique handholding method was introduced where leading States were partnered with laggard States/UTs. West Bengal merits a special mention for its effort for conducting a 3 day workshop for Nagaland

- iii. Priority reforms was identified for North east States and others with low implementation score
 - iv. 8 workshops were conducted along with the World Bank to address queries posed by States/UTs in Tripura, Punjab, Haryana, Daman & Diu, Dadra Nagar Haveli, Andaman and Nicobar Islands, Goa and Karnataka
 - v. To handhold all the 8 north-eastern States, video conferences were arranged.
 - vi. The assessment of States/UTs under Business Reform Action Plan, 2017-18 was released jointly by DPIIT and the World Bank on 10th July, 2018.
6. Some important achievements under the exercise for 2017-18 are:-
- i. 19 States have designed an Information Wizard providing information for all approvals, licenses, registrations timelines, and procedure to establish business/industrial unit (pre-establishment & pre-operation).
 - ii. 21 States/UTs have designed and implemented online Single Window System.
 - iii. 16 States/UTs have stipulated Construction Permits to be provided within 45 days (Building plan approval to be provided in 30 days/ Plinth level inspection to be completed in 7 days, final occupancy certificate provided in 8 days). Telangana, Assam and Tamil Nadu have mandated even shorter timelines of 29, 30 and 37 days, respectively. Tamil Nadu has claimed to have done away with the process of issuance of completion certificate.
 - iv. 21 States/UTs have implemented a GIS system to provide details about the land earmarked for industrial use across the State
 - v. 23 States/UTs have reduced the number of documents required for Obtaining Electricity connection to only 2
 - vi. 18 States/UTs have brought all compliance inspections conducted by Labour, Factories, Boilers Departments and Pollution Control Boards under Central Inspection Framework
 - vii. 12 States/UTs have merged of the payment of court fees and process fees into a single transaction with some states like Jharkhand, Maharashtra, and Gujarat even repealing process fees from the Court Fees Act
 - viii. 29 States/ UTs have notified a list of white category industries exempted from taking pollution clearances.
 - ix. 20 States/UTs implementing an online application system Wholesale Drug License and Retail Drug License (Pharmacy).
 - x. 18 States/UTs have online systems for Registration of Partnership firms and Societies,

- xi. 20 States/UTs have implemented an online system for registration and renewal under the Legal Metrology Act, 2009.
7. Business Reform Action Plan 2019 for States
- i. An 80 point Action Plan, 2019 has been prepared by DPIIT and shared with all the States and UTs for implementation of reforms.
 - ii. As capacity building initiatives, 7 workshops have been conducted in Union Territories (Dadra & Nagar Haveli, Delhi, Chandigarh, Daman & Diu, Puducherry, Andaman & Nicobar Islands and Lakshadweep).
 - iii. 8 regional workshops have been conducted in Lucknow (North Region), Kolkata (East Region), Mumbai (West Region), Bengaluru (South Region) and Guwahati (North-eastern Region).
8. District Reform Action Plan: A comprehensive 218-point District Reform Plan has been prepared and shared with the State Governments with a request to implement the same in the districts. The Action Plan is spread across 8 areas: Starting a Business for Construction, Urban Local Body Services, Paying Taxes, Land Reform Enabler, Land Administration and Property Registration Enablers, Obtaining Approval, Miscellaneous and Grievance Redressal/ Paperless Courts and Law & Order.

Sample Questions

1. The World Bank released the Doing Business Report (DBR), 2019 on _____.
(a) 31st October, 2018
(b) 31st August, 2018
(c) 31st July, 2018
(d) 31st May, 2018
2. The DBR is an assessment of _____ and covers 10 indicators which span the lifecycle of a business.
(a) 200 economies
(b) 190 economies
(c) 180 economies
(d) 170 economies
3. In the World Bank's latest Doing Business Report(DBR, 2019), India has recorded a jump of 23 positions to be placed at _____ among 190 countries
(a) 77th rank
(b) 87th rank
(c) 97th rank
(d) 107th rank
4. Who gave the following definition, "Business environment is the aggregate of all conditions, events and influence that surrounds and affect it"?
(a) FW Taylor
(b) Henry Fayol

(c) Keith Davis

(d) Maslow

5. According to Ease of Doing Business Index by Department for Promotion of Industry and Internal Trade (DPIIT) for States, what is the rank of India with reference to starting a business?

(a) 140

(b) 157

(c) 167

(d) 137

Lesson 8

**Key Government
Institutions**

NITI AAYOG

Objectives

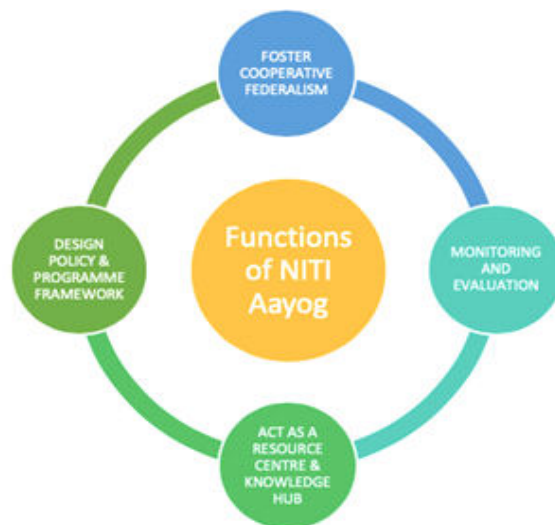
- To evolve a shared vision of national development priorities, sectors and strategies with the active involvement of States.
- To foster cooperative federalism through structured support initiatives and mechanisms with the States on a continuous basis, recognizing that strong States make a strong nation.
- To develop mechanisms to formulate credible plans at the village level and aggregate these progressively at higher levels of government.
- To ensure, on areas that are specifically referred to it, that the interests of national security are incorporated in economic strategy and policy.
- To pay special attention to the sections of our society that may be at risk of not benefiting adequately from economic progress.
- To design strategic and long term policy and programme frameworks and initiatives, and monitor their progress and their efficacy. The lessons learnt through monitoring and feedback will be used for making innovative improvements, including necessary mid-course corrections.
- To provide advice and encourage partnerships between key stakeholders and national and international like-minded Think tanks, as well as educational and policy research institutions.
- To create a knowledge, innovation and entrepreneurial support system through a collaborative community of national and international experts, practitioners and other partners.
- To offer a platform for resolution of inter-sectoral and inter-departmental issues in order to accelerate the implementation of the development agenda.
- To maintain a state-of-the-art Resource Centre, be a repository of research on good governance and best practices in sustainable and equitable development as well as help their dissemination to stake-holders.
- To actively monitor and evaluate the implementation of programmes and initiatives, including the identification of the needed resources so as to strengthen the probability of success and scope of delivery.
- To focus on technology upgradation and capacity building for implementation of programmes and initiatives.
- To undertake other activities as may be necessary in order to further the execution of the national development agenda, and the objectives mentioned above.

Features

NITI Aayog is developing itself as a State-of-the-art Resource Centre, with the necessary resources, knowledge and skills, that will enable it to act with speed, promote research and innovation, provide strategic policy vision for the government, and deal with contingent issues.

NITI Aayog's entire gamut of activities can be divided into four main heads:

1. Design Policy & Programme Framework
2. Foster Cooperative Federalism
3. Monitoring & Evaluation
4. Think Tank and Knowledge & Innovation Hub



The different verticals of NITI provide the requisite coordination and support framework for NITI to carry out its mandate. The list of verticals is as below:

1. Agriculture
2. Health
3. Women & Child Development
4. Governance & Research

5. HRD
6. Skill Development & Employment
7. Rural Development
8. Sustainable Development Goals
9. Energy
10. Managing Urbanization
11. Industry
12. Infrastructure
13. Financial Resources
14. Natural Resources & Environment
15. Science & Tech
16. State Coordination & Decentralized Planning (SC&DP)
17. Social Justice & Empowerment
18. Land & Water Resources
19. Data management & Analysis
20. Public-Private Partnerships
21. Project Appraisal and Management Division (PAMD)
22. Development Monitoring and Evaluation Office
23. National Institute of Labour Economics Research and Development (NILERD)

Sustainable Action For Transforming Human Capital (SATH)

'SATH' the programme for Sustainable Action for Transforming Human Capital (SATH) focuses on two main sectors — Education and Health and to build three 'Role Model' States.

After an elaborate selection process based on the Challenge Method, three States namely, Jharkhand, Madhya Pradesh and Odisha, were selected for the project. The program is being implemented in these States along with knowledge partners Boston Consulting Group (BCG) & Piramal Foundation for Education Leadership (PFEL) consortium with NITI Aayog as a facilitator and coordinator in the process.

The project is being implemented in three phases over a period of 30 months, coming to an end in 2020. The two phases of the project have been completed. It is now in the third phase of implementation, which will last for 18 months.

Major achievements under the project SATH-Education include:

- In depth field diagnosis of districts and schools of Jharkhand, Odisha, and Madhya Pradesh.
- State transformation roadmaps released for all the three States, which contain quarterly milestones committed for each initiative.
- Critical interventions including school mergers, remediation program, training, monitoring teacher recruitment/ rationalization, institutional reorganization at district and state level and proper utilization of MIS are in execution mode since January, 2018.

Progress of the project is being monitored through a National Steering Group (NSG) and Central Project Monitoring Unit (CPMU) at national level and State Project Monitoring Unit (SPMU) at State level.

MINISTRY OF CORPORATE AFFAIRS

The Ministry is primarily concerned with administration of the Companies Act 2013, the Companies Act 1956, the Limited Liability Partnership Act, 2008 & other allied Acts and rules & regulations framed there-under mainly for regulating the functioning of the corporate sector in accordance with law. The Ministry is also responsible for administering the Competition Act, 2002 to prevent practices having adverse effect on competition, to promote and sustain competition in markets, to protect the interests of consumers through the commission set up under the Act. Besides, it exercises supervision over the three professional bodies, namely, Institute of Chartered Accountants of India (ICAI), Institute of Company Secretaries of India (ICSI) and the Institute of Cost Accountants of India (ICAI) which are constituted under three separate Acts of the Parliament for proper and orderly growth of the professions concerned. The Ministry also has the responsibility of carrying out the functions of the Central Government relating to administration of Partnership Act, 1932, the Companies (Donations to National Funds) Act, 1951 and Societies Registration Act, 1980.

The affiliated offices of Ministry of Corporate Affairs are as under:

- (i) *Serious Fraud Investigation Office* : The Government in the backdrop of major failure of non-banking financial institutions, phenomenon of vanishing companies, plantation companies and the recent stock market scam had decided to set up Serious Fraud Investigation Office (SFIO), a multi-disciplinary organization to investigate corporate frauds. The Organization has been established and it has started functioning since 1st October, 2003.
- (ii) *Competition Commission of India* : The Competition Commission of India (CCI) was established under the Competition Act, 2002 for the administration, implementation and enforcement of the Act, and was duly constituted in March 2009. The following are the objectives of the Commission.
 1. To prevent practices having adverse effect on competition.

2. To promote and sustain competition in markets.
3. To protect the interests of consumers and
4. To ensure freedom of trade

Consequent upon a challenge to certain provisions of the Act and the observations of the Hon'ble Supreme Court, the Act was amended by the Competition (Amendment) Act, 2007. The Monopolies and Restrictive Trade Practices Act, 1969 [MRTP Act] repealed and is replaced by the Competition Act, 2002, with effect from 01st September, 2009 [Notification Dated 28th August, 2009].

- (iii) *Indian Institute Of Corporate Affairs*: IICA has been established by the Indian Ministry of Corporate Affairs for capacity building and training in various subjects and matters relevant to corporate regulation and governance such as corporate and competition law, accounting and auditing issues, compliance management, corporate governance, business sustainability through environmental sensitivity and social responsibility, e-Governance and enforcement etc.

One of the Wings of IICA, the ICLS Academy, has the responsibility for conducting the Induction & Advanced Training for probationary Officers (POs) belonging to the Indian Corporate Law Service recruited through the Common Exam of Civil Services Examination conducted by UPSC.

The Institute has been designed with an eye on the future to provide a platform for dialogue, interaction and partnership between governments, corporate, investors, civil society, professionals, academicians and other stake holders in the emerging 21st century.

SECURITIES AND EXCHANGE BOARD OF INDIA

Securities and Exchange Board of India (SEBI) is a statutory regulatory body entrusted with the responsibility to regulate the Indian capital markets. It monitors and regulates the securities market and protects the interests of the investors by enforcing certain rules and regulations. SEBI was founded on April 12, 1992, under the SEBI Act, 1992. Headquartered in Mumbai, India, SEBI has regional offices in New Delhi, Chennai, Kolkata and Ahmadabad along with other local regional offices across prominent cities in India.

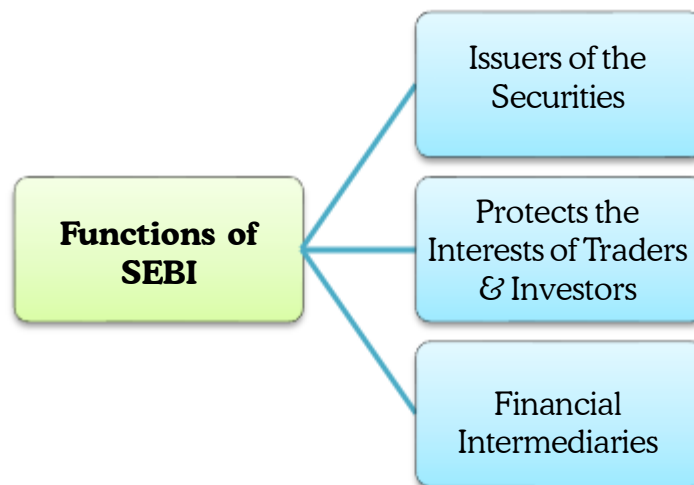
The objective of SEBI is to ensure that the Indian capital market works in a systematic manner and provide investors with a transparent environment for their investment. To put it simply, the primary reason for setting up SEBI was to prevent malpractices in the capital market of India and promote the development of the capital markets.

The Preamble of the Securities and Exchange Board of India describes the basic functions of the Securities and Exchange Board of India as:

“...to protect the interests of investors in securities and to promote the development of, and to regulate the securities market and for matters connected therewith or incidental thereto.”

Functions of SEBI

The functions and powers of SEBI have been listed in the SEBI Act, 1992. SEBI caters to the needs of three parties operating in the Indian Capital Market. These three participants are mentioned below:



- *Issuers of the Securities* : Companies that issue securities are listed on the stock exchange. They issue shares to raise funds. SEBI ensures that the issuance of Initial Public Offerings (IPOs) and Follow-up Public Offers (FPOs) can take place in a healthy and transparent way.
- *Protects the Interests of Traders & Investors* : It is a fact that the capital markets are functioning just because the traders exist. SEBI is responsible for safeguarding their interests and ensuring that the investors do not become victims of any stock market fraud or manipulation.
- *Financial Intermediaries* : SEBI acts as a mediator in the stock market to ensure that all the market transactions take place in a secure and smooth manner. It monitors every activity of the financial intermediaries, such as broker, sub-broker, NBFCs, etc

Powers of SEBI

Securities and Exchange Board of India has the following three powers:

Quasi-Judicial : With this authority, SEBI can conduct hearings and pass ruling judgements in cases of unethical and fraudulent trade practices. This ensures transparency, fairness, accountability and reliability in the capital market. SEBI PACL case is an example of this power.

Quasi-Legislative : Powers under this segment allow SEBI to draft rules and regulations for the protection of the interests of the investor. One such regulation is SEBI LODR (Listing Obligation and Disclosure Requirements). It aims at consolidating and streamlining the provisions of existing listing agreements for several segments of the financial market like equity shares. This type of regulation formulated by SEBI aims to keep any malpractice and fraudulent trading activities at bay.

Quasi-Executive : SEBI is authorised to file a case against anyone who violates its rules and regulation. It is empowered to inspect account books and other documents as well if it finds traces of any suspicious activity.

RESERVE BANK OF INDIA (RBI)

The Reserve Bank of India was established on April 1, 1935 in accordance with the provisions of the Reserve Bank of India Act, 1934.

The Central Office of the Reserve Bank was initially established in Calcutta but was permanently moved to Mumbai in 1937. The Central Office is where the Governor sits and where policies are formulated.

Though originally privately owned, since nationalisation in 1949, the Reserve Bank is fully owned by the Government of India.

The Preamble of the Reserve Bank of India describes the basic functions of the Reserve Bank as:

"to regulate the issue of Bank notes and keeping of reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage; to have a modern monetary policy framework to meet the challenge of an increasingly complex economy, to maintain price stability while keeping in mind the objective of growth."

Main Functions of RBI

Monetary Authority

- Formulates, implements and monitors the monetary policy.
- Objective: maintaining price stability while keeping in mind the objective of growth.

Regulator and supervisor of the financial system

- Prescribes broad parameters of banking operations within which the country's banking and financial system functions.
- Objective: maintain public confidence in the system, protect depositors' interest and provide cost-effective banking services to the public.

Manager of Foreign Exchange

- Manages the Foreign Exchange Management Act, 1999.
- Objective: to facilitate external trade and payment and promote orderly development and maintenance of foreign exchange market in India.

Issuer of currency

- Issues and exchanges or destroys currency and coins not fit for circulation.
- Objective: to give the public adequate quantity of supplies of currency notes and coins and in good quality.

Developmental role

- Performs a wide range of promotional functions to support national objectives.

Regulator and Supervisor of Payment and Settlement Systems

- Introduces and upgrades safe and efficient modes of payment systems in the country to meet the requirements of the public at large.
- Objective: maintain public confidence in payment and settlement system

Related Functions

- Banker to the Government: performs merchant banking function for the central and the state governments; also acts as their banker.
- Banker to banks: maintains banking accounts of all scheduled banks.

Other Significant Facts

- Has 27 regional offices, most of them in state capitals and 04 Sub-offices.
- Deposit Insurance and Credit Guarantee Corporation of India (DICGC), Bharatiya Reserve Bank Note Mudran Private Limited (BRBNMPL), Reserve Bank Information Technology Private Limited (ReBIT), Indian Financial Technology and Allied Services (IFTAS) are fully owned subsidiaries of Reserve Bank of India.
- Has six training establishments- Three, namely, RBI Academy, College of Agricultural
- Banking and Reserve Bank of India Staff College are part of the Reserve Bank.

Others are autonomous, such as, National Institute for Bank Management, Indira Gandhi Institute for Development Research (IGIDR), Institute for Development and Research in Banking Technology (IDRBT)

INSOLVENCY AND BANKRUPTCY BOARD OF INDIA (IBBI)

The Insolvency and Bankruptcy Board of India was established on 1st October, 2016 under the Insolvency and Bankruptcy Code, 2016 (Code). It is a key pillar of the ecosystem responsible for implementation of the Code that consolidates and amends the laws relating to reorganization and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner for maximization of the value of assets of such persons, to promote entrepreneurship, availability of credit and balance the interests of all the stakeholders.

It is a unique regulator: regulates a profession as well as processes. It has regulatory oversight over the Insolvency Professionals, Insolvency Professional Agencies, Insolvency Professional Entities and Information Utilities. It writes and enforces rules for processes, namely, corporate insolvency resolution, corporate liquidation, individual insolvency resolution and individual bankruptcy under the Code. It has recently been tasked to promote the development of, and regulate, the working and practices of, insolvency professionals, insolvency professional agencies and information utilities and other institutions, in furtherance of the purposes of the Code. It has also been designated as the 'Authority' under the Companies (Registered Valuers and Valuation Rules), 2017 for regulation and development of the profession of valuers in the country.

NATIONAL COMPANY LAW TRIBUNAL (NCLT)

The Central Government has constituted National Company Law Tribunal (NCLT) under section 408 of the Companies Act, 2013 (18 of 2013) w.e.f. 01st June 2016.

In the first phase the Ministry of Corporate Affairs have set up eleven Benches, one Principal Bench at New Delhi and ten Benches at New Delhi, Ahmadabad, Allahabad, Bengaluru, Chandigarh, Chennai, Guahati, Hyderabad, Kolkata and Mumbai. These Benches will be headed by the President and 16 Judicial Members and 09 Technical Members at different locations.

National Company Law Tribunal is the outcome of the Eradi Committee. NCLT was intended to be introduced in the Indian legal system in 2002 under the framework of Companies Act, 1956 however, due to the litigation with respect to the constitutional validity of NCLT which went for over 10 years, therefore, it was notified under the Companies Act, 2013. It is a quasi-judicial authority incorporated for dealing with corporate disputes that are of civil nature arising under the Companies Act. However, a difference could be witnessed in the powers and functions of NCLT under the previous Companies Act and the 2013 Act. The constitutional validity of the NCLT and specified allied provisions contained in the Act were re-challenged. Supreme Court had preserved the constitutional validity of the NCLT, however, specific provisions were rendered as a violation of the constitutional principles.

NCLT works on the lines of a normal Court of law in the country and is obliged to fairly and without any biases determine the facts of each case and decide with matters in accordance with principles of natural justice and in the continuance of such decisions, offer conclusions from decisions in the form of orders. The orders so formed by NCLT could assist in resolving a situation, rectifying a wrong done by any corporate or levying penalties and costs and might alter the rights, obligations, duties or privileges of the concerned parties. The Tribunal isn't required to adhere to the severe rules with respect to appreciation of any evidence or procedural law.

Major Functions of NCLT

1. Registration of Companies

The new Companies Act, 2013 has enabled questioning the legitimacy of companies because of specific procedural errors during incorporation and registration. NCLT has been empowered in taking several steps, from cancelling the registration of a company to dissolving any company. The Tribunal could even render the liability or charge of members to unlimited. With this approach, NCLT can de-register any company in specific situations when the registration certificate has been obtained by wrongful manner or illegal means under section 7(7) of the Companies Act, 2013.

2. Transfer of shares

NCLT is also empowered to hear grievances of rejection of companies in transferring shares and securities and under section 58- 59 of the Act which were at the outset were under the purview of the Company Law Board. Going back to Companies Act, 1956 the solution available for rejection of transmission or transfer were limited only to the shares and debentures of a company but as of now the prospect has been raised under the Companies Act, 2013 and the now covers all the securities which are issued by any company.

3. Deposits

The Chapter V of the Act deals with deposits and was notified several times in 2014 and Company Law Board was the prime authority for taking up the cases under said chapter. Now, such powers under the chapter V of the Act have been vested with NCLT. The provisions with respect to the deposits under the Companies Act, 2013 were notified prior to the inception of the NCLT. Unhappy depositors now have a remedy of class actions suits for seeking remedy for the omissions and acts on part of the company that impacts their rights as depositors.

4. Power to investigate

As per the provision of the Companies Act, 2013 investigation about the affairs of the company could be ordered with the help of an application of 100 members whereas previously the application of 200 members was needed for the same. Moreover, if a person who isn't related to a company and is able to persuade NCLT about the presence of conditions for ordering an investigation then NCLT has the power for ordering an investigation. An investigation which is ordered by the NCLT could be conducted within India or anywhere in the world. The provisions are drafted for offering and seeking help from the courts and investigation agencies and of foreign countries.

5. Freezing assets of a company

The NCLT isn't just empowered to freezing the assets of a company for using them at a later stage when such company comes under investigation or scrutiny, such investigation could also be ordered on the request of others in specific conditions.

6. Converting a public limited company into a private limited company

Sections 13-18 of the Companies Act, 2013 read with rules control the conversion of a Public limited company into the Private limited company, such conversion needs an erstwhile confirmation from the NCLT. NCLT has the power under section 459 of the Act, for imposing specific conditions or restrictions and might subject granting approvals to such conditions.

NATIONAL COMPANY LAW APPELLATE TRIBUNAL (NCLAT)

National Company Law Appellate Tribunal (NCLAT) was constituted under Section 410 of the Companies Act, 2013 for hearing appeals against the orders of National Company Law Tribunal(s) (NCLT), with effect from 1st June, 2016.

NCLAT is also the Appellate Tribunal for hearing appeals against the orders passed by NCLT(s) under Section 61 of the Insolvency and Bankruptcy Code, 2016 (IBC), with effect from 1st December, 2016. NCLAT is also the Appellate Tribunal for hearing appeals against the orders passed by Insolvency and Bankruptcy Board of India under Section 202 and Section 211 of IBC.

NCLAT is also the Appellate Tribunal to hear and dispose of appeals against any direction issued or decision made or order passed by the Competition Commission of India (CCI) – as per the amendment brought to Section 410 of the Companies Act, 2013 by Section 172 of the Finance Act, 2017, with effect from 26th May, 2017.

Jurisdiction of NCLAT

The National Company Law Appellate Tribunal is headed by the Chairperson and consists of not more than eleven members. It is a higher law governing forum than NCLT. The Appellate Tribunal hears appeals filed against the Tribunal court orders. The appeal can be placed within 45 days from the date on which NCLT announces its decisions. The Appellate Tribunal court goes through the evidence transferred from the Tribunal, making changes or confirming the order given by the latter. This process happens within a time span of six months.

Dissatisfaction with Tribunal Orders

If a group or an individual is to be dissatisfied with the orders passed by the Tribunal Court it is obvious to move on to the next, only, option, that is filing an appeal to the Appellate Court where the decisions of NCLT are reviewed and checked from the point of law and facts. The Tribunal Court is in charge of finding and gathering evidence while the Appellate Court decides cases based on the already collected evidence. If the outcome is not satisfactory even then, one should approach the Supreme Court.

Sample Questions

1. The Insolvency and Bankruptcy Board of India was established on _____.
(a) 1st October, 2016
(b) 1st October, 2017
(c) 1st October, 2015
(d) 1st October, 2018
2. Which of the following is not the affiliated office of Ministry of Corporate Affairs?
(a) Serious Fraud Investigation Office
(b) Competition Commission of India
(c) Indian Institute of Corporate Affairs
(d) Central Statistics Office
3. National Company Law Tribunal is the outcome of the _____
(a) Srikrishna Committee
(b) NL Mitra Committee
(c) Eradi Committee
(d) Uday Kotak Committee
4. National Company Law Appellate Tribunal (NCLAT) was constituted under _____ of the Companies Act, 2013
(a) Section 310
(b) Section 410
(c) Section 510
(d) Section 610

5. The Reserve Bank of India was established on _____
- (a) April 1, 1940
 - (b) April 1, 1950
 - (c) April 1, 1935**
 - (d) April 1, 1960

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