

## Economic Environment

\* Meaning: The economic environment relates to all the economic determinants that influence commercial and consumer compliance. The term economic environment indicates all the external economic circumstances that affect the purchasing practices of customers and markets. Hence, it influences the production of the business.

As a component of economic reformations, the government of India declared a new industrial system in July 1991. The extensive characteristics of this system were as follows:

- The government decreased the number of ~~ext~~ enterprises below mandatory licensing to six.
- Many of the businesses held for the public sector under the initial policy were justified. The purpose of the public sector was defined only to four industries of vital importance.
- Disinvestment was conducted in case of many public sector industrial companies.
- The automatic approval was now given for technology transactions with foreign firms.

## \* Elements of Economic Environment:

- Economic System
- Economic Conditions
- International economic environment
- Economic Policies

### I Economic System:

The scope of private and public sector and extent of government intervention in business depends on the nature of economic system, which is a crucial element of economic environment.

Mainly, there are three types of economic system:

- Capitalism
- Socialism
- Mixed Economy

#### 1. Capitalism:

Under the capitalism, all the factors of production are controlled and used by the private hands for profit motive.

It is characterized by economic liberty, i.e. freedom to choose any economic activity and employment. Capitalism system involves minimum government intervention in economic decisions.

#### 2. Socialism:

Socialism means economic system

Date : .....  
Page No. : .....

where all the economic factors are owned and controlled by the state.

These factors are used for the benefits of society. Under socialism system, government plays very active role in every economic activities.

### 3. Mixed Economy :

Mixed economic system is a combination of capitalist and socialist system of economy.

The main features of mixed economy is the co-existence of both public and private sector.

In this system, government role is limited only to regulate and control private sector. At present, many countries of the world such as India have mixed economic system of economy.

## II. Economic Conditions :

There are different economic factors which determine the nature and structure of an economy.

These factors also have significant impact on functioning and decision making of a firm.

The factors act as an opportunity or threat for a business.

Some of these economic factors are as follows :

- Gross Domestic Product (GDP)
- Per capita Income
- Inflation
- Breivailing interest rates
- Exchange Rate

### 1. Gross Domestic Product :

→ GDP is a very important indicator of health of an economy.

→ It is the gross value of goods and service produced in a economy during a particular accounting year.

→ GDP can be estimated by multiplying the quantity of goods and services produced with the market price.

→ The high growth of GDP indicates green signal for investment in the economy.

### 2. Per capita Income :

→ Per capita Income means the average annual income per person.

→ It can be calculated by dividing the national income by total population of the country.

### 3. Inflation :

- > Inflation refers to the increment in general price level or fall in the purchasing power.
- > Higher inflation rate adversely affects the aggregate demand in the economy.
- > High inflation rate increases the cost of production and makes the business uncompetitive.
- > High inflation rate also reduces the purchasing power of people in the economy.

### 4. Prevailing interest rates :

- > Prevailing interest in the economy influences both corporate borrowings and household borrowings.
- > The capital structure decision of a business firm completely depends on the market interest rates.
- > The expansion plans and decision of firm also depends on availability of funds at lower interest rates.

### s. Exchange Rate:

→ If a business is involved in international trade then it is also influenced by the exchange rate of currency.

→ The exchange rate can be defined as a price of one currency in terms of another currency.

### II International Economic Environment:

With an increase in foreign trade, foreign investment and scope of international organizations in the international economic environment has increased.

If any organization is involved in international business then it is not governed only by local economic environment but also by the international economic environment.

Various countries enter in trade agreements to facilitate foreign trade in the economy. These trade agreements also affect trade between member countries of agreement.

### IV Economic Policies :

All the business operations and activities are directly influenced by the economic policies of the government.

These policies are changed from time to time in view of changing requirements of

present economic scenario and political expediency.

Broadly economic policies include :

1. Industrial policies,
2. Trade policies.
3. Monetary policies
4. Fiscal policies

[in PPT or assignment]