

# BUSINESS ENVIRONMENT ( I BBA )

## UNIT- IV

PROF .K.PANNEERSELVAM

ASST PROFESSOR

ADAIKALAMATHA INSTITUTE OF MANAGEMENT,

VALLAM,THANJAVUR.

Panneerselvam.k@outlook.com

### FINANCIAL ENVIRONMENT

A **financial environment** is a part of an economy with the major players being firms, investors, and markets. Essentially, this sector can represent a large part of a well-developed economy as individuals who retain private property have the ability to grow their capital.

#### What are the components of financial environment?

The complete system of **financial environment** comprises of four important **components**. T

- (1) **financial** managers
- (2) investors
- (3) **financial** markets and
- ( 4) **Financial** instruments.

#### How does the financial environment operate?

A '**financial** system' is a system that allows the exchange of funds between **financial** market participants such as lenders, investors, and borrowers. **Financial** systems operate at national and global levels. ... **Financial** systems allow funds to be allocated, invested, or moved between economic sectors.

### The Reserve Bank of India (RBI)

What Is the Reserve Bank of India (RBI)?

The Reserve Bank of India (RBI) is the central bank of India, which was established on Apr. 1, 1935, under the Reserve Bank of India Act. The Reserve Bank of India uses monetary policy to create financial stability in India, and it is charged with regulating the country's currency and credit systems.

- The Reserve Bank of India (RBI) is the central bank of India,
- The RBI was originally set up as a private entity in 1935, but it was nationalized in 1949.
- The main purpose of the RBI is to conduct consolidated supervision of the financial sector in India, which is made up of commercial banks, financial institutions, and non-banking finance firms.

What is RBI and its functions?

- Reserve Bank of India (**RBI**) is **the** Central Bank of India. ...  
Key **functions** of **RBI** are, banker's bank, **the** custodian of foreign reserve, controller of credit and to manage printing and supply of currency notes in **the** country.

### **What Is a Commercial Bank?**

A commercial bank is a type of financial institution that accepts deposits, offers checking account services, makes various loans, and offers basic financial products like certificates of deposit (CDs) and savings accounts to individuals and small businesses. A commercial bank is where most people do their banking, as opposed to an investment bank.

Commercial banks make money by providing loans and earning interest income from those loans. The types of loans a commercial bank can issue vary and may include mortgages, auto loans, business loans, and personal loans. A commercial bank may specialize in just one or a few types of loans.

Customer deposits, such as checking accounts, savings accounts, money market accounts, and CDs, provide banks with the capital to make loans. Customers who deposit money into these accounts effectively lend money to the bank and are paid interest. However, the interest rate paid by the bank on money they borrow is less than the rate charged on money they lend.

- There is no difference between the type of money creation that results from the commercial money multiplier or a central bank, such as the Federal Reserve.
- Commercial banks make money by providing loans and earning interest income from those loans.
- A growing number of commercial banks operate exclusively online, where all transactions with the commercial bank must be made electronically.

#### **How a Commercial Bank Works**

The amount of money earned by a commercial bank is determined by the spread between the interest it pays on deposits and the interest it earns on loans it issues, which is known as net interest income.

Customers find commercial bank investments, such as savings accounts and CDs, attractive because they are insured by the Federal Deposit Insurance Corp. (FDIC), and money can be easily withdrawn. However, these investments traditionally pay very low interest rates compared with mutual funds and other investment products. In some cases, commercial bank deposits pay no interest, such as checking account deposits.

In a fractional reserve banking system, commercial banks are permitted to create money by allowing multiple claims to assets on deposit. Banks create credit that did not previously exist when they make loans. This is sometimes called the money multiplier effect. There is a limit to the amount of credit lending institutions can create this way. Banks are legally required to keep a certain minimum percentage of all deposit claims as liquid cash. This is called the reserve ratio. The reserve ratio in the United States is 10%. This means for every \$100 the bank receives in deposits, \$10 must be retained by the bank and not loaned out, while the other \$90 can be loaned or invested.

## Deposits

The largest source by far of funds for banks is deposits; money that account holders entrust to the bank for safekeeping and use in future transactions, as well as modest amounts of interest. Generally referred to as "core deposits," these are typically the checking and savings accounts that so many people currently have.

In most cases, these deposits have very short terms. While people will typically maintain accounts for years at a time with a particular bank, the customer reserves the right to withdraw the full amount at any time. Customers have the option to withdraw money upon demand and the balances are fully insured, up to \$250,000, therefore, banks do not have to pay much for this money. Many banks pay no interest at all on checking account balances, or at least pay very little, and pay interest rates for savings accounts that are well below U.S. Treasury bond rates.

## What is financial system and its functions?

A **financial system** is a network of **financial** institutions, **financial** markets, **financial** instruments and **financial** services to facilitate the transfer of funds. ... The **financial system** provides channels to transfer funds from individual and groups who have saved money to individuals and group who want to borrow money.

## Main Functions of Financial System

The functions of financial system can be enumerated as follows:

- Financial system works as an effective conduit for optimum allocation of financial resources in an economy.
- It helps in establishing a link between the savers and the investors.
- Financial system allows 'asset-liability transformation'. Banks create claims (liabilities) against themselves when they accept deposits from customers but also create assets when they provide loans to clients.
- Economic resources (i.e., funds) are transferred from one party to another through financial system.
- The financial system ensures the efficient functioning of the payment mechanism in an economy. All transactions between the buyers and sellers of goods and services are effected smoothly because of financial system.
- Financial system helps in risk transformation by diversification, as in case of mutual funds.
- Financial system enhances liquidity of financial claims.
- Financial system helps price discovery of financial assets resulting from the interaction of buyers and sellers. For example, the prices of securities are determined by demand and supply forces in the capital market.
- Financial system helps reducing the cost of transactions.

## Services Provided by the Financial System

1. **Risk Sharing:** Financial system provides risk sharing by allowing savers to hold many assets. It also means financial system enables individuals to transfer risk. Financial markets can create instruments to transfer risk from savers to borrowers who do not like uncertainty in returns or payments to savers or investors who are willing to bear risk. The ability of the

financial system to provide risk sharing makes savers more willing to buy borrowers' IOUs. This willingness, in turn, increases borrowers' ability to raise funds in the financial system.

2. **Liquidity:** The second service that financial system provides for savers and borrowers is liquidity, which is the ease with which an asset can be exchanged for money to purchase other assets or exchanged for goods and services. Most of the savers view the liquidity as a benefit. If an individual needs their assets for their own consumption and investment, they can just exchange it. Liquid assets allow an individual or firm to respond quickly to new opportunities or unexpected events. Bonds, stocks, or checking accounts are created by financial assets, which have more liquidity than cars, machinery and real estate.
3. **Information:** The third service of financial system is collection and communication of information or we can say that it is the facts about borrowers and expectations about returns on financial assets. The first informational role the financial system plays is to gather information. That includes finding out about prospective borrowers and what they will do with borrowed funds. Another problem that exists in most transactions is asymmetric information. This means that borrowers possess information about their opportunities or activities that they don't disclose to lenders or creditors and can take advantage of this information. The second informational role that financial system plays is communication of information. Financial markets do that job by incorporating information into the prices of stocks, bonds, and other financial assets. Savers and borrowers receive the benefits of information from the financial system by looking at asset returns. As long as financial market participants are informed, the information works its way into asset returns and prices.

## **International Economic Institutions**

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A broad set of institutions—from the World Trade Organization (WTO) to the World Bank and International Monetary Fund—underpin global trade and economic exchange. GTIPA-member reports in this category examine a variety of facets of international economic institutions, from WTO reform to the effect of regional development banks.

### **World Trade Organisation (WTO)**

#### **Introduction**

The World War–II, which lasted from 1939 to 1945, left many countries in Europe and Asia totally ravaged. Their economies were shattered; there was tremendous strain on political and social systems resulting in wide spread annihilation and migration of people. International peace was ruffled. Something had to be done to put these war-ravaged economies back in shape. Simultaneously, the various colonies in Asia and Africa were acquiring political freedom. And there was urgent pressure on them for rapid economic development and political stabilization. In this background the United Nations Organisation (UNO) was born on the collective wisdom of the world. Progressively, the UNO came to encompass the concerns for development in economic, commercial, scientific, social and cultural sphere of

the member nations. It formed various forums and agencies. One such forum under the UNO was the General Agreement on Tariffs and Trade (GATT) which was established in 1947.

GATT emerged from the —ashes of the Havana Charter. In International Conference on Trade and Employment in Havana in the winter of 1947-48, fifty-three nations drew up and signed a charter for establishing an International

Trade Organisation (ITO). But the US Congress did not ratify the Havana Charter with the result that the ITO never came into existence.

Simultaneously, twenty-three nations agreed to continue extensive tariff negotiations for trade concessions at Geneva, which were incorporated in a General Agreement of Tariffs and Trade. This was signed on 30th October 1947 and came into force from 1st January 1948 when other nations had also signed it.

The critical juncture was reached during the Uruguay Round of multilateral trade negotiations, which may be called the final act. It was signed by 12 countries in which India was signatory. Popularly known as Dunkel agreement, It finally emerged as the World Trade Organisation (WTO) on 1st January, 1995.

### **What is GATT**

The General Agreement on Tariffs and Trade (GATT) is neither an organisation nor a court of justice. It is simply a multinational treaty which now covers eighty per cent of the world trade. It is a decision making body with a code of rules for the conduct of international trade and a mechanism for trade liberalisation. It is a forum where the contracting parties meet from time to time to discuss and solve their trade problems, and also negotiate to enlarge their trade. The GATT rules provide for the settlement of trade disputes, call for consultations, waive trade obligations, and even authorize retaliatory measures.

The GATT has been a permanent international organisation having a permanent Council of Representative with headquarters at Geneva. 25 governments have signed it. Its function is to call International conferences to decide on trade liberalizations on a multilateral basis.

### **GATT 'Rounds' of Global Trade Negotiations**

The brief particulars of the various GATT 'Rounds' (conferences) for global trade negotiations are discussed below:

1. First Round:- The earlier rounds of GATT have achieved a limited measure of success. In the first round of talks held in Havana in 1947, 23 countries, which had formed GATT, exchanged tariff concessions on 45,000 products worth 10 billion US dollars of trade per annum.

2. Second Round:- Ten more countries had joined GATT when its second round was held in Annecy (France) in 1949. In this round, customs and tariffs on 5000 additional items of international trade were reduced.

3. Third Round:- The Third round was organized in Torquay (England) in 1950-51. 38 member countries of GATT participated in it and they adopted tariff reduction on 8700 items.

4. Fourth Round:- The fourth round of world trade negotiations were held in Geneva in 1955-56. In this round countries decided to further cut duties on goods entering international trade. The value of merchandise trade subjected to tariff cut was estimated at \$ 2.5b.

5. Fifth Round:- The fifth round took place during 1960-62 at Geneva. In this round the negotiations covered the approval of common external tariff (CET) of the European countries and cut in custom duties amounting to US \$ 5 billion on 4400 items. Twenty-six countries participated in this round.

6. Sixth Round or the Kennedy Round:- With the formation EEC, the US had been put at a disadvantage. As a reaction to this, the US Congress passed the Trade Expansion Act in October 1962 which authorised the Kennedy administration to make 50 per cent tariff reduction in all commodities. This paved the way for the opening of the Kennedy round of trade negotiations at Geneva in May 1964, which were to be completed by 30 June 1967.

This round had the participation of 62 countries and negotiated tariff reductions of approximately \$ 40 billion, covering about four-fifths of the world trade. The major industrial countries in this group applied substantial cuts on their dutiable imports, e.g. as much as 64 per cent cuts in the case of the United States, 3 per cent in case of Britain, 30 per cent in case of Japan, 24 per cent in case of Canada. They left the US and European tariff on the manufactured goods in the range of 5 to 15 per cent.

However, with regard to agricultural products, the negotiations had lesser success. They agreed on an average duty reduction of 25 per cent on agricultural items. Non-tariff obstacles, too remained untouched and scant attention was paid to the problems of developing countries.

An IMF study revealed that weighted average tariff for all industrial products had been reduced to 7.7 per cent, 9.8 per cent on finished manufactured products, 8 per cent on semi-finished products and 2 per cent on raw materials. Thus trade in industrial products after the completion of Kennedy Round was substantially free of restrictions.

7. Seventh Round or Tokyo Round:- The Seventh Round of Multilateral Trade Negotiations (MTN) was launched in September 1973 under the auspices of GATT. Its objectives were laid down in the Tokyo Declaration. The Declaration set out a far-reaching programme for the negotiations in six areas. These are (i) tariff reduction; (ii) reduction of elimination of non-tariff barriers; (iii) coordinated reduction of all trade barriers in selected sectors; (iv) discussion on the multilateral safeguard system; (v) trade liberalisation in the agricultural sector taking into account the special characteristics and (vi) special treatment of tropical products. It also emphasized that MTN must take into account the special, interests and problems of developing countries.

8. Eight Round or the Uruguay Round:- The Eighth Round of GATT negotiations which began at Punta Del Esta in Uruguay in September 1986 ought to have been concluded by the end of 1990. But at the ministerial meeting in Brussels in December 1990, an impasse was reached over the area of agriculture and the talks broke down.

The talks were restarted in February 1991 and continued till August 1991. On 20 December 1991, Aurthur Dunkel, the then Director-General of GATT tabled a Draft Final Act of the Uruguay Round, known as the Dunkel Draft Text. This was a —take-it-or-leave-itll document which was hotly discussed at various fora in the member countries through 1992 till July 1993 when the then Director General, Sutherland relaunched the negotiations in Geneva. On 31 August 1993, the Trade Negotiations Committee (TNC) passed a resolution to conclude the Uruguay Round by 15 December. On 15 December 1993 at the final session, Chairman Sutherland declared that seven years of Uruguay Round negotiations had come to an end. Finally, on 15 April 1994, 123 Ministers of member countries ratified the results of the Uruguay Round at Marrakesh (Morocco) and the GATT disappeared and passed into history and it was absorbed by the World Trade Organization (WTO) on 1 January 1995.

The Uruguay Round of trade negotiations undertaken by the GATT since its establishment in 1947 had a wide agenda. The GATT originally covered international trade rules in the goods sector only. Domestic policies were outside the GATT purview and it operated only at international border. In the Uruguay Round, the GATT extended to three new areas, viz.

Intellectual property rights services and investment. It also covered agriculture and textiles, which were outside the GATT jurisdiction.

The final year embodying the results of the Uruguay Round of Multilateral Trade Negotiations comprises 28 Agreements. It had two components: the WTO Agreement and the Ministerial decisions and declarations. The WTO Agreement

covers the formation of the organisation and the rules governing its working. Its Annexures contain the Agreements covering trade in goods, services, intellectual property rights, plurilateral trade, GATT Rules 1994, dispute settlement rules and trade policy review.

The Uruguay Round was concerned with two aspects of trade in goods and services. The first related to increasing market access by reducing or eliminating trade barriers. Reductions in tariffs, reductions in non-tariff support in agriculture, the elimination of bilateral quantitative restrictions, and reductions in barriers to trade in services met this. The second related to increasing the legal security of the new levels of market access by strengthening and expanding rules and procedures and institutions.

## **WORLD TRADE ORGANISATION (WTO)**

The WTO was established on January 1, 1995. It is the embodiment of the Uruguay Round results and the successor to GATT. 76 Governments became members of WTO on its first day. It has now 146 members, India being one of the founder members. It has a legal status and enjoys privileges and immunities on the same footing as the IMF and the World Bank. It is composed of the Ministerial Conference and the General Council. The Ministerial Conference (MC) is the highest body. It is composed of the representatives of all the Members. The Ministerial Conference is the executive of the WTO and responsible for carrying out the functions of the WTO. The MC meets at least once every two years.

The General Council (GC) is an executive forum composed of representatives of all the Members. The GC discharges the functions of MC during the intervals between meetings of MC. The GC has three functional councils working under its guidance and supervision namely:

- a) Council for Trade in Goods.
- b) Council for Trade in Services.



c) Council for Trade Related Aspects of Intellectual Property Rights (TRIPs).

Director-General heads the secretariat of WTO. He is responsible for preparing budgets and financial statements of the WTO. WTO has now become the third pillar of United Nations Organization (UNO) after World Bank and International Monetary Fund.

### **Objectives Of WTO**

In its preamble, the Agreement establishing the WTO lays down the following objectives of the WTO.

1. Its relation in the field of trade and economic endeavor shall be conducted with a view to raising standards of living, ensuring full employment and large and steadily growing volume of real income and effective demand, and expanding the production and trade in goods and services. 2. To allow for the optimal use of the world's resources in accordance with the objective of sustainable development, seeking both (a) to protect and preserve the environment, and (b) to enhance the means for doing so in a manner consistent with respective needs and concerns at different levels of economic development. 3. To make positive efforts designed to ensure that developing countries especially the least developed among them, secure a share in the growth in international trade commensurate with the needs of their economic development. 4. To achieve these objectives by entering into reciprocal and mutually advantageous arrangements directed towards substantial reduction of tariffs and other barriers to trade and the elimination of discriminatory treatment in international trade relations. 5. To develop an integrated, more viable and durable multilateral trading system encompassing the GATT, the results of past trade liberalisation efforts, and all the results of the Uruguay Round of multilateral trade negotiations.

6. To ensure linkages between trade policies, environment policies and sustainable development. Functions of WTO

The following are the functions of the WTO:

1. It facilitates the implementation, administration and operation of the objectives of the Agreement and of the Multilateral Trade Agreements. 2. It provides the framework for the implementation, administration and operation of the Plurilateral Trade Agreements relating to trade in civil aircraft, government procurement, trade in dairy products and bovine meat. 3. It provides the forum for negotiations among its members concerning their multilateral trade

relations in matters relating to the agreements and a framework for the implementation of the result of such negotiations, as decided by the Ministerial Conference. 4. It administers the Understanding on Rules and Procedures governing the Settlement of Disputes of the Agreement. 5. It cooperates with the IMF and the World Bank and its affiliated agencies with a view to achieving greater coherence in global economic policy-making. Differences Between GATT And WTO

The WTO is not an extension of the GATT but succession to the GATT. It completely replaces GATT and has a very different character. The major differences between the two are:

1. The GATT had no status whereas the WTO has a legal status. It has been created by international treaty ratified by governments and legislatures of member states. 2. The GATT was a set of rules and procedures relating to multilateral agreements of selective nature. There were separate agreements on separate issues, which were not binding on members. Any member could stay out of the agreement. The agreements, which form part of the WTO, are permanent and binding on all members. 3. The GATT dispute settlement system was dilatory and not binding on the parties to the dispute. The WTO dispute settlement mechanism is faster and binding on all parties.

4. GATT was a forum where the member countries met once in a decade to discuss and solve world trade problems. The WTO, on the other hand, is a properly established rule based World Trade Organization where decisions on agreement are time bound. 5. The GATT rules applied to trade in goods. Trade in services was included in the Uruguay Round but no agreement was arrived at. The WTO covers both trade in goods and trade in services. 6. The GATT had a small secretariat managed by a Director General. But the WTO has a large secretariat and a huge organizational setup. Implications for India

After the Uruguay Round, India was one of the first 76 Governments that became member of the WTO on its first day. Different views have been expressed in support and against our country becoming a member of the WTO.

### **Favourable Factors**

1. Benefits from reduction of tariffs on exports. 2. Improved prospects for agricultural exports because the prices of agricultural products in the world market will increase due to reduction in domestic subsidies and barriers to trade. 3. Likely increase in the exports of textiles and

clothing due to the phasing out of MFA by 2005. 4. Advantages from greater security and predictability of the international trading system. 5. Compulsions imposed on India to be competitive in the world market.

### **Unfavourable Factors**

1. Tariff reductions on goods of export interest to India are very small. 2. Less prospects of increase in agricultural exports due to the limited extent of agricultural liberalisation. 3. There will be hardly any liberalisation of our textile exports during the next 10 years. 4. India will be under pressure to liberalize the services industries. 5. There will be only marginal liberalisation to the movement of labour services in which it is competitive.

6. Increased outflows of foreign exchange due to commitments undertaken in the fields of TRIPS, TRIMS and services. 7. Technological dependence on foreign firms will increase as the R & D required to take advantages of Uruguay Round agreement may not be undertaken on adequate scale due to paucity of funds. 8. Only a few large firms or transnational corporations may benefit and smaller firms may disappear. 9. Increasing intrusion in our domestic space in TRIPs, TRIMs and services and agriculture. 10. The Uruguay Round has paved way for similar other institutions in future through linkage between trade, environment, labour standard and treatment of foreign capital. 11. Trend towards neo-protectionism in developed countries against our exports. To conclude, we may say that WTO membership is going to be beneficial to India in terms of global market thrown open to its goods and services. We must know how to take advantage of this situation. We should try to strengthen our position to sell our products abroad. For that we have to improve the quality of goods and services, cut down costs and wastage and improve our competitive strength.

### **Evaluation of WTO**

WTO has been in action for about nine years now. During this period of time, the WTO has proved that it is very different from its predecessor, GATT, in the following ways:

(a) GATT did not have any powers, whereas WTO with its dispute settlement mechanism has been an outstanding success. WTO has brought to book even USA in several cases. (b) GATT negotiating rounds took place once in a decade or so. What used to take decades to complete has been done in a few years by the WTO. Following are the achievements of WTO in the short period it has been in existence:

1. WTO has helped in making greater market orientations a general rule.

2. Tariff based protection has become the rule. 3. Restrictive measures, which were being used for balance of payments purposes, have declined markedly. 4. WTO has brought services trade into the multilateral system. Many countries are opening their markets for trade and investment either unilaterally or through regional or multilateral negotiations. 5. Many underdeveloped countries have promoted economic growth in their countries. They have undergone radical trade, exchange and domestic reforms, which have improved the efficiency of resource use and opened new investment opportunities. 6. Bilateralism has been, to a great extent, placed under control by the extension of WTO provisions to services, TRIPS and TRIMS and by the unified dispute settlement mechanism, in which the possibility of unilaterally blocking the adoption of panel decisions no longer exists. 7. The Trade Policy Review Mechanism has created a process of continuous monitoring of trade policy developments, which by promoting greater transparency has assisted in the process of liberalisation and reform. The WTO, however, has still to make progress on the following issues:

1. The trade reform process is incomplete in many countries, some tariff peaks remain, and negotiations are still proceedings in various areas, notably in basic telecommunications and financial services. 2. There have been at least some reversals in the overall liberalisation process in some developing countries. Examples may be increasing of antidumping measures, selective tariff increases and investment related measures. 3. The combination of globalisation and technological change creates a premium on high skill as against low skill. Concerns have been raised that this will amount to growing social divisions. 4. The major share of the benefits of the WTO has gone to the countries of the North. WTO has been much more beneficial to the developed countries where the benefits of free trade accrue primarily to the underdeveloped countries, the progress has been much slower. 5. The WTO has not done much for the development of non-tariff barriers to imports from the underdeveloped countries such as anti dumping duties.

6. —One size fits all approach is increasingly getting embedded in the WTO rules and disciplines. The policies and rules appropriate or advantages to the industrialized world are getting established as common rules to be obeyed by the developing countries as well. As a result, the multilateral trade rules are increasingly becoming a codification of the policies, perceptions, laws and regulations of the industrialized countries. 7. As a result of pressures

resulting from WTO, the interests of international trade, which are primarily the interests of transnational corporations take precedence over local concerns and policies even if such a course exposes the local population to serious health and security risks. 8. All the WTO members are not equally integrated in the multilateral system. 9. As brought out in the last Ministerial Meeting at Mexico in September 2003, the implementation related issues are becoming a source of serious concern. The implementation issues cover a whole range of demands. The issues requiring WTO attention relate to:

(i) TRIPS (ii) TRIMS (i) Anti-dumping (ii) Movement of natural persons (iii) Agriculture (iv) Textiles (v) Industrial tariffs including peak tariffs (vi) Services (vii) Rules to protect investments (viii) Competition policy (ix) Transparency in government procurement (x) Trade facilitation WTO has now become a forum for perpetual negotiations on newer and newer subjects and for using trade rules to establish standards and enforce compliance even in non-trade areas. Everything now seems to require the hand of WTO, be

it foreign investment, environmental or labour standards, child labour, good governance or human rights.

However, efforts should be made to see that WTO is not expanded into a sort of world government covering every economic subject under the sun and then using the threat of trade sanctions to bring about a new World Order. Trade Related Intellectual Property Rights

The Trade Related Intellectual Property Rights (TRIPs) Agreement covers the following seven categories of intellectual property:

1. Copyright and Related Rights: The members are required to comply with the Berne Convention for the protection of literary and artistic works. Computer Programmes are included in literary works. Authors of computer programmes and broadcasting organisations are to be given the right to authorize or prohibit the commercial rental of their works to public. This protection is extended for 50 years.
2. Trademarks: The owner of a registered trademark has the inclusive right to prevent all third parties not having the owner's consent from using in the course of trade identical or similar signs for goods or services. Registration and renewal of a trademark is for a period of not less than seven years.
3. Geographical Indications: Members are required to provide the legal means for interested parties to prevent the use of any indication which misleads the consumer as to the origin of goods and any use which would constitute an act of unfair competition. Additional protection is applied for

geographical indications for wines and spirits. 4. Industrial Designs: Industrial designs are protected for a period of 10 years. Owners of protected designs would be able to prevent the manufacture, sale or importation of articles bearing or embodying a design, which is a copy of the protected design for commercial purposes. 5. Patents: Patents shall be available for any inventions, whether products or processes, in all fields of technology, provided they are new, involve an inventive step and are capable of industrial application. Patent owner shall have the right to assign or transfer by succession, the patent and to conclude licensing contracts. The Agreement requires 20 years protection. The Agreement requires both process and product patent. It provides for 20 years product patent and a successive 20 years process patent.

6. Integrated Circuits: The TRIPs Agreement provides protection to the layout designs (topographies) of integrated circuits for a period of 10 years. But the protection shall lapse after 15 of the creation of the layout design. 7. Trade Secrets: Trade secrets and know-how having commercial value shall be protected against breach of confidence and other acts. Test data submitted to governments in order to obtain marketing approval for pharmaceuticals or agricultural chemicals shall be protected against unfair commercial use. This Agreement refers to the control of anti-competitive practices in contractual licenses pertaining to intellectual property rights. It provides for consultations between governments in order to protect intellectual property rights from being abused.

The Agreement requires a one-year transition period for developed countries to bring their legislation and practices into conformity with TRIPs. Developing countries will have 5 year transition period whereas the least developed countries will have a 11 year transition period. Those developing countries which do not provide product patent protection have been given 10 years.

**Trade Related Investment Measures** This agreement calls for the removal at all trade related investment measures within a period of five years. These measures are confined to quantitative restrictions and national treatment. In particular, they relate to such measures as investment in identified areas, level of foreign investments for treating foreign companies at par with the national companies, export obligation, and use of local raw materials. It prevents the imposition of any performance clauses on foreign investors in respect of earnings of foreign exchange, foreign equity participation, and transfer of technology. It requires foreign

investment companies to be treated at par with national companies. It requires free import of raw material, components and intermediates.

The Agreement recognizes that certain investment measures restrict and distort trade. It, therefore, requires mandatory notification of all non-conforming Trade Related Investment measures and their removal within seven years for developed countries, within five years for developing countries and within seven years for the least developed countries. It establishes a committee on Trade Related Investment Measures which will monitor the implementation of these commitments and report to the Council of Trade in Goods annually.

### **Agreement on Trade in Services**

This Agreement covers all internationally traded services. Foreign services and service suppliers would be treated on equal footings with domestic and service suppliers. However, governments may indicate Most Favoured Nation (MFN) exemptions, which will be reviewed after 5 years, with a normal limit of 10 years.

It requires transparency, which includes the publication of all-relevant laws and regulations relating to services trade. International payments and transfers relating to trade in services shall not be restricted, except in the event of balance of payments difficulties where such restrictions will be temporary limited and subjected to conditions. Any liberalization of trade in services would be progressive in character. It would be through negotiations at five-year intervals in order to reduce or remove the adverse effects of measures on trade in services and to increase the general level of specific commitments by the governments.

WTO 6th Ministerial conferences - Hong Kong (13–18 December, 2005) Ministers from the WTO's 149 member governments approved a declaration that many described as significant progress both since the July 2004 —package and after six days of intensive negotiations in Hong Kong which the chairperson described as —working like a dog. Despite the long hours and hard work, —it was worth it, WTO Director-General Pascal Lamy told a press conference late in the evening of the final day. —We

have managed to put the Round back on track after a period of hibernation. Hong Kong's Commerce, Industry and Technology Secretary John Tsang, who chaired the conference, outlined the achievements in the declaration: □ —We have secured an end date for all export subsidies in agriculture, even if it is not in a form to everybody's liking. □ —We have an agreement on cotton. □ —We have a very solid duty-free, quota-free access for the 32

least developed country members. □ —In agriculture and NAMA (non-agricultural market access), we have fleshed out a significant framework for full modalities. □ —And in services, we now have an agreed text that points positively to the way forward.¶ The declaration was agreed after several days of meetings late into the night, the last two continuing to the morning. —It's been a hard day's night. And I've been working like a dog,¶ Secretary Tsang said, quoting John Lennon and Paul McCartney. With the 44-page document now agreed, members face intense pressure in the new year to complete —full modalities¶ in agriculture and non-agricultural market access by the new deadline they have set themselves, 30 April 2006. Compared to the draft forwarded to Hong Kong from Geneva, a number of issues have been settled or partly settled. The most straightforward is the agreement to end export subsidies in agriculture by 2013, but this was only agreed at the last minute, and members paid tribute to the European Union which had the greatest difficulty on this issue. The declaration makes clear that the agreed date is conditional. Loopholes have to be plugged to avoid hidden export subsidies in credit, food aid and the sales of exporting state enterprises. For cotton the elimination is accelerated to the end of 2006. In addition, cotton exports from least-developed countries will be allowed into developed countries without duty or quotas from the start of the period for implementing the new agriculture agreement. Ministers have also agreed to aim to cut trade-distorting domestic subsidies on cotton by more than would normally apply under the new agreement, and to do so more quickly. The two sides negotiating this difficult subject paid tribute to each other for what they described as the spirit of compromise: United States and the four countries pushing for an agreement on cotton (Benin, Burkina Faso, Chad and Mali). A number of other details have been agreed in agriculture, non-agricultural market access and services

## **INTERNATIONAL MONETARY FUND (IMF)**

The International Monetary Fund, A Global Institution, is frequently in the news, but its role and functions are often misunderstood.

### The Origins of the IMF

The IMF was conceived in July 1944 at an international conference held at Bretton Woods, New Hampshire, U.S.A. Delegates from 44 governments agreed on a framework for economic cooperation partly designed to avoid a repetition of the disastrous economic policies that had contributed to the Great Depression of the 1930s. During that decade, as economic activity in the major industrial countries weakened, countries attempted to defend



their economies by increasing restrictions on imports; but this just worsened the downward spiral in world

trade, output, and employment. To conserve dwindling reserves of gold and foreign exchange, some countries curtailed their citizens' freedom to buy abroad, some devalued their currencies, and some introduced complicated restrictions on their citizens' freedom to hold foreign exchange. These fixes, however, also proved self-defeating, and no country was able to maintain its competitive edge for long. Such "beggar-thy-neighbor" policies devastated the international economy; world trade declined sharply, as did employment and living standards in many countries. As World War II came to a close, the leading allied countries considered various plans to restore international monetary. The country representatives drew up the charter (or Articles of Agreement) of an international institution to oversee the international monetary system and to promote both the elimination of exchange restrictions relating to trade in goods and services, and the stability of exchange rates. The IMF came into existence in December 1945, when the first 29 countries signed its Articles of Agreement. The statutory purposes of the IMF today are the same as when they were formulated in 1944. Since then, the world has experienced unprecedented growth in real incomes. And although the benefits of growth have not flowed equally to all—either within or among nations—most countries have seen increases in prosperity that contrast starkly with the interwar period, in particular. Part of the explanation lies in improvements in the conduct of economic policy, including policies that have encouraged the growth of international trade and helped smooth the economic cycle of boom and bust. The IMF is proud to have contributed to these developments. In the decades since World War II, apart from rising prosperity, the world economy and monetary system have undergone other major changes—changes that have increased the importance and relevance of the purposes served by the IMF, but that have also required the IMF to adapt and reform. Rapid advances in

technology and communications have contributed to the increasing international integration of markets and to closer linkages among national economies. As a result, financial crises, when they erupt, now tend to spread more rapidly among countries. In such an increasingly integrated and interdependent world, any country's prosperity depends more than ever both on the economic performance of other countries and on the existence of an open and stable global economic environment. Equally, economic and financial policies that individual countries follow affect how well or how poorly the world trade and payments system operates. Globalization thus calls for greater international cooperation, which in turn has

increased the responsibilities of international institutions that organize such cooperation—including the IMF. The IMF's purposes have also become more important simply because of the expansion of its membership. The number of IMF member countries has more than quadrupled from the 44 states involved in its establishment, reflecting in particular the attainment of political independence by many developing countries and more recently the collapse of the Soviet bloc. The expansion of the IMF's membership, together with the changes in the world economy, has required the IMF to adapt in a variety of ways to continue serving its purposes effectively. Countries that joined the IMF between 1945 and 1971 agreed to keep their exchange rates pegged at rates that could be adjusted, but only to correct a "fundamental disequilibrium" in the balance of payments and with the IMF's concurrence. This so-called Bretton Woods system of exchange rates prevailed until 1971 when the U.S. government suspended the convertibility of the U.S. dollar (and dollar reserves held by other governments) into gold. At the same time as the IMF was created, the International Bank for Reconstruction and Development (IBRD), more commonly known as the World Bank, was set up to promote long-term economic development, including

through the financing of infrastructure projects, such as road-building and improving water supply. The IMF and the World Bank Group—which includes the International Finance Corporation (IFC) and the International Development Association (IDA)—complement each other's work. While the IMF's focus is chiefly on macroeconomic performance, and on macroeconomic and financial sector policies, the World Bank is concerned mainly with longer-term development and poverty reduction issues. Its activities include lending to developing countries and countries in transition to finance infrastructure projects, the reform of particular sectors of the economy, and broader structural reforms. The IMF, in contrast, provides financing not for particular sectors or projects but for general support of a country's balance of payments and international reserves while the country takes policy action to address its difficulties. When the IMF and World Bank were established, an organization to promote world trade liberalization was also contemplated, but it was not until 1995 that the World Trade Organization was set up. In the intervening years, trade issues were tackled through the General Agreement on Tariffs and Trade (GATT).

### The Purposes of IMF

The purposes of the International Monetary Fund are:

i. To promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems. ii. To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy. iii. To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.

iii. To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade. iv. To give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards, thus providing them with opportunity to correct maladjustment in their balance of payments without resorting to measures destructive of national or international prosperity. v. In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members. Decisions making at the IMF

The IMF is accountable to its member countries, and this accountability is essential to its effectiveness. The day-to-day work of the IMF is carried out by an Executive Board, representing the IMF's 184 members, and an internationally recruited staff under the leadership of a Managing Director and three Deputy Managing Directors—each member of this management team being drawn from a different region of the world. The powers of the Executive Board to conduct the business of the IMF are delegated to it by the Board of Governors, which is where ultimate oversight rests. The Board of Governors, on which all member countries are represented, is the highest authority governing the IMF. It usually meets once a year, at the Annual Meetings of the IMF and the World Bank. Each member country appoints a Governor—usually the country's minister of finance or the governor of its central bank—and an Alternate Governor. The Board of Governors decides on major policy issues but has delegated day-to-day decision-making to the Executive Board. Key policy issues relating to the international monetary system are considered twice yearly in a committee of Governors called the International Monetary and Financial Committee, or IMFC (until September 1999 known as the Interim Committee). A joint committee of the Boards of Governors of the IMF

and World Bank called the Development Committee advises and reports to the Governors on development policy and other matters of concern to developing countries. The Executive Board consists of 24 Executive Directors, with the Managing Director as chairman. The Executive Board usually meets three-times a week, in full-day sessions and more often if needed, at the organization's headquarters in Washington, D.C. The IMF's five largest shareholders—the United States, Japan, Germany, France, and the United Kingdom—along with China, Russia, and Saudi Arabia, have their own seats on the Board. The other 16 Executive Directors are elected for two-year terms by groups of countries, known as constituencies. Unlike some international organizations that operate under a one-country-onevote principle (such as the United Nations General Assembly), the IMF has a weighted voting system: the larger a country's quota in the IMF—determined broadly by its economic size—the more votes it. But the Board rarely makes decisions based on formal voting; rather, most decisions are based on consensus among its members and are supported unanimously. The Executive Board selects the Managing Director, who besides serving as the chairman of the Board, is the chief of the IMF staff and conducts the business of the IMF under the direction of the Executive Board. Appointed for a renewable five-year term, the Managing Director is assisted by a First Deputy Managing Director and two other Deputy Managing Directors. IMF employees are international civil servants whose responsibility is to the IMF, not to national authorities. The organization has about 2,800 employees recruited from 141 countries. About two-thirds of its professional staff are economists. Directors, who report to the Managing Director, head the IMF's 26 departments and offices. Most staff works in Washington, although about 90 resident representatives are posted in member countries to help advice on economic policy. The IMF maintains offices in Paris and Tokyo for liaison with

other international and regional institutions, and with organizations of civil society; it also has offices in New York and Geneva, mainly for liaison with other institutions in the UN system.

### Funding of IMF

The IMF's resources come mainly from the quota (or capital) subscriptions that countries pay when they join the IMF, or following periodic reviews in which quotas are increased. Countries pay 25 percent of their quota subscriptions in Special Drawing Rights or major currencies, such as U.S. dollars or Japanese yen; the IMF can call on the remainder, payable in the member's own currency, to be made available for lending as needed. Quotas determine

not only a country's subscription payments, but also the amount of financing that it can receive from the IMF, and its share in SDR allocations. Quotas also are the main determinant of countries' voting power in the IMF. Quotas are intended broadly to reflect members' relative size in the world economy: the larger a country's economy in terms of output, and the larger and more variable its trade, the higher its quota tends to be. The United States of America, the world's largest economy, contributes most to the IMF, 17.5 percent of total quotas; Palau, the world's smallest, contributes 0.001 percent. The most recent (eleventh) quota review came into effect in January 1999, raising IMF quotas (for the first time since 1990) by about 45 percent to SDR 212 billion (about \$300 billion). If necessary, the IMF may borrow to supplement the resources available from its quotas. The IMF has two sets of standing arrangements to borrow if needed to cope with any threat to the international monetary system: □ the General Arrangements to Borrow (GAB), set up in 1962, which has 11 participants (the governments or central banks of the Group of Ten industrialized countries and Switzerland), and □ the New Arrangements to Borrow (NAB), introduced in 1997, with 25

participating countries and institutions. Under the two arrangements combined, the IMF has up to SDR 34 billion (about \$50 billion) available to borrow.

### **Concept of SDR**

The SDR, or special drawing right, is an international reserve asset introduced by the IMF in 1969 (under the First Amendment to its Articles of Agreement) out of concern among IMF members that the current stock, and prospective growth, of international reserves might not be sufficient to support the expansion of world trade. The main reserve assets were gold and U.S. dollars, and members did not want global reserves to depend on gold production, with its inherent uncertainties, and continuing U.S. balance of payments deficits, which would be needed to provide continuing growth in U.S. dollar reserves. The SDR was introduced as a supplementary reserve asset, which the IMF could "allocate" periodically to members when the need arose, and cancels, as necessary.

SDRs—sometimes known as "paper gold" although they have no physical form—have been allocated to member countries (as bookkeeping entries) as a percentage of their quotas. So far, the IMF has allocated SDR 21.4 billion (about \$32 billion) to member countries. The last allocation took place in 1981, when SDR 4.1 billion was allocated to the 141 countries that were then members of the IMF. Since 1981, the membership has not seen a need for another

general allocation of SDRs, partly because of the growth of international capital markets. In September 1997, however, in light of the IMF's expanded membership—which included countries that had not received an allocation—the Board of Governors proposed a Fourth Amendment to the Articles of Agreement. When approved by the required majority of member governments, this will authorize a special one-time "equity" allocation of SDR 21.4 billion, to be distributed so as to raise all members' ratios of cumulative SDR allocations to quotas to a common benchmark.

IMF member countries may use SDRs in transactions among themselves, with 16 "institutional" holders of SDRs, and with the IMF. The SDR is also the IMF's unit of account. A number of other international and regional organizations and international conventions use it as a unit of account, or as a basis for a unit of account.

The SDR's value is set daily using a basket of four major currencies: the euro, Japanese yen, pound sterling, and U.S. dollar. On July 1, 2004, SDR 1 = US\$1.48. The composition of the basket is reviewed every five years to ensure that it is representative of the currencies used in international transactions, and that the weights assigned to the currencies reflect their relative importance in the world's trading and financial systems.

The IMF helps its member countries by: □ reviewing and monitoring national and global economic and financial

developments and advising members on their economic policies; □ lending them hard currencies to support adjustment and reform policies designed to correct balance of payments problems and promote sustainable growth; and □ offering a wide range of technical assistance, as well as training for government and central bank officials, in its areas of expertise.

#### Advice on Policies and Global Oversight

The IMF's Articles of Agreement call for it to oversee the international monetary system, including by exercising firm "surveillance"—that is, oversight—over its member countries' exchange rate policies. Under the Articles, each member country undertakes to collaborate with the IMF in its efforts to ensure orderly exchange arrangements and to promote a stable system of exchange rates. More specifically, member countries agree to direct policies toward the goals of orderly economic growth with reasonable price stability, together with orderly underlying economic and financial conditions, and to avoid manipulating exchange rates for

unfair competitive advantage. In addition, each country undertakes to provide the IMF with the information necessary for its effective surveillance. The membership has agreed that the IMF's surveillance of each member's exchange rate policies has to be carried out within the framework of a comprehensive analysis of the general economic situation and economic policy strategy of the member. The regular monitoring of economies, and associated provision of policy advice, that IMF surveillance involves can help signal dangers ahead and enable members to act in a timely way to avoid trouble. The IMF conducts its oversight in three ways: i) Country surveillance, which takes the form of regular (usually yearly) comprehensive consultations with individual member countries about their economic policies, with interim discussions as needed. The consultations are

referred to as "Article IV consultations" as they are mandated by Article IV of the IMF's charter. (They are also referred to as "bilateral" consultations, but this is strictly speaking a misnomer: when the IMF consults with a member country, it represents the entire membership, so that the consultations are really always multilateral). The IMF supplements its usually annual country consultations with additional staff visits to member countries when needed. The Executive Board also holds frequent, informal meetings to review economic and financial developments in selected member countries and regions. ii) Global surveillance, which entails reviews by the IMF's Executive Board of global economic trends and developments. The main reviews of this kind are based on World Economic Outlook and Global Financial Stability reports prepared by IMF staff, normally twice a year, before the semiannual meetings of the International Monetary and Financial Committee. The reports are published in full prior to the IMFC meetings, together with the Chairman's summing up of the Executive Board's discussion. The Executive Board also holds more frequent, informal discussions on world economic and market developments. iii) Regional surveillance, under which the IMF examines policies pursued under regional arrangements. This includes, for example, Board discussions of developments in the European Union, the euro area, the West African Economic and Monetary Union, the Central African Economic and Monetary Community, and the Eastern Caribbean Currency Union. IMF management and staff also participate in surveillance discussions of such groups of countries as the G-7 (the Group of Seven major industrial countries) and APEC (the Asia-Pacific Economic Cooperation forum).

Instruments of IMF lending and their evolution

The IMF provides loans under a variety of policies or "facilities" that have evolved over the years to meet the needs of the membership. The duration, repayment terms, and lending conditions attached to these facilities vary,

reflecting the types of balance of payments problem and circumstances they address.

Most of the IMF's financing is provided through three different types of lending policies: Stand-By Arrangements form the core of the IMF's lending policies. First used in 1952, they are designed to deal mainly with short-term balance of payments problems. Medium-term extended arrangements under the Extended Fund Facility are intended for countries with balance of payments difficulties related to structural problems, which may take longer to correct than macroeconomic weaknesses. Structural policies associated with extended arrangements include reforms designed to improve the way economy function, such as tax and financial sector reforms, privatization of public enterprises, and steps to enhance the flexibility of labor markets. The IMF has been providing concessional lending to help its poorest member countries achieve external viability, sustainable economic growth, and improved living standards since the late 1970s. The current concessional facility, the Poverty Reduction and Growth Facility (PRGF), replaced the Enhanced Structural Adjustment Facility (ESAF) in November

1999, with the aim of making poverty reduction and economic growth the central objectives of policy programs in the countries concerned. In the late 1990s, the IMF introduced facilities designed to help countries cope with sudden losses of market confidence, and to prevent "contagion"—the spread of financial crises to countries with sound economic policies. (See pages 30-33 for highlights of the IMF's evolving facilities.) The IMF also provides loans to help countries cope with balance of payments problems caused by natural disasters, the aftermath of military conflicts, and temporary shortfalls in export earnings (or temporary increases in cereal import costs) beyond their control. Just as new facilities have been introduced to meet new challenges, redundant facilities have over time been terminated. Indeed, the Executive Board initiated in early 2000 a review of facilities. The review led to the elimination of four obsolete facilities. The Board's consideration of modifications to other nonconcessional facilities led to agreement to: □ adapt the terms of Stand-By Arrangements and Extended Fund Facility loans to encourage countries to avoid reliance on IMF resources for unduly long periods or in unduly large amounts; □ reaffirm the Extended Fund Facility as one confined to cases where longer-term financing is clearly required; and □ enhance



monitoring of IMF-supported programs after their expiration, especially when a member's credit outstanding exceeds a certain threshold.

#### Selected IMF Lending Facilities

i) Stand-By Arrangements—form the core of the IMF's lending policies. A Stand-By Arrangement provides assurance to a member country that it can draw up to a specified amount, usually over 12-18 months, to deal with a short-term balance of payments problem.

ii) Extended Fund Facility—IMF support for members under the Extended Fund Facility provides assurance that a member country can draw up to a specified amount, usually over three to four years, to help it tackle structural economic problems that are causing serious weaknesses in its balance of payments. iii) Poverty Reduction and Growth Facility—(which replaced the Enhanced Structural Adjustment Facility in November 1999). A low-interest facility to help the poorest member countries facing protracted balance of payments problems (see page 46, "A New Approach to Reducing Poverty"). The cost to borrowers is subsidized with resources raised through past sales of IMF-owned gold, together with loans and grants provided to the IMF for the purpose by its members. iv) Supplemental Reserve Facility—Provides additional short-term financing to member countries experiencing exceptional balance of payments difficulty because of a sudden and disruptive loss of market confidence reflected in capital outflows. The interest rate on SRF loans includes a surcharge over the IMF's usual lending rate. v) Emergency Assistance—Introduced in 1962 to help members cope with balance of payments problems arising from sudden and unforeseeable natural disasters, this form of assistance was extended in 1995 to cover certain situations in which members have emerged from military conflicts that have disrupted institutional and administrative capacity. At present, IMF borrowers are all either developing countries, countries in transition from central planning to market-based systems, or emerging market countries recovering from financial crises. Many of these countries have only limited access to international capital markets, partly because of their economic difficulties. Since the late 1970s, all industrial countries have been able to meet their financing needs from capital markets, but in the first two decades of the IMF's existence over half of the IMF's financing went to these countries.

#### Technical Assistance and Training

The IMF is probably best known for its policy advice and its policy-based lending to countries in times of economic crisis. But the IMF also shares its expertise with member countries on a regular basis by providing technical assistance and training in a wide range of areas, such as central banking, monetary and exchange rate policy, tax policy and administration, and official statistics. The objective is to help strengthen the design and implementation of members' economic policies, including by strengthening skills in the institutions responsible, such as finance ministries and central banks. Technical assistance complements the IMF's policy advice and financial assistance to member countries and accounts for some 20 percent of the IMF's administrative costs. The IMF began providing technical assistance in the mid-1960s when many newly independent countries sought help in setting up their central banks and finance ministries. Another surge in technical assistance occurred in the early 1990s, when countries in central and eastern Europe and the former Soviet Union began their shift from centrally planned to market-based economic systems. More recently, the IMF has stepped up its provision of technical assistance as part of the effort to strengthen the architecture of the international financial system. Specifically, it has been helping countries bolster their financial systems, improve the collection and dissemination of economic and financial data, strengthen their tax and legal systems, and improve banking regulation and supervision. It has also given considerable operational advice to countries that have had to reestablish government institutions following severe civil unrest or war. The IMF provides technical assistance and training mainly in four areas: □ strengthening monetary and financial sectors through advice on banking system regulation, supervision, and restructuring, foreign exchange management and operations, clearing and settlement systems for

payments, and the structure and development of central banks; □ supporting strong fiscal policies and management through advice on tax and customs policies and administration, budget formulation, expenditure management, design of social safety nets, and the management of internal and external debt; □ compiling, managing, and disseminating statistical data and improving data quality; and □ drafting and reviewing economic and financial legislation.

The IMF offers training courses for government and central bank officials of member countries at its headquarters in Washington and at regional training centers in Brasília, Singapore, Tunis, and Vienna. In the field, it provides technical assistance through visits by IMF staff, supplemented by hired consultants and experts. Supplementary financing for IMF

technical assistance and training is provided by the national governments of such countries as Japan and Switzerland, and international agencies such as the European Union, the Organization for Economic Cooperation and Development, the United Nations Development Program, and the World Bank.

### **3.5 WORLD BANK**

#### **Introduction**

A need arises to finance various projects in various countries to promote the development of economically backward regions. The United States and other countries have established a variety of development banks whose lending is directed to investments that would not otherwise be funded by private capital. The investments include dams, roads, communication systems, and other infrastructural projects whose economic benefits cannot be computed and/or captured by private investors, as well as projects, such as steel mills or chemical plants, whose value lies not only in the economic terms but also, significantly in the political and social advantages to the nation. The loans generally are medium-term to long-term and carry concessional rates.

Even though most lending is done directly to a government, this type of financing has two implications for the private sector. First, the projects require goods and services which corporations can produce. Secondly, by establishing an infrastructure, new investment opportunities become available for multinational corporations.

The World Bank or the International Bank for Reconstruction and Development (IBRD) was established in 1945 under the Bretton Woods Agreement of 1944. An International Monetary and Financial Conference was held at Bretton Woods, New Hampshire during July 1-22, 1944. The main purpose of the conference was finalisation of the Articles of Association of IMF and establishment of an institution for the reconstruction of the war shattered world economies. Thus, the conference has given birth to World Bank or International Bank for Reconstruction and Development (IBRD). World Bank was established to provide long-term assistance for the reconstruction and development of the economies of the member countries while IMF was established to provide shortterm assistance to correct the balance of payment disequilibrium.

The World Bank is an inter-governmental institution, corporate, in form, the capital stock of which is entirely owned by its members-governments. Initially, only nations that were

members of the IMF could be members of the World Bank. This restriction on membership was subsequently relaxed. The World Bank makes loans at nearly conventional terms for projects of high economic priority. To qualify for financing, a project must have costs and revenues that can be estimated with reasonable accuracy. A government guarantee is a necessity for World Bank funding. The Bank's main emphasis has been on large infrastructure projects such as roads, dams, power plants, education and agriculture. However, in recent years the Bank has laid greater emphasis on quick loans to help borrower countries to alleviate their balance of payments problems. These loans are tied to the willingness of the debtor nations to adopt

economic policies that will spur growth, free trade, more open investment, and a more vigorous private sector. Besides its members subscriptions, the World Bank raises funds by issuing bonds to private sources.

### **Functions of the World Bank**

The principal functions of the IBRD are set forth in Article I of the agreement and are as follows :

1. To assist in the reconstruction and development of the territories of its members by facilitating the investment of capital for productive purposes.
2. To promote private foreign investment by means of guarantee of participation in loans and other investments made by private investors and, when private capital is not available on reasonable terms, to make loans for productive purposes out of its own resources or from funds borrowed by it.
3. To promote the long term balanced growth of international trade and the maintenance of equilibrium in balance of payments by encouraging international investment for the development of the productive resources of members.
4. To arrange loans made or guaranteed by it in relation to international loans through other channels so that more useful and urgent projects, large and small alike, will be dealt first.

It appears that the World Bank was created to promote and not to replace private foreign investment. In this respect the Bank considers its role to be a marginal one, to supplement and assist private foreign investment in the member countries. Membership of the World Bank

All the members of the IMF are also the members of the World Bank. Any country can join as a member of the IBRD by signing in the Charter of the Bank as its subscriber. It had 184 members in 2003. Bank has the authority to suspend any member, if the country concerned

fails to discharge its responsibilities to the IBRD. Similarly, every member is free to resign from the membership but it has to pay back all loans with interest on due dates. The member is also required to

pay its share of the loss on demand if the Bank incurs a financial loss in the year in which a member resigns.

### **Capital Structure of the World Bank**

The World Bank or IBRD started with an authorised capital of US \$ 10 billion divided into 1,00,000 shares of US \$ 1,00,000 each. The subscribed capital at that time was US \$9.4 billion. The authorised capital was increased to 7,16,500 shares of the par value of SDR 1,00,000 each in 1985. In July 1992, the total authorised capital of the bank was \$14.1 billion with a capital increase of \$9.3 billion. This increase of 77,159 shares was subscribed by the republics of the former Soviet Union. The bank has raised capital worth \$23 billion in 2002.

The member countries contribute their share capital to the Bank as follows:

- (1) 2% of the share in the form of gold and US dollars. The World Bank utilizes this amount freely for granting loans.
- (2) 18% of the share capital in the form of own currency. This amount is also used by Bank for granting loans.
- (3) 80% of the share capital is payable at the request of the Bank. This amount is also used by Bank for granting loans. But it can use this amount in discharging its responsibilities.

### **Organisation Structure of the World Bank**

The World Bank like IMF is also managed by a three-tier structure including Board of Governors, Executive Directors and President.

- (1) Board of Governors: The Board of Governors has full authority and control over the Bank's activities. Normally, each country appoints its Finance Minister as a Governor and the Governor of its Central Bank as Alternate Governor on the Board of Governors for a period of 5 years. The strength of the voting rights to the Governors depends upon the subscribed capital by the member country. In

the absence of Governor, the Alternate Governor can exercise the voting right. Normally the Board of Governors meets annually.

(2) Executive Directors: The bank has 24 Executive Directors. They supervise the entire operations of the Bank. Out of these 24 Directors, are appointed by USA, UK, Germany, Finance and Japan. The remaining 19 Directors are elected by the remaining member countries. The Executive Directors normally meet regularly once in a month. The 24 Directors elect the President of the Bank who presides over the meetings of the Board of Executive Directors.

The Scope of Decisions of the Executive Directors Include:

- (a) Policy making within the framework of the Articles of Agreement.
- (b) Loans and credit proposals.

Function of Board of Executive Directors

- (a) To Present audited annual reports. (b) To prepare administrative budget. (c) To prepare and present to Board of Governors annual reports on the operation and policies of the Bank.
- (3) President: Normally the president does not have any voting right except in case of exercising equal rights. He is assisted by senior Vice-Presidents and Directors of various departments and regions

.

### **Funding Strategy of the World Bank**

There are the four basic objectives of the World Bank's funding strategy:

- (1) To make sure availability of funds in the market. (2) To provide the funds at the lowest possible cost to the borrowers through appropriate currency mix of its borrowing and opting to borrow when interest rates are expected to rise. (3) To control volatility in net income and overall loan changes.
- (4) To provide an appropriate degree of maturity transformation between its lending and the borrowing. Maturity transformation depicts the Bank's capacity to lend for longer period than it borrows. Bank's Borrowings

Bank's main function is to lend the money to the needy member. For lending activities, it needs money and therefore it has to borrow.

Sources: The bank borrows from the following sources:

(1) The Bank borrows from international market both for long-term and short-term periods. (2) The Bank also borrows under currency swap agreements (CSA). (3) The Bank also borrows under the Discount-Note Programme by two methods. First, it places bonds and notes directly with its member countries. Second, it offer issues to investors and in public markets. Two new borrowings instruments were evolved by the Bank. The first one is Central Bank Facility and US Dollar Dominated Facility. The second instrument is Floating Rate Notes. The World Bank borrows from the commercial banks and other financial institutions with the help of this instrument.

#### **(a) Bank's Lending Activities**

The Bank grants loans to members in any one or more of the following ways:

- (1) by participating or granting indirect loans out of its own funds;
- (2) by granting loans out of funds raised in the market of a member or otherwise borrowed by the Bank; and
- (3) by guaranteeing in whole or part, loans made by private investors through the investment channels.

The total outstanding amount of the total direct and indirect loans made or guaranteed by the Bank is not to exceed 100 per cent of its total unimpaired subscribed capital, resources and surpluses. Bank imposes following conditions in granting loans:

- (1) The bank is satisfied that the borrower is unable to borrow under reasonable conditions in the prevailing market conditions. (2) The project for which loan is required should be recommended by the competent authority in the form of a written report after careful examination of the project. (3) The loan is required for productive purpose. (4) The borrower or guarantor has reasonable prospects of repaying loans and interest on loans. (5) If the project is located on the territory of the member but itself is not a borrower, then the member or its central bank has to guarantee the repayment of loan, interest on loans and other charges on loan.

In 1991, the Executive Board of the Bank modified the repayment terms which include extension of repayment period from 3 to 5 years for middle income countries and review of repayment terms for middle income countries within 3 years. The cumulative lending of the Bank is of \$ 383 billion and in the fiscal year 2003, it has lended \$ 11.2 billion for 99 new operations in 37 countries.

### **Facilities to Member Countries**

The Bank provides the following facilities to member countries:

(1) Structural Adjustment Facility (SAF): In order to reduce their balance of payment deficit and maintaining or regaining the economic growth of member countries, the World Bank has introduced SAF in 1985. These funds are used to finance the general imports with a few agreed exceptions such as luxury and military imports. These funds are released in two parts and in a series of upto five SAFs to a borrowing country. Generally, the bank imposes stiff conditions for these. These are provided to support to programmes running from 5 to 7 years.

(2) Enhanced Structural Adjustment Facility (ESAF): In order to increase the availability of concessional resources to the low income member countries, ESAF was established in December 1987. It provides new concessional

resources of SDR 6 billion which will be financed by special loans and contributions from developed and OPEC countries. The purposes for advancing the amount is same, i.e., to reduce balance of payment deficits of borrowing member countries and encourage growth. The interest rate charged by the Bank is 0.5 per cent to be repaid in ten semi-annual installments beginning after 5½ years of disbursements.

(3) Special Action Programme (SAP): The Special Action Programme (SAP) has been started in 1983 to strengthen the IBRD's ability to assist member countries in adjusting to the current economic environment. It has four major elements:

(i) Provide lending for structural adjustment, policy changes, exportoriented production, full utilisation of existing capacity and maintenance of critical infrastructure. (ii) Provide advisory services regarding policies. (iii) Enlisting familiar efforts by other donors for fast disbursing assistance. Other Activities of the World Bank

In addition to lending activities, the Bank also undertakes the following activities:



(1) Training: In 1956, the Bank set up a staff college to provide training to senior officials of the member countries. This college is known as Economic Development Institute (EDI). The Institute helps the officials in improving the management of their economies and to increase the efficiency of their investment programmes. The EDI also organises seminars in Washington and in different regions of the World in Cooperation with regional institutes.

(2) Technical Assistance: The World Bank also provides technical assistance to its member countries. This assistance include:

(i) Engineering – related: It includes feasibility studies, engineering design and construction supervision; (ii) Institution-related: It includes diagnostic policy and institutional studies, management. The primary way of providing technical assistance is through loans made for supervision, implementation and engineering services, energy, power, transportation, water supply, etc. In 1975, the Bank created Project Preparation Facility (PPF) for meeting gaps in project preparation and for institution building. The Bank also acts as executing agency for project financed by the United Nations Development Programme (UNDP).

(3) Inter-Organisational Co-operation: The World Bank is also engaged in inter-organisational cooperation. It is based on formal agreement between it and international organisations, such as, the cooperative programmes between it and FAO, the UNESCO, the WHO, the GATT, the UNCTAD, the UNEP (United Nation Environment Programmes), The UNDP, The UNIDO (United Nations Industrial Development Organisation) the ILO, the African Development Bank, the Asian Development Fund, the International Fund for Agriculture Development (IFAD), etc.

(4) Economic and Social Research: In 1983, the Bank established a Research Policy Council (RPC). It provides leadership in the guidance, co-ordination and evaluation of all bank research. The Bank's own research staff undertakes research activities and also in collaboration with outside researchers.

(5) Operations Evaluation: The Bank has set up the Operations Evaluation Department (OED) to help borrowers in the post-evaluation of Bank assisted projects. Members of borrowers' staff visit this Department for seeking help in the preparation of project completion report.

(6) Settlement of Investment Disputes: The Bank has set up the International Centre of Settlement of Investment Disputes (ICSID) between states and

nationals of other states. The Bank has successfully mediated in solving many international investment disputes such as the River Water Dispute between India and Pakistan, and the Suez Canal dispute between Egypt and the U.K.

### Criticism of the World Bank

The modus operandi of the Bank has been criticised on various counts by different quarters as follows:

1. It is alleged that bank charges a very high rate of interest on loans. For example, some of the loans which India has received in recent years bear an interest of 5.75 per cent including the commission at 1% which is put in the Bank's special reserve. 2. The Bank's insistence, prior to the actual grant of loan, on the country having the capacity to transfer or repay, is open to criticism. The Bank should not apply orthodox standards to judge the transfer capacity of any borrowing country. Transfer capacity follows rather than precede the loan. 3. The financial help given by the Bank does not amount to more than a drop in the big ocean of financial requirements so essential for various development projects.

### India and the World Bank

India is the founder member of the Bank and held a permanent seat for number of years on its Board of Executive Directors. India is one of the largest receiver of assistance since 1949. Upto June 2002, cumulative lendings of the World Bank to India amounted to \$ 26.69 billion in 187 loans. The total amount borrowed by India from the World Bank and the IDA till June 2002 amounted to \$ 58.54 billion in 434 loans. This amounted to 11.6 per cent of the total loans and credits approved by the World Bank groups. During 2001-02, India received \$ 893 million from the World Bank accounting for 11.22 per cent of its total loans.

India is helped by the World Bank in its planned economic development through granting loans, conducting field surveys, sending study terms and missions and

through rendering expert advice. The Bank also provides training to Indian personnel at EDI. There is also a Chief of Missions of the Bank at New Delhi. He is representing the Bank for its aided projects in India for monitoring and consultations. The Bank has been helping India in various objects like development of ports, oil exploration including the Bombay high and gas power projects, aircrafts, coal, iron, aluminum, fertilizers, railway modernisation and

technical assistance etc. It also helped India to solve its river water dispute with Pakistan. The benefits desired by India from the World bank are:

(i) India has received a lot of assistance from the World Bank for its development projects. (ii) Aid India Club was founded in 1950 by the efforts of the World Bank with a view to help India. This club is now called India Development Forum. This Forum had decided to give loans amounting to \$ 600 crore to India for implementing its structural adjustment. (iii) The bank's role in solving the Indus water dispute between India and Pakistan has been invaluable. (iv) General loans have also been granted by the World Bank to India, to be utilised as per its own discretion. (v) As a member of the World Bank, India has become the members of International Finance Corporation, International Development Association and Multilateral Investment Guarantee Agency also. (vi) India has received technical assistance from time to time from the World Bank for its various projects. The Expert Team of the Bank has visited India and given valuable suggestions also. (vii) The massive population of India has always created problems in the economic development of the country. World Bank has been helping India in the population control programmes and urban development. For this purpose loans amounting to \$ 495 crore have also been given to India. (viii) World Bank has been giving financial assistance to NGOs operating in India e.g. Leprosy Elimination, Education Projects, Child development service projects etc.

On the other hand, critics argue that the World Bank have endangered the economic freedom of India. The basic points of criticism are as follows:

(i) The World Bank has laid a great deal of emphasis on measures of economic liberalisation and more free play of market forces. (ii) A lot of stress has been laid on going very slow on the setting up of public sector enterprises including financial intermediaries and encouraging private sector. (iii) India's dependence on World Bank has been increasing which is adversely affecting its economic freedom. (iv) The attitude of World Bank reflects the preference for free enterprise and a market oriented economy. It shows dissatisfaction with the general performance of economies which are based on planning and regulation. At different occasions the Bank has tried to undermine the Significance of our Planning Commission. (v) The devaluation of Indian rupee in 1966 and 1991 was done at the insistence of the World Bank only. India's main problem till now has been the government's incapacity to act rightly, firmly and effectively in time, on account of being more emotional to set ideologies and

compromising attitude to safeguard the political party's interest more than the national interest.

### **Affiliates to the World Bank**

The Bank has four affiliates. These are:

International Development Association (IDA)

The IDA was set up in 1960 as a subsidiary of the World Bank to provide —soft loans to the member countries. Thus, the object of the IDA is to provide loans to member countries on liberal terms with regard to the rate of interest and the period of repayment. Another attraction of the IDA loans is that they can be repaid in the currency of the member country.

In approving an IDA credit, three criteria are observed:

1. Poverty Test : IDA's assistance is limited to the poorest of those countries classified as Part II countries, and which continue to face such severe handicaps as excessive dependence on volatile primary products markets, heavy debt servicing burden, and often, rates of population growth eat outweigh the gains of production.
2. Performance Test: Within the range of difficulties of establishing objective standards of performance, the following factors serve as the yardstick for an adequate performance test: satisfactory overall economic policies and past success in project execution.
3. Project Test: The purpose of the IDA is soft loans, not soft projects. IDA projects are appraised according to the same standard as that applied to the Bank projects – the test essentially requires that proposed projects promise to yield financial and economic returns adequate to justify the use of scarce capital.

The Objective of IDA are:

1. To provide development finance on easy terms to less developed member countries; and
2. To promote economic development, increase productivity and thus raise standards of living in the underdeveloped areas.

Since the IDA charges nominal rates of interest on its loans, it has also been nicknamed the —soft-loan windows.

**Membership:** All the members of the World Bank are the members of the IDA. It had 164 members in June, 2003. There are two types of members. In IDA- Part I members are the developed countries which are 24 in number and therefore are called as G-24 countries. Part II members are the developing countries.

**Organisation:** The organisation of IDA is same as that of the World Bank. Generally, the staff of the World Bank operates this association with few separate sections.

**Loans:** IDA loans are known as IDA credits. Only a member country can borrow from IDA with a restriction that a member country is eligible to borrow from IDA only if its per capita income is less than US \$ 695 at 1990 price index. Those projects get assistance from IDA which are not financed by the World Bank. IDA observes the poverty criterion, performance criterion and project criterion while approving the projects.

**Terms of Loans: Conditions for IDA loans are:**

- (1) Repayment period is 35-40 years.
- (2) Grace period is 10 years.
- (3) Interest rate varies between zero to 0.5% which is waived now.
- (4) Administrative fee is 0.75% on the loan amount disbursed.

Gross disbursement by IDA during the year 2002-03 were \$8.1 billion. India received \$686.6 million interest free loan during the year 2002-03. The cumulative commitments of IDA were of \$ 142 billion and commitments of \$7.3 billion for 141 new operations in 55 countries were made in fiscal year 2003.

**International Finance Corporation (IFC)**

The International Finance Corporation (IFC) is the private sector arm of the World Bank family which was established in July 1956. It is the major multilateral agency promoting productive private investment in developing private investment in developing countries. It helps finance private sector projects to mobilise finance for them in the international financial markets, and provides advice and technical assistance to businesses and governments.

**Membership**

The Articles of Agreement of the IFC are similar to that of the World Bank. A country has to be a member of the World Bank in order to join the IFC. In June 2003, it had 175 members.

## Objectives

The objectives for which the IFC was set up have been laid down in Article 1 of its Articles of Agreement as under:

—The purpose of the Corporation is to further economic development by encouraging the growth of productive private enterprise in member countries, particularly in the less developed areas, thus supplementing the activities of the International Bank for Reconstruction and Development. In carrying out this purpose, the Corporation shall:

(i) in association with private investors, assist in financing the establishment, improvement and expansion of productive private enterprise which would contribute to the development of its member countries by making investments, without guarantee of repayment by the member Government concerned, in cases where sufficient private investment is not available on reasonable terms;

(ii) seek to bring together investment opportunities, domestic and foreign private capital, and experienced management; and

(iii) seek to stimulate, and to help create conditions conducive to the flow of private capital, domestic and foreign, into productive investment in member countries.

IFC is the largest multinational source of loan and equity financing for private sector projects in the developing world. It offers a full array of financial products and services to companies in its developing member countries:

– long-term loan in major currencies, at fixed or variable rates. – equity investment.

– quasi-equity instruments (subordinated loans, preferred stock, income rates). – guarantees and standby financing. – risk management (intermediation of currency and interest rate swaps, provision of hedging facilities). IFC has approved \$3.9 billion in financing 204 projects in various sectors in 64 developing countries in the fiscal year 2003. IFC invested in 11 projects involving an amount of \$48.1 million in India. It is composed to \$25.4 million in the form of loan and \$ 22.7 million in the form of equity.

In recent years, greater emphasis has been placed by the corporation on helping to develop resources and to increase the availability of foodstuffs.

The special feature of the IFC is that, unlike commercial financial institutions, it judges potential ventures in terms of both their financial viability and their contribution to the economic development of the country concerned. At the same time, unlike other official development institutions, it participates directly with the private sector in both the developed and developing worlds. Unlike both types of institutions, it provides both equity and fixed rate financing.

## UNIT V

### IMPACT OF CULTURE ON BUSINESS:

Every culture has its own ways of expression, which reflects in its communication and interaction practices. Good attentions may lead to misinterpretations in other cultures, if their perception does not involve common understanding of related criteria and values . As , Europe is reach on cultural diversity, cultural harmonization between countries , interaction is very important in order to ensure good understanding . It is the key for the establishment of a loyal relation and smooth cooperation .The project for Harmonization of Culture and Arts in Turkey and Austria . Both countries are rich on culture and traditions and they carry enormous potential for mutual benefits across collaborations on intellectual and business level . A company's strategy's to realize ethical and socially responsible behaviour across the organization as a corporate code of conduct. External codes provide recommendations and rules within society in order to enhance corporate responsibility A firm set global policies that must be complied with , whenever the company operates ,communicate the code to all employees within the organization and to all suppliers, subcontractors, customers, ensure that its policies are carried out in all instances and report result to its stakeholders in creating its own code of corporate ethics. The codes of conduct address areas as employment practices , human rights , standards of ethical conduct and care of the environment .The problem in managing multicultural teams effectively is to recognise underlying cultural causes of conflict and to intervene in ways that not only get the teams back to achieve sucess but empower their members to deal with future challenges effectively. Strategies like adaptation structural and managerial intervention to solve the problem .

### CULTURE AND SOCIO –CULTURAL ENVIRONMENT

#### Culture

Culture is a holistic concept, outcome of social interaction among people over a period of time , cumulative , a basic determinant of human personality, provides socially acceptable pattern for meeting biological & social needs and independent of any individual or group. A set of beliefs, customs, practices and behavior that exists within the population.

#### **Socio-Cultural Environment**

Culture is of two types – material & non-material which influence by social and cultural factors, not within the control of business. It is known as Socio-Cultural Environment. The factors include in social cultural environment: attitude of people to work, family and caste system, religion, education, marriage etc. Culture is not innate. International companies often include an examination of the socio-cultural environment prior to entering their target markets and achieve the goals with following ethics in business.



## **Culture and Globalization**

Technology has effect on a global culture. The Internet, Fax Machines, Satellites, and Cable TV are readily available throughout the world at the click of the mouse. Global entertainment companies shape the perceptions and dreams of common man, spread of values, norms, and culture tends to promote Western ideals of capitalism. Globalization is a process of interaction and integration among individuals, businesses, and Governments. It is a process driven by international trade and investment and aided by modern technology and has effects on the environment, on culture, on political systems, on economic development and on human physical well-being in societies around the world. The spread of globalization bring changes to all countries. It is argued that one of the consequences of globalization will be the end of cultural diversity, and the triumph of a uni-polar culture serving the needs of transnational corporations.

## **BUSINESS AND BUSINESS ENVIRONMENT**

### **Business**

The persons who supply raw material and required components to the company, must be reliable and business environment must have multiple suppliers i.e. they should not depend upon only one supplier. Customers are regarded as the king of the market. Success of every business depends upon the level of their customer's satisfaction. The customers are Wholesalers, Retailers, Industries, Government and

Other Institutions, Foreigners Market Intermediaries etc.. Every move of the competitors affects the business. Business has to adjust itself according to the strategies of the Competitors. Any group who has actual interest in business enterprise is termed as public e.g. media and local public. They may be the users or non-users of the product.

Macro/General Environment, includes factors that create opportunities and threats to business units. The elements of Macro Environment-- Economic Environment is very complex and dynamic in nature that keeps on changing with the change in policies or political situations. It has three elements, Economic Conditions of Pubic, Economic Policies of the country, Economic System. Other Economic Factors --Infrastructural Facilities, Banking, Insurance companies, money markets, capital markets etc. Non-Economic Environment include Political Environment- affects different business units extensively and components, Political Belief of Government, Political Strength of the Country, Relation with other countries, Defense and Military Policies, Centre State Relationship in the Country, thinking opposition parties towards business unit.

### **Business Environment**

The business environment is business and environment- business in its economic sense means economic activities like production, purchase or sales of goods that are performed for earning profits. It consists of suppliers --, customers, market Intermediaries, competitors and public. Environment -internal & external includes five Ms i.e. man, material, money, machinery and management, usually within the control of

business. Business make changes in these factors due to the change in the functioning of enterprise. The factors Government and Legal , Geo --Physical , Political , Socio-Cultural , Demo-Graphical , which are beyond the control of business enterprise , included in external environment . It is of two types- Micro/Operating Environment, the environment which is close to business and affects its capacity to work is known as Micro or Operating Environment . Macro/General Environment ,that is , □ International Environment : important for industries directly depending on import or exports and the factors that affect the business are : Globalization, Liberalization, Foreign business policies , Cultural exchange . □ Demographic Environment : perspective of population i.e. its size , standard of living , growth rate, age-sex composition , family size , income level (upper level , middle level and lower level) , education level etc. □ Natural Environment : includes natural resources , weather , climatic conditions, port facilities, topographical factors such as soil, sea, rivers, rainfall etc. □ Technological Environment: have scientific knowledge to practical world , changes in products, services, lifestyles and living conditions.

### **Competitive Industry**

Competition with other firms is a key aspect of running a business of any size , from a brand new venture to a large corporation . In competitive markets, companies have to fight over the business of potential consumers , ideal competitive environment that exhibits certain key structural characteristics beneficial to consumers . The competitive industry is the presence of many different sellers of a particular good or service and many potential buyers. For example , the market for pizza restaurants in a certain large city might be highly competitive, since anyone can choose to open a new pizza shop , and existing owners can close their doors whenever they please . High costs , Government regulations and other factors restrict the ability of firms to leave or enter a certain industry and serve to limit competition . In a competitive industry, firms must offer products that are similar enough to one another to be considered interchangeable. For instance , a company that sells baseballs might not be in direct competition with a company that sells softballs, even though the balls are somewhat similar, because a baseball is not a substitute for a softball .The totality of economic factors, such as employment, income, inflation, interest rates, productivity, and wealth that influence the buying behavior of consumers and institutions.The benefits of environmental analysis are development of broad strategies and longterm policies of the firm , development of action plans to deal with technological advancements , to foresee the impact of socio-economic changes at the national and international levels .

#### **a. Business and Society**

The corporate sector has found itself for environmentally problematic activities . Small and medium-sized enterprises are also under increasing pressure to adopt environment friendly practices . Companies play an important role in society, impacting on communities and regions as well as individual employees. The concept of corporate social responsibility recognizes that businesses often voluntarily integrate social and environmental concerns into their business models.Issues of corporate governance come into play particularly in cases of company restructuring . The Foundation monitors developments through its European

Restructuring Monitor . Through their business operations, companies have an important impact on the natural environment .

### **b. Social Responsibilities of Business**

Social responsibility is an ethical ideology or an entity. An organization or individual has an obligation to act to benefit the society. This responsibility can be passive , by avoiding engaging in socially harmful acts , or active by performing activities that directly advance social goals. A formal review of a

company's endeavor is in social responsibility . In the era of corporate social responsibility , where corporations are often expected not just to deliver value to consumers and shareholders but also to meet environmental and social standards desirable by some members of the public .

### **c. Social Audit**

Social audits are optional--companies can choose whether to perform them and whether to release the results publicly or only use them internally. A social audit looks at factors such as a company's record of charitable giving , volunteer activity , energy use , transparency , work environment and worker pay and benefits to evaluate what kind of social and environmental impact a company is having in the locations where it operates . Social audits can help companies create , improve and maintain a positive public relations image.

### **d .Business Ethics:**

The study of proper business policies and practices regarding potentially controversial issues, such as corporate governance, insider trading, bribery, discrimination, corporate social responsibility and fiduciary responsibilities, Business ethics are often guided by law, while other times provide a basic framework that businesses may choose to follow in order to gain public acceptance. Business ethics are implemented in order to ensure that a certain required level of trust exists between consumers and various forms of market participants with businesses. For example, a portfolio manager must give the same consideration to the portfolios of family members and small individual investors. Such practices ensure that the public is treated fairly.

### **e. Corporate Governance:**

Corporate governance refers to the system by which corporations are directed and controlled. The governance structure specifies the distribution of rights and responsibilities among different participants in the corporation (such as the board of directors, managers, shareholders, creditors, auditors, regulators, and other stakeholders) and specifies the rules and procedures for making decisions in corporate affairs. Governance provides the structure through which corporations set and pursue their objectives, while reflecting the context of the social, regulatory and market environment . Governance is a mechanism for monitoring the actions, policies and decisions of corporations . Governance involves the alignment of interests among the stakeholders .The basic motive to maximize long term share holders

value. The main issues transparency key pillars of corporate governance due to accuracy ,adequate and timely disclosure, accountability creating shareholders value, independent decision making through business prudence ,reporting –adequate, accurate and frequent report to shareholders , management to develop the business..

## **I THE ROLE OF BUSINESS IN SOCIETY**

The concept of the social role of business was placed in focus in the 50s of the twentieth century [1]. This was partly due to the development of cooperation between business and the governments of the industrial countries during the Second World War and later, in the years of the "Cold War". During this period, the Committee for Economic Development was established, which included the most prominent representatives of the business world. The main purpose of the Committee was to advise the governments on economic and commercial issues. Its importance, however, proved to be essential, because in this way it helped extend the participation of the business world in addressing issues of social and governmental policy. It was also in the 50s of the twentieth century when the first thorough work on the subject [3] appeared, written by Howard Bowen. In the book, he discussed the concept of social responsibility that can be applied in business. Awareness of broader social objectives in the process of \* Corresponding author: Rousse, Bulgaria, 6, Otetz Paisii Street Tel.: +359 82 820980; Fax: +359 82 820982; E-mail addresses: terziev@skmat.com business decision-making can bring social and economic benefits to society. The debate about the role of business in society was sparked by the events during the 1960s and 1970s. Jacoby [4] argues that a serious opposition emerges in the public opinion against the business world. In different spheres of society a live interest arises in problems such as civil rights, the wars, women's equality, industrial pollution of the environment and the condition of our living surroundings as a whole, as well as the laws on consumer rights protection introduced by J.F. Kennedy in 1962. During the 1970s and 1980s of the XX century, in the centre of attention are the problems related to disarmament, nuclear power utilization, saving peoples in the Third World from starvation.

## **II. LEGAL AND SOCIAL RESPONSIBILITY OF THE ORGANIZATION**

Social expectations towards business have changed over the years, and these changes have in turn entailed changes of the opinion of society about the role of business. Most important in the process of social evaluation is that distinction is made between legal and social responsibility of organizations. Legal responsibility refers to observance of state laws and of applicable statutory regulations relating to a specific business that define what the organization is allowed or not allowed to do. The organization acting in compliance with all statutory requirements conducts its business in a legally responsible manner, but this does not necessarily mean it is socially responsible as well. Social responsibility, as opposed to legal responsibility, implies a certain level of voluntary response to the social problems of the society. Arguments in favour of and against social responsibility Disputes about the role of

business in society have given rise to numerous arguments in favour of and against its social responsibility

### **A) Arguments supporting social responsibility**

1. Long-term growth perspectives favourable for the business. The social activities of a company that improve the living standard of the local community or eliminate the need for state Moreover, sizeable social allowances can, in the long term, stimulate development and profit growth, as consumers, suppliers, and the local community, create a more attractive image of the organization.

2. Changing needs and expectations of buyers. Business-related social expectations are constantly changing. To narrow the gap between new expectations and the actual response of companies, their involvement in solving social issues becomes an important and necessary task.

3. Availability of resources for rendering assistance in solving social issues. Essentially, business has at its disposal human and financial resources and is expected to make part of these available for use for social purposes.

4. The moral obligation to behave socially responsible. A company is a member of society and therefore must abide by ethic norms that control its conduct. In other words, the company, like each individual member of the public, must act in a socially responsible manner and contribute to strengthening the moral principles of society. Furthermore, regulations are not always sufficient to provide a solution for every case, and the organization must behave in a responsible manner to maintain public order and establish better relations between its members.

### **B) Arguments against social responsibility**

1. Violation of the principle of profit maximization. The part of the resources allocated for social needs influences the achievement of profit maximization. The company does its best to act a socially responsible one, but first and foremost it focuses on achieving its economic interests, leaving social issues to public institutions and agencies to deal with.

2. Expenses for social security contributions. These funds are regulated by the government authorities but ultimately reflect on consumers in the form of higher prices.

3. Lack of operational transparency to the public. Most often company managers fail to realize that they are to a certain extent accountable to the public, to some of its circles. The market economic system has a good control over the economic indicators of the company's standing and performance in the market but poorly controls its social responsibility to the public as a whole or to particular social groups. Here of utmost importance is the role of society and its organizations in establishing moral principles and obligations and involving public authorities and businesses in certain social activities that they otherwise find irrelevant and disregard, without assuming any responsibility to the public.

4. Insufficient knowledge or skills to solve social issues. Any company's staff is generally well prepared to work in the field of economics, marketing and technology. However, they lack experience that would allow them to contribute to finding solutions to social issues concerning the staff members themselves as well as the society as a whole. In this regard, the improvement of the level of social responsibility requires the society to produce experts who, when appointed at the respective governmental positions or in charitable organizations, will be able to work for problem solving in the social sphere.

### **III. GOOD PRACTICES OF SOCIAL RESPONSIBILITY**

Managers having participated in the research believe that the pressure for increasing the social responsibility of business is real, is of substantial importance, and will continue its upward trend. Other studies indicate that representatives of company managements are involved in the work of various NGOs and their bodies that deal with the issue of social responsibility to society. Among the most substantial obstacles in developing programs related to social responsibility are the demands raised by employees (managers and workers) of the company for an increase of their income (salaries). The ambition for a rapid increase in profits and income forces the company management to walk away from allocating part of company resources for programs focused on the social responsibility to society. 1) Educational level improvement programs To support people's motivation to pursue improvement of their education, the companies may distribute subsidies for further training and re-qualification in various educational institutions.

### **IV. ETHICS AND CONTEMPORARY MANAGEMENT**

The main challenges facing social responsibility are the personal qualities of the members of the organisation and their perception of right and wrong. Individuals who believe that "the organisation has to maximize profits in compliance with the legal regulations" consider profitability, effectiveness and strict observance of the laws to be of primary importance and place insufficient value to the altruism. They believe that an organisation is well managed and socially responsible as long as its activities follow certain values. To be able to make the right choice of behaviour an individual should be first acquainted with the notion of ethics. Ethics is built on certain principles based on the concept of right and wrong behaviour. Ethics in business does not relate merely to the idea of socially responsible behaviour. It encompasses a wider range of behavioural decisions for both managers and employees. The managers of an organisation must exercise dynamic decision making while respecting the necessary balance between the business interests of the organisation and the behavioural limits, deemed unacceptable by the society [7]. The ethical business problems relate to the conflict [8] or to a lesser degree to the probability of such a conflict, between the financial performance of the organisation, revenues, expenses and profit and the social responsibility performance, expressed through the obligation of the organisation towards its members and society. A modern approach to increase social responsibility performance is to train the

organisation's managers and other responsible employees how to handle ethical issues which they encounter in their daily work. Ethics could be also taught at universities thus creating an initial understanding of its related issues. Organisations are undertaking various measures and decisions, such as specialized training sessions, to form the ethical norms of behaviour of their managers and employees. The ethical norms of an organization represent a system of shared values and ethical rules, which should be observed by each employee. Their purpose is to describe the goals of the organization, to create a healthy ethical environment and to determine the ethical guidelines for decision making. The management of IBM states that the company expects from each employee in every situation to act in accordance with the business standards. Business ethics are of utmost importance in international relations as well. It is obvious, that while acting in their own interests, multi-national companies must also consider their role as intermediaries for the exchange of economic and social development. As such companies tend to have a lasting impact on parties they engage with during their business activities, the ethical issues should become an important element of the overall planning of their organization. The ethical standards are different in the different countries. The ethics do not have a "maximum limit". Multinational companies would typically have a sophisticated organization of the business and production activities and, in most cases, a high level of ethical behaviour and control. The focus of organizations on ethics is expected to At present, an opinion is being formed and adopted in our country (and the countries of the former socialist camp) that organizations should allocate part of their financial resources and efforts to support local communities in which they operate, and the society as a whole. As pointed out by Lee Preston in [2], "An organization cannot operate responsibly for a long time while being in conflict with its environment." In order to be successful, the organization must be able to adapt and respond to problems arising in the social environment so as to make this environment more favorable to the organization. Expenditure on social responsibility is justified also by the fact that it contributes to improving various segments of society, as well as improving the public's attitude toward the company. This has to be associated with higher consumer loyalty to product manufacturers and hence lead to general improvement of the condition of society. The presented good practices do not apply to the social behavior of large organizations. All other small businesses and organizations such as schools, universities and hospitals, are socially responsible. It should be noted, however, that the main purpose of an industrial enterprise is to secure wages for the employees who earn their living by working in it, and only afterwards to attend to the problems of society. If it is not able to conduct business at a profit, the question of social responsibility remains primarily in the academic sense. Nevertheless, an organization should conduct its affairs so as to be consistent with public expectations. In other words, the social responsibility of a company means more than just philanthropy. Naturally, the organization acts responsibly and in accordance with the concerns and hopes of the general public. In conclusion, the following paraphrase of a statement in book [6] can be expressed: "The company management is obliged to use all their talents to achieve maximum profit and growth. But the enlightened self-interest of the company requires it to fulfill every reasonable expectation towards it by the community and the various public circles concerned. Open recognition of priorities and socially responsible behavior of the company ensure the

achievement of important secondary targets. Profitability and expansion go hand in hand with fair treatment of employees, of consumers at all levels, and of the local community.

### Corporate Social Responsibility (CSR) – Prioritizing Positive Societal Impact

Corporate Social Responsibility (CSR) is a mechanism by which companies hold themselves to a set of legal, ethical, social and ecological standards. It is a form of business self-regulation that has developed alongside greater public awareness of ethical and environmental issues. But is it always a force for good?

We live in an ever-more globalised world. Not only have national economies become highly intermingled and interdependent, but humanity's most pressing problems are increasingly cross-border issues. The capacities of individual governments to address these issues alone are limited, and there has been a growing attention paid towards the role businesses have to play.

definitions of Corporate Social Responsibility (CSR) vary, it is generally understood to be a mechanism whereby companies take responsibility for the impacts of their decisions and practices by holding themselves to a set of ethical, social and ecological standards - with the aim of contributing towards the health, welfare and sustainable development of society. The term was coined in the 1950s, although the real impetus came later on after a number of industrial disasters, such as the 1969 Santa Barbara oil spill, which led to low public confidence in businesses and translated into massive public protests. These culminated in the first Earth Day in 1970, and spurred a host of new environmental regulations in the USA, as well as the founding of a number of businesses grounded in CSR norms.

In the 1990s CSR began to gather steam on an international level. This decade saw high profile international events such as the UN Summit on the Environment and Development and the signing of the Kyoto Protocol on climate change, which, among other things, raised expectations on corporate behaviour. Moreover it was a period of rapid economic globalisation, and as companies expanded internationally they faced uneven regulatory frameworks and increased global visibility and reputational risk.

### **Responsible Companies in the Age of Globalisation**

Over the past few decades, expectations on corporate behaviour have continued to rise alongside greater public awareness around human rights, environmental protection and other issues. The institutionalisation of CSR is stronger than ever, as many companies have sought to adapt to this more socially-conscious customer base.

There is strong evidence to suggest that highlighting responsible business practices endows a company with clear competitive advantages. A study looking into the coffee industry, for



example, found that Fair Trade certified growers enjoyed higher sales, despite higher prices. Indeed, recent studies have shown that a majority of consumers will choose to spend more money on a product from a 'sustainable' brand. Businesses seen as responsible also benefit from greater employee productivity and retention. So savvy companies have sought to protect their corporate image, seeing the direct impact it can have on relationships with investors, employees, and customers.

## **Corporate social responsibility**

Corporate social responsibility (CSR) is a type of international private business self-regulation that aims to contribute to societal goals of a philanthropic, activist, or charitable nature by engaging in or supporting volunteering or ethically-oriented practices. While once it was possible to describe CSR as an internal organisational policy or a corporate ethic strategy, that time has passed as various international laws have been developed and various organisations have used their authority to push it beyond individual or even industry-wide initiatives. While it has been considered a form of corporate self-regulation for some time, over the last decade or so it has moved considerably from voluntary decisions at the level of individual organisations, to mandatory schemes at regional, national and international levels.

Considered at the organisational level, CSR is generally understood as a private firm policy. As such, it must align with and be integrated into a business model to be successful. With some models, a firm's implementation of CSR goes beyond compliance with regulatory requirements and engages in "actions that appear to further some social good, beyond the interests of the firm and that which is required by law". The choices of 'complying' with the law, failing to comply, and 'going beyond' are three distinct strategic organisational choices. While in many areas such as environmental or labor regulations, employers may choose to comply with the law, or go beyond the law, other organisations may choose to flout the law. These organisations are taking on clear legal risks. The nature of the legal risk, however, changes when attention is paid to soft law. Soft law may incur legal liability particularly when businesses make misleading claims about their sustainability or other ethical credentials and practices. Overall, businesses may engage in CSR for strategic or ethical purposes. From a strategic perspective, the aim is to increase long-term profits and shareholder trust through positive public relations and high ethical standards to reduce business and legal risk by taking responsibility for corporate actions. CSR strategies encourage the company to make a positive impact on the environment and stakeholders including consumers, employees, investors, communities, and others.[ From an ethical perspective, some businesses will adopt CSR policies and practices because of ethical beliefs of senior management. For example, a CEO may believe that harming the environment is ethically objectionable.

Proponents argue that corporations increase long-term profits by operating with a CSR perspective, while critics argue that CSR distracts from businesses' economic role. A 2000 study compared existing econometric studies of the relationship between social and financial

performance, concluding that the contradictory results of previous studies reporting positive, negative, and neutral financial impact, were due to flawed empirical analysis and claimed when the study is properly specified, CSR has a neutral impact on financial outcomes. Critics questioned the "lofty" and sometimes "unrealistic expectations" in CSR, or that CSR is merely window-dressing, or an attempt to pre-empt the role of governments as a watchdog over powerful multinational corporations. In line with this critical perspective, political and sociological institutionalists became interested in CSR in the context of theories of globalization, neoliberalism and late capitalism. Some institutionalists viewed CSR as a form of capitalist legitimacy and in particular point out that what began as a social movement against uninhibited corporate power was transformed by corporations into a "business model" and a "risk management" device, often with questionable results.

CSR is titled to aid an organization's mission as well as serve as a guide to what the company represents for its consumers. Business ethics is the part of applied ethics that examines ethical principles and moral or ethical problems that can arise in a business environment. ISO 26000 is the recognized international standard for CSR. Public sector organizations (the United Nations for example) adhere to the triple bottom line (TBL). It is widely accepted that CSR adheres to similar principles, but with no formal act of legislation.



### **Definition of CSR**

Since the 1960s,[18] corporate social responsibility has attracted attention from a range of businesses and stakeholders. A wide variety of definitions have been developed but with little consensus. Part of the problem with definitions has arisen because of the different interests represented. A business person may define CSR as a business strategy, an NGO activist may see it as 'greenwash' while a government official may see it as voluntary regulation." [1] In addition, disagreement about the definition will arise from the disciplinary approach." [1] For example, while an economist might consider the director's discretion necessary for CSR to be implemented a risk of agency costs, a law academic may consider that discretion to be an appropriate expression of what the law demands from directors.[19][20]

Corporate social responsibility has been defined by Sheehy as "international private business self-regulation." [1] Sheehy examined a range of different disciplinary approaches to defining CSR. The definitions reviewed included the economic definition of "sacrificing profits," a management definition of "beyond compliance", institutionalist views of CSR as a "socio-political movement" and law's own focus on directors' duties. Further, Sheehy considered Archie Carroll's description of CSR as a pyramid of responsibilities, namely, economic, legal, ethical, and philanthropic responsibilities.[21] While Carroll was not defining CSR, but simply arguing for classification of activities, Sheehy developed a definition differently following the philosophy of science—the branch of philosophy used for defining phenomena.

Carroll extended corporate social responsibility from the traditional economic and legal responsibility to ethical and philanthropic responsibility in response to the rising concerns on ethical issues in businesses.[21] This view is reflected in the Business Dictionary which

defines CSR as "a company's sense of responsibility towards the community and environment (both ecological and social) in which it operates. Companies express this citizenship (1) through their waste and pollution reduction processes, (2) by contributing educational and social programs and (3) by earning adequate returns on the employed resources." [22][23][23]

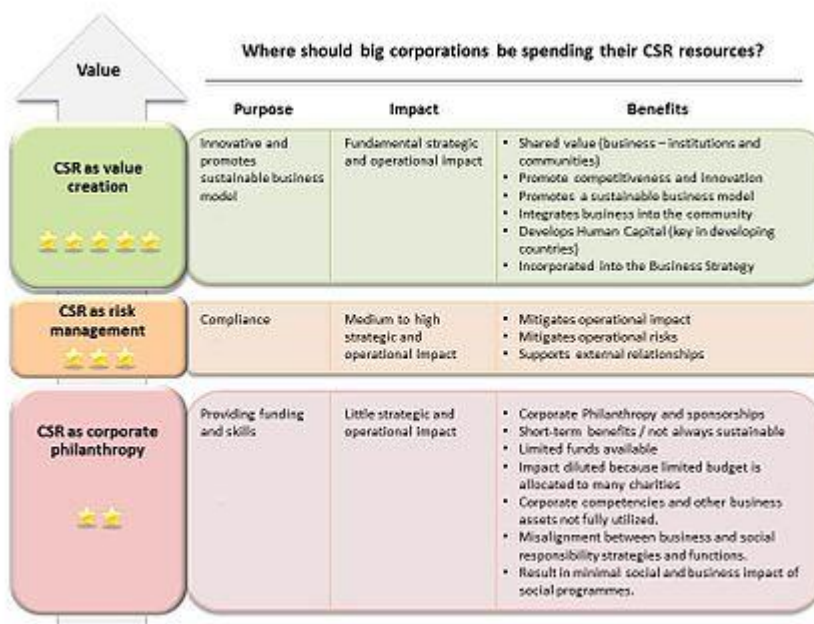
### Consumer perspectives

Businesses have changed when the public came to expect and require different behavior [...] I predict that in the future, just as in the past, changes in public attitudes will be essential for changes in businesses' environmental practices.

— Jared Diamond, "Big businesses and the environment"

Most consumers agree that while achieving business targets, companies should engage in CSR efforts at the same time. [25] Most consumers believe companies doing charity work will receive a positive response. [26] Somerville also found that consumers are loyal and willing to spend more on retailers that support charity. Consumers also believe that retailers selling local products will gain loyalty. [27] Smith (2013) [28] shares the belief that marketing local products will gain consumer trust. However, environmental efforts are receiving negative views given the belief that this would affect customer service. [27] Oppewal et al. (2006) found that not all CSR activities are attractive to consumers. [29] They recommended that retailers focus on one activity. [30] Becker-Olsen (2006) [31] found that if the social initiative done by the company is not aligned with other company goals it will have a negative impact. Mohr et al. (2001) [32] and Groza et al. (2011) [33] also emphasise the importance of reaching the consumer.

### Approaches



### CSR approaches

Some commentators have identified a difference between the Canadian (Montreal school of CSR), the Continental European and the Anglo-Saxon approaches to CSR.[34] It is said that for Chinese consumers,[35] a socially responsible company makes safe, high-quality products; for Germans it provides secure employment; in South Africa it makes a positive contribution to social needs such as health care and education.[36] Even within Europe, the discussion about CSR is very heterogeneous.[37]

A more common approach to CSR is corporate philanthropy. This includes monetary donations and aid given to nonprofit organizations and communities. Donations are made in areas such as the arts, education, housing, health, social welfare and the environment, among others, but excluding political contributions and commercial event sponsorship.[38]

Another approach to CSR is to incorporate the CSR strategy directly into operations, such as procurement of Fair Trade tea and coffee.

Creating shared value or CSV is based on the idea that corporate success and social welfare are interdependent. A business needs a healthy, educated workforce, sustainable resources and adept government to compete effectively. For society to thrive, profitable and competitive businesses must be developed and supported to create income, wealth, tax revenues and philanthropy. The Harvard Business Review article "Strategy & Society: The Link between Competitive Advantage and Corporate Social Responsibility" provided examples of companies that have developed deep linkages between their business strategies and CSR.[39] CSV acknowledges trade-offs between short-term profitability and social or environmental goals, but emphasizes the opportunities for competitive advantage from building a social value proposition into corporate strategy. CSV gives the impression that only two stakeholders are important – shareholders and consumers.

Many companies employ benchmarking to assess their CSR policy, implementation and effectiveness. Benchmarking involves reviewing competitor initiatives, as well as measuring and evaluating the impact that those policies have on society and the environment, and how others perceive competitor CSR strategy.[40]

### **Cost-benefit analysis**

In competitive markets cost-benefit analysis of CSR initiatives can be examined using a resource-based view (RBV). According to Barney (1990), "formulation of the RBV, sustainable competitive advantage requires that resources be valuable (V), rare (R), inimitable (I) and non-substitutable (S)."[41][42] A firm introducing a CSR-based strategy might only sustain high returns on their investment if their CSR-based strategy could not be copied (I). However, should competitors imitate such a strategy, that might increase overall social benefits. Firms that choose CSR for strategic financial gain are also acting responsibly.

RBV presumes that firms are bundles of heterogeneous resources and capabilities that are imperfectly mobile across firms. This imperfect mobility can produce competitive advantages for firms that acquire immobile resources. McWilliams and Siegel (2001) examined CSR activities and attributes as a differentiation strategy. They concluded that managers could

determine the appropriate level of investment in CSR by conducting cost benefit analysis in the same way that they analyze other investments. Reinhardt (1998) found that a firm engaging in a CSR-based strategy could only sustain an abnormal return if it could prevent competitors from imitating its strategy.[43]

Moreover, when it comes to cost benefit analysis, one should look at Waddock and Graves (1997), who showed that corporate social performance was positively linked to financial performance, meaning that the benefit of being socially responsible outweighs the costs. McWilliams and Siegel (2000) noted that Waddock and Graves had not taken innovation into account, that companies that did CSR were also very innovative, and that the innovation drove financial performance, not CSR. Hull and Rothenberg (2007) then found that when companies are not innovative, a history of CSR does in fact help financial performance.[44]

### **Scope**

Initially, CSR emphasized the official behaviour of individual firms. Later, it expanded to include supplier behaviour and the uses to which products were put and how they were disposed of after they lost value.

### **Supply chain**

In the 21st century, corporate social responsibility in the supply chain has attracted attention from businesses and stakeholders. Corporations' supply chain is the process by which several organizations including suppliers, customers and logistics providers work together to provide a value package of products and services to the end user, who is the customer.[45]

Corporate social irresponsibility in the supply chain has greatly affected the reputation of companies, leading to a lot of cost to solve the problems. For instance, incidents like the 2013 Savar building collapse, which killed over 1000 people, pushed companies to consider the impacts of their operations on society and environment. On the other side, the horse meat scandal of 2013 in the United Kingdom affected many food retailers, including Tesco, the largest retailer in the United Kingdom,[46] leading to the dismissal of the supplier. Corporate social irresponsibility from both the suppliers and the retailers has greatly affected the stakeholders who lost trust for the affected business entities, and despite the fact that sometimes it is not directly undertaken by the companies, they become accountable to the stakeholders. These surrounding issues have prompted supply chain management to consider the corporate social responsibility context. Wieland and Handfield (2013) suggested that companies need to include social responsibility in their reviews of component quality. They highlighted the use of technology in improving visibility across the supply chain.[47]

### **Corporate social initiatives**

Corporate social responsibility includes six types of corporate social initiatives:[2]

Corporate philanthropy: company donations to charity, including cash, goods, and services, sometimes via a corporate foundation

Community volunteering: company-organized volunteer activities, sometimes while an employee receives pay for pro-bono work on behalf of a non-profit organization

Socially-responsible business practices: ethically produced products which appeal to a customer segment

Cause promotions and activism: company-funded advocacy campaigns

Cause-related marketing: donations to charity based on product sales

Corporate social marketing: company-funded behavior-change campaigns

All six of the corporate initiatives are forms of corporate citizenship. However, only some of these CSR activities rise to the level of cause marketing, defined as "a type of corporate social responsibility (CSR) in which a company's promotional campaign has the dual purpose of increasing profitability while bettering society." [48]

Companies generally do not have a profit motive when participating in corporate philanthropy and community volunteering. On the other hand, the remaining corporate social initiatives can be examples of cause marketing, in which there is both a societal interest and profit motive.

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