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1. Learning Outcomes

After studying this module, you shall be able to

- understand the concept and types of governments,
- identify the various roles of government in different aspects of business environment,
- compare the role of government in different economic systems,
- Evaluate the need of government intervention in business.

2. Introduction

Government is one of the important contributors of business environment that influence every business enterprise in the economy at macro level. It governs the nation on the path of the development and achieving the national goals according to its constitution. It plays direct and indirect role in creating competitive advantages for an industry in the economy. In most of the economies, it acts as a referee that decides the rules of business game and ensures the fair play in the economy. It also sets rules and regulations in order to provide a legal framework for smooth functioning of a business.

Adam Smith, in 18^{th} century discussed the role of government in his book *"The Wealth of Nations"*. He opined that the government plays a role of a mentor who makes and enforces the laws to safeguarding the interest of different stakeholders and provide infrastructural support to business within the ambit of national objectives, mission and vision.

Concept of Government

Government may be a person, group of persons or group of people's representative who holds the authority to govern the society which is determined by the constitution of the country. Government can be termed as the state's machinery which includes various departments and institutions that make laws and policies, execute them and ensure that they are enforced with same spirit.

Government in India

The Constitution of India is a written document that lays down the rights and duties and states political and socio- economic objectives of governance. It also explains the distribution of powers among different layers of government.

The Constitution of India was adopted on November 26, 1949 and come into force on January 26, 1950. It explains Parliamentary form of government. It also elaborates the governmental set up and distribution of powers between central and states.

Three Levels of Government

In India, Government has generally three levels with three distinct sets of powers. The first level is the legislature, whose role is to make law. The second is the executive which implements the law. The third level is judiciary which interprets and applies the law.

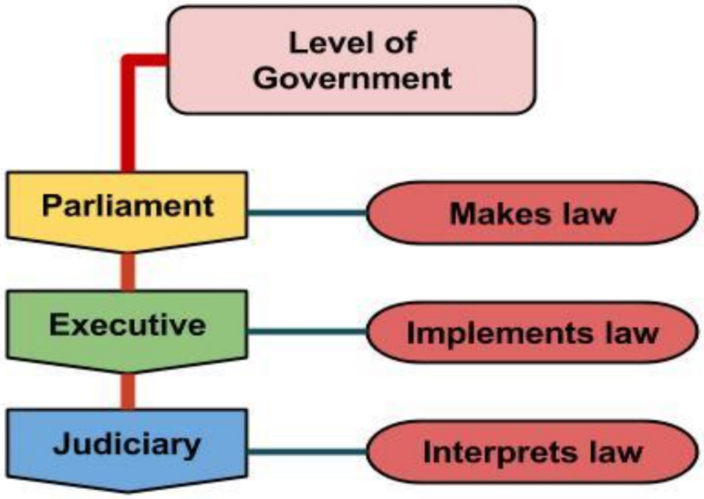

Figure 1 Level of Government

- ***Parliament***: In India Parliament consists of President and two houses e.g. Rajya Sabha and Lok Sabha. Parliament of India performs the functions such as passing of the Budgets, enacting all the laws, discusses national issues, ratifies the treaties, frame policies for international relations etc.
- ***Executive***: Executive is an administrative body that performs the following functions such as implement the laws made by the parliament, protects and defends the constitution of the country, make the important appointments and frames foreign policies.
- ***Judiciary***: Judiciary is a branch of government that is independent to Parliament and Executive body. It is held responsible for review and interpret the laws and oversees and administers the judiciary system of the country etc.

3. Forms of Government

There are various forms of government that exist in different countries of the world. Each form of government has its own unique features and characteristics. Some of the common forms of governments are:

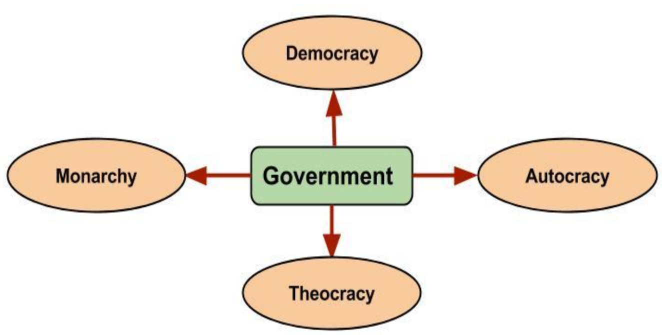

Figure 2: Types of Government

- ***Democracy-*** The word "democracy" means "rule by the people". In democracy, state is governed by the people directly and indirectly through their representatives. These representatives are selected through free and fair elections.
  For an example, India is the largest democracy in the world. India has Parliamentary system of government in which people's representative are selected on the basis of universal adult franchise.
- ***Autocracy-*** in Autocracy, the power to govern the society is held by a particular person or party. The power is inherited or obtained by military force. The person exercises his absolute power to control all aspects of social and economic life of citizens.
  Hitler had enjoyed its powers as a greatest autocrat of the world.Benito Mussolini and Joseph Stalin were Famous autocrats of Italy and USSR respectively.

- ***Theocracy*** – In a theocracy, government is led by the religious persons of the society. The state is governed according to law which is based on religious teachings and state's legal system is also based on religious law.
  Currently, Iran is an Islamic state which is ruled as per *Sharia* law by the government led by Islamic cleric.
- ***Monarchy*** - Monarchy is the form of government where the supreme power to govern the state is held by a single person called "King" or "Queen". Earlier almost every nation had a monarchy system. Now, Great Britain is having Monarchy system.
  Qatar, a west Asian country has a monarchy system of government which is solely ruled by the Al Thani Dynasty.

4. Government and different aspects of Business

Government has an impact on different aspects of business such as profitability, operations and functions of business. Government makes and enforces laws to regulate the different areas of business. The main areas which are affected by government are as follows:

1. ***Government and financial resources:*** The government channelizes the financial resources among different sectors of economy through taxations and public borrowings. The network of financial institutions which mobilize the funds in economy, functions under the guidance and control of state machinery. Financial decisions of a business entity are also influenced by the fiscal and monetary policy of the government. It plays an important role in deciding interest rates in the economy which directly affects cost of borrowed capital for a business unit.
2. ***Government and business administration:*** Government also influences the administration and functioning of a business. It sets rules, regulations, guidelines and codes of conduct according to which a business is operated.
3. ***Government and business stakeholders:*** It is generally argued by the state interventionists that managers only serve the interest of shareholders and neglect the expectations of other stakeholders of business. To safeguarding the interest of different stakeholders, Government posses obligations on business enterprises through various laws and regulations.
   For example, there are different acts such as Company Act 2013, Industrial Disputes Act 1947, Payment of Bonus Act 1965, Income Tax Act 1961 etc. that govern the different business activities.

5. National Competitive Advantage and Government

Porter has explained four major attributes that determines the competitive advantage for an industry. He maintains an additional factor, Government that indirectly affects the level of competitive advantage of an industry. All these four determinants are influenced by the government at macro level.

5.1 ***Government and factor conditions***- Factors conditions are influenced by the government policies and decisions. Government creates a favorable environment conditions for development of different factors that play an important role in success of an industry in the economy. These factors include:

a. Roads, railways, shipping etc.

b. Schools, colleges, training institutions

5.2 ***Government and demand conditions***- Government tries to control the demand of a specific product by setting up high quality standard and imposing different types of duty and taxes on the product. Sometimes government encourages demand of a product by providing financial assistance in the form of subsidies and tax exemptions.

5.3 ***Government and related and supported industries***- Government supports an industry in the economy by promoting its related industries i.e. industries that provide raw material and other services to a particular industry. Government helps some related and supported industries by providing financial and infrastructural support. The supported and related industries includes Banking industries, transport industries etc.

5.4 ***Government and firm's strategy, structure and rivalry***- The intensity of competition in an industry depends on government intervention in the market. Government encourages healthy competition in the industry by enforcing anti-trust policies and monopoly restrictive laws. It confirms the availability of equal opportunities to all the participants in the market.

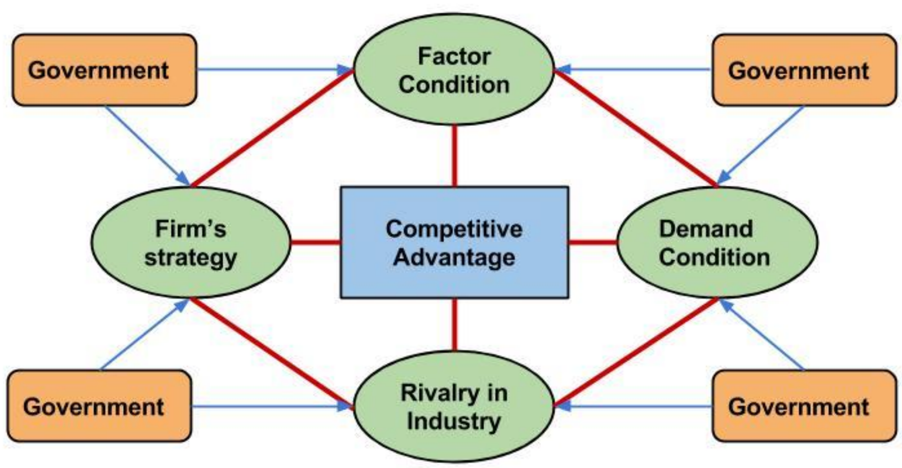

Figure 3 : Determinants of competitive advantage and government

6. Role of government

The government plays various roles in the country. There are some economic roles of government that are concerned with growth and development of industrial sector of the country. The main four economic roles are discussed below:

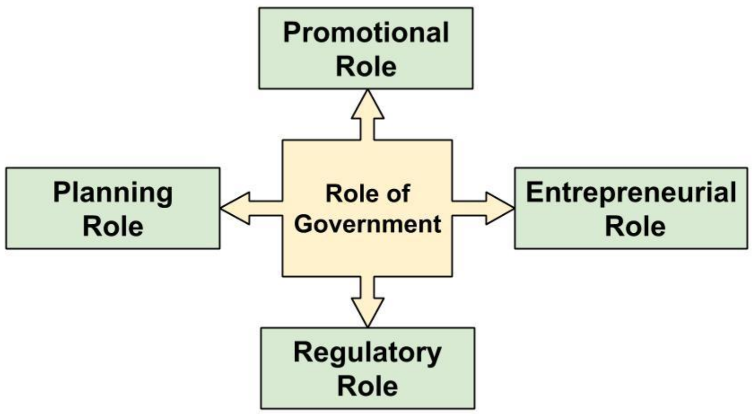

Figure 4 : Role of Government

- ***Promotional role***: Government plays a significant role in development of different industries by providing infrastructural facilities, such as power, transport, banking, insurance etc. The promotional role of government consists:
    - To provide financial support by way of subsidies and grants, power and water supply at concessional rates, tax holidays for development of particular industry or in a backward region.
    - To provide monetary and other incentives for the development of priority sectors or industry of public interest.
    - To provide cover against certain risk
- ***Regulating role***: Governments may also reserve the right to regulate different business activities for some social and economic purposes. Government prescribes laws related to administration of business, to raise capital, distribution of income etc. The regulatory role of government is -
    - To formulate rules or regulations in order to set standards for firm behaviour. The different types of fines and penalties are imposed for non- compliance of prescribed rules and regulations.
    - To control different trade activities through various types of instruments, e.g. tariffs, quota and taxes.

- ***Planning role***: In the role of a planner, Government ensures the optimum use of scarce resources of the economy by proper allocation of resources as per national priorities. Government lays down the plans for acquisition, distribution and utilization of such resources to achieve socio-economic objectives of the country. In India, Planning Commission formulates the five year plans which are executed by different concerned departments.

- ***Entrepreneurial role***: As an entrepreneur, government participates in business activities by owning and managing different government undertakings. In the economy, private players operate in the market solely for profit motive and hence they do not involve in production of common public goods which relatively gives lower returns. But in this situation government runs different non-profit public undertakings and works in the economy as a “social entrepreneur”.
  Apart from participating in business activities, entrepreneurial role of government involves encourage the entrepreneurial activities in country by announcing different policies and establishing entrepreneurship development institutions.

6.1 Role of government in different economic systems

The role of government in business varies from country to country. It depends on type economic system exists in the country. There are mainly three types of economic i.e. capitalism, socialism and mixed economy. The level of government intervention differs in each economic system.
In capitalism, all the factors of production are controlled and owned by private sector. All the decision related to production and distribution of goods and services are made by the market forces without any intervention from business. In capitalist economy, government plays minimum role in the business environment. It maintains legal framework in the economy, protect individual property rights and provides public goods.
Under socialist economic system, government plays a significant role in the economy. All the means of productions are owned by the government. The central planning system makes all the decisions related to production and distribution. No private profits are allowed in the economy, everyone works for the government in order to achieve social objectives which are set by the government.
Under mixed economy system, both public and private sector exist in the economy. The private sector primarily works with profit motive and the public sector which is governed by the state designs programs and policies to promote the welfare of the society. Both the sector works together to ensure overall development of the economy. Government implements laws and regulations to check undesirable economic activities. In mixed economic system, the government provides infrastructural support for rapid economic development through the public sector.

Economic system

An organize system of allocating resources as well as production of goods and services in order to satisfy the needs of people.

According to Loucks, “An economic system consists of those institutions which are selected or accepted by given people or nation or group of nations as the means through which resources are utilized for satisfaction of human wants.

7. Rationality of government intervention in business

7.1 Reasons for government intervention in business

Government intervenes in business for a variety of reasons. The main reason for intervention is to safeguard the interest of the society. The main reasons for intervention are:

1. ***Provide vision and mission-*** Government directs all economic activities by setting up targets and providing roadmaps under the five year plans. It decides the overall economic goals under which different business organization sets their individual objectives and makes strategies.
2. ***Preserve competition in the market-*** Government intervenes in business environment to maintain healthy competition in the market by enforcing anti-trust laws. These laws prohibit the formation of monopolies and unfair activities in the market. It ensures fair play in the market.
3. ***Promote economical performance of industries-*** Many times; government helps different sectors or industries in growth and revival by providing tax holidays, exemptions or duties.
4. ***Provide legal framework-*** Government creates legal framework in the economy by enforcing different laws in the country. These laws help in enforcement of different types of business contracts and safeguard the intellectual property rights.
5. ***Provide public goods-*** The private sector does not produce public goods because there are no economical incentives to do so. Therefore, government produce public goods for the benefit of the society.
6. ***Regulate private sector-*** Under capitalist and mixed economy system, government regulates private sector in order to check unfair practices such as mismanagement of funds, concealment and manipulation of facts and figures, unfair trade practices. There are different government agencies such as RBI, TRAI, and SEBI etc that regulate their concerned areas.

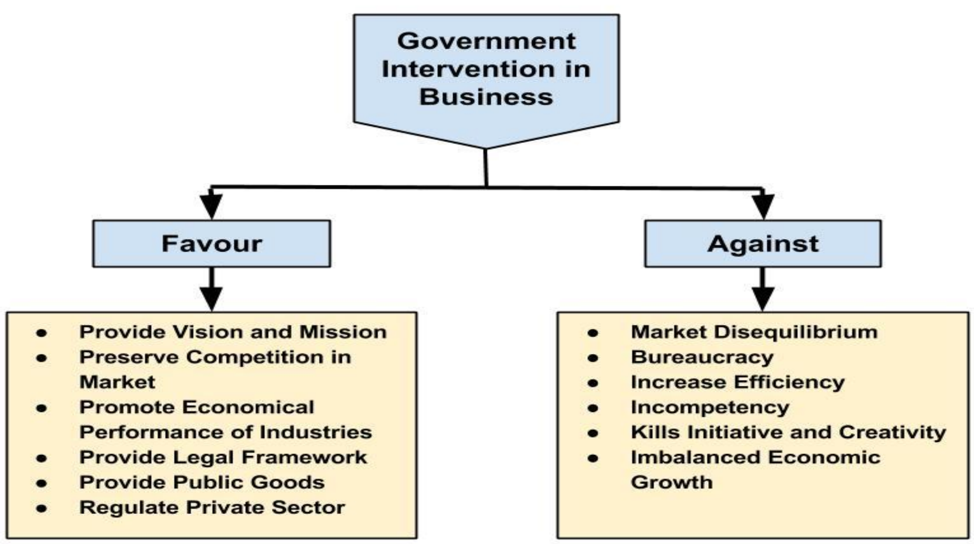

Figure 5 : Arguments in Favour and Against of Government Intervention

7.2 Arguments against government intervention

1. ***Market disequilibrium***- When the government intervenes in the market by controlling market prices, it creates the problem of shortage or over-supply. If the government sets the prices below the equilibrium level then it results in excess demand or shortage of commodity in market. Contrary, if the prices are fixed above the equilibrium price then it decreases the demand in the market.
2. ***Bureaucracy***- Government intervention through its rules and regulations creates bureaucratic hurdles in the growth of business. Sometimes, government intervention unnecessarily delays the decision making process of a business and negatively affects its efficiency and growth.
3. ***Increase inefficiency***- Unnecessary support of government to a particular industry, negatively affects the efficiency and creativity of that industry. It increases the dependence of business on the government.
4. ***Incompetency***- Government intervention in business increases the incompetency in the economy. Many times government announces some industrial policies that support a particular industry and some other policies that becomes a threat for another industry. These policies hamper the competition in the market and make domestic industries incompetent to face global competition.
5. ***Kills initiative and creativity***- Large number of legal formalities and regulations discourage the initiative for setting up a new business. Because of these bureaucratic hurdles, people prefer to be an intrapreneur instead of entrepreneur.
6. ***Imbalanced economic growth***- Government support to a particular sector or industry inversely affects the inclusive growth of the economy. It leads to inefficient allocation of the resources.

8. Summary

- Government is an important part of external business environment.
- There are four common forms of government e.g. democracy, autocracy, theocracy and monarchy. India is a democratic country which follows the parliamentary system of government.
- Government influence an industry in the economy by affecting the following factors that decides its competitive position in the economy: - Demand condition, factor condition, firm strategy and rivalry in industry.
- The government plays four economic roles for growth and development of industrial sector. These economic roles are: - promotional, entrepreneurial, regulating and planning role.
- The government intervenes in the economy to: - provide vision and mission, legal framework and economical support to business, preserve competition in the market and regulate private sector.