



Online Journal

ISSN : 2347 - 9671

www . epratrust.com

February 2014 Vol - 2 Issue- 2

IMPACT OF LEGAL AND ECONOMIC ENVIRONMENT ON IT INDUSTRY

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ABSTRACT



The significant contribution made by the IT sector to the country's economic growth is well known. It is therefore necessary to ascertain if such contribution can be improved upon for accelerating the country's economic growth. No other sector of the economy has made such rapid strides in the country's recent history. Therefore, the country has an inherent strength in the sector. It is necessary in the circumstances to examine how this strength can be leveraged to catalyse the economic growth of the country. However, no sector of the economy can grow on its own all the time. It should be supplemented by other enablers like the right business environment and the right investment policy, amongst other things. Hence the impact of the business environment in the IT industry, in Karnataka in particular, should be examined first. It will help in identifying and subsequently overcoming the constraints that come to the fore as a result.

KEY WORDS: Law, Protection of IPRs in India, Business Freedom, Monetary Freedom, Fiscal Freedom, Tax Rates on IT Sector.

INTRODUCTION

The information technology (IT) sector has been playing a significant role in the country's external sector. The country recorded a surplus on the current account of its balance of payments (BOP) in the recent past because of the IT sector's contribution to exports. Lately, however, the sector has been helping in reducing the country's current account deficit (CAD) again by contributing generously to the country's exports. In the process, it has attracted foreign investments, direct and institutional. It has created jobs in other fields of economic activity too through the domino effect.

IT companies hire commercial vehicles so their employees can be transported to the workplace, thereby reducing the burden on the local transport system which anyway is bursting at the seams. This has created jobs. The catering industry has revived itself up in order to cater to the huge demand placed on it by IT units whose employees often work three shifts a day. They leave for the workplace well ahead of other employees in order to beat the traffic and report to the workplace promptly. Their breakfast, lunch, supper, etc., are arranged by the IT units in the workplace. Armed with the newly-gained purchasing power, thanks to their attractive remuneration (at least by Indian standards) the IT employees patronize the durable and non-durable consumer goods industry. They spend liberally on consumption.

But this development is not without its flip side. For example, the rapid growth of the IT sector has placed a heavy burden on the infrastructure of the local city which is already bursting at the seams. Amenities have fallen far short of the demand; prices

have been rising and maintenance of law and order has been becoming even more challenging.

Karnataka has been in the forefront of IT and Bangalore, its capital city, is the acknowledged IT capital of India. The state was the first to announce an "IT Policy" in the year 1997. It followed it up with a "Millennium IT Policy" in the year 2000. The policy catalysed the growth of the industry in the state. It helped in promoting the use of Kannada software and launching several e-governance initiatives. These have in turn led to a visible improvement in the quality and transparency of government services being delivered to the layman. The industry is amongst the major creators of jobs in the state. It provides direct employment to over half a million people and indirect employment to over 1.5 million people. Bangalore is the fourth best technology hub in the world, after Silicon Valley, Boston and London, according to UNDP. Almost all the Fortune 500 companies have one or the other of their operations outsourced to Bangalore. Many global brands such as GE, Texas Instruments, Intel, AMD, SAP, CISCO, Microsoft, Motorola and Nokia have housed their R&D activity in Bangalore.

Within the country, the state of Karnataka takes the cake for contributing the biggest chunk to the IT pie. It is home to at least two of the top five IT companies of the country. In addition, mid-cap and small-cap IT companies, purely foreign-owned, jointly owned and locally-owned are conspicuous in the state. The state's capital, namely Bangalore, where the said IT companies are headquartered is rightly called the Silicon Valley of India. International IT behemoths like IBM and HP too are conspicuous in the city. Several reputed US-based IT companies of all shapes and sizes have set up research

centres, centres of excellence, etc, in the city in addition to centres for software development, business process management (BPM) operations, etc. Bangalore has become an international IT hub and a force to reckon with on the global IT map.

REVIEW OF LITERATURE

- 1) Ashish Arora and Surendrakumar Bagde (Heinz School of Public Policy and Management Carnegie Mellon University, Pittsburgh PA 15213, USA), in their research paper "The Indian Software Industry: the Human Capital Story", study the contribution and effect of human capital, namely, skilled labour on the growth of the Indian software industry. They attribute the rapid growth of software exports from certain regions, of the country to two factors: the large capacity of the undergraduate engineering colleges in the said regions to train students and the sheer size of the electronics hardware industry.
- 2) According to NASSCOM-McKinsey Report (2005), the market for global off-shoring at USD 300 billion has substantial potential. India can maintain its lead in the IT and BPO sectors by harnessing the off-shoring potential. The Indian IT industry's future growth will rely on a number of factors: government policy initiatives in promoting infrastructure, higher education and trade development, NASSCOM's efforts in encouraging the establishment of skill development centres and working with academia and industry to boost operational excellence in companies and the companies' initiatives in creating specialists and global delivery centres. Customers also have a role in encouraging the industry's potential by focusing on quality rather than cost and

partnering with educational institutions to help transfer talent and training practices.

- 3) Subhash Bhatnagar (IIM, Ahmedabad), in his research paper "India's Software Industry", recalls the factors that have led to a phenomenal growth in India's software industry. He has attributed the inspiring growth in India's exports to the policy initiatives of the government as well as the efforts of various institutions. Technologically knowledgeable manpower (largely attributable to the abundant and ever-increasing technical colleges specifically in South India) as well as efficient networking of employees sent abroad on assignments led to a shift from low-cost programming jobs to development of all-inclusive software solutions by the industry at home.
- 4) Rajiv Kumar Bhatt, Dr (Associate Professor, Department of Economics, Banaras Hindu University, Varanasi-221005, India), in his research paper "Recent Global Meltdown and its Impact on Indian Economy" (presented at the 2011 International Conference on Economics, Trade and Development, Singapore) examines the effect of the US economic recession on the Indian economy. While the study focuses on the various aspects of the economy that were impacted by the US crisis, it also touches upon the effect on software exports. The reduction in foreign institutional investments (FII) as a result of the meltdown had an adverse effect on the various sectors of the Indian economy. While the stock and forex markets crashed, exports of software and IT services too suffered a set-back.

RESEARCH DESIGN**Objectives of the Study:-**

To Study the impact of the legal environment for IT industry and also to assess the impact of the economic environment on IT industry

Methodology:-

By intent, this is a descriptive study involving fact-finding investigation with adequate interpretation. It focuses on specific aspects or dimensions of the problems taken up by the study. Designed to gather descriptive information, it provides information for formulating more sophisticated studies.

By methodology, this is a fact-finding survey study. It involves collection of data directly from the sample respondents. Hence, data have been collected by interviewing the respondents and documenting the interviews with the help of Interview Schedules. The data have been analyzed using such statistical techniques as are warranted by the objectives of the study.

ANALYSIS**Table No 1. Resolving the Issue of the Applicable Law**

Resolving the Issue	Number of Respondents	Percentage
We expect the client company to agree to arbitration by a recognized arbitration court like the International Court of Arbitration of the International Chamber of Commerce in Paris since India is not a signatory to CIGS.	50	100
We ensure that the client company country government has ratified the UN Convention on Contracts for the International Sale of Goods (CIGS)	0	0
Total	50	100

All the respondents say that they expect the client company to agree to arbitration by a recognized arbitration court

Sources of Data:-

Primary data have been collected from IT Industries. Secondary data have been collected from industry bodies / industry associations, including NASSCOM, MAIT, CII and FICCI. In addition, secondary data has been downloaded from the web sites of the government of India, government of Karnataka, the Reserve Bank of India (RBI) and the financial press.

Sampling Plan:-

IT Industries constitute the sampling universe. Interview Schedules were administered to 50 IT Industries in Bangalore Probability sampling in the form of simple random sampling was applied so every IT Industries stood an equal and independent chance of being selected. Interview schedules, duly completed and received from the 50 IT Industries in Bangalore. They constitute the sample size.

like the International Court of Arbitration of the International Chamber of Commerce in Paris since India is not a signatory to CIGS.

The unanimous view of the respondents is that they expect the client company to agree to arbitration by a recognized arbitration court like the International Court of Arbitration of the International Chamber of Commerce in Paris since India is not a signatory to CIGS.

Table No. 2 Rating of the Protection of IPRS in India

Rating Levels	Frequency	Mode
Excellent (1)	4	3
Good (2)	9	
Neither Good nor Bad (3)	22	
Poor (4)	13	
Bad (5)	2	

According to the Table, the value of the variate for which the frequency is maximum (22) is (3) which represents 'Neither good nor bad'. The protection of IPRs in India has been rated as 'Neither good nor bad' by the respondents.

Table No. 3 India's Economic Freedom in terms of Business Freedom

Rating Levels	Frequency	Mode
Excellent (1)	4	3
Good (2)	9	
Neither Good nor Bad (3)	22	
Poor (4)	13	
Bad (5)	2	

According to the Table, the value of the variate for which the frequency is maximum (21) is (3) which represents 'Neither Good nor Bad'. India's economic freedom in terms of business freedom has been rated as 'neither good nor bad' by the respondents.

Table No. 4 India's Economic Freedom in terms of Monetary Freedom

Rating Levels	Frequency	Mode
Excellent (1)	2	4
Good (2)	8	
Neither Good nor Bad (3)	10	
Poor (4)	27	
Bad (5)	3	

According to the Table, the value of the variate for which the frequency is maximum (27) is (4) which represents 'Poor'. India's economic freedom in terms of monetary freedom has been rated as poor.

Table No. 5 India's Economic Freedom in terms of Fiscal Freedom

Rating Levels	Frequency	Mode
Excellent (1)	0	3
Good (2)	0	
Neither Good nor Bad (3)	31	
Poor (4)	11	
Bad (5)	8	

According to the Table, the value of the variate for which the frequency is maximum (31) is (3) which represents 'Neither Good nor Bad'.

India's economic freedom in terms of fiscal freedom has been rated as 'neither good nor bad'.

Table No. 6 Issues that Characterise the Present IT Business Environment

Issues	Number of Respondents
Spiralling inflation	43
Policy instability	39
Restrictive labour laws	28
Difficulty in accessing finance	23
Inadequate infrastructure	21
Higher tax rates	19
Inefficient government and bureaucracy	17
Unfavourable tax regulations	6
Restrictive foreign currency regulations	4
Corruption	3

43 respondents identify the spiralling inflation amongst the issues that characterise the present business environment. 39 cite policy instability amongst the issues, 28 cite restrictive labour laws amongst the issues, 23 cite difficulty in accessing finance amongst the issues, 21 cite inadequate infrastructure amongst the issues, 19 cite

higher tax rates amongst the issues, 17 cite inefficient government and bureaucracy amongst the issues, six cite unfavourable tax regulations amongst the issues, four cite restrictive foreign currency regulations amongst the issues and three cite corruption amongst the issues.

Table No. 7 Impact of Tax Rates on IT Sector

Impact	Number of Respondents
The Finance Act, 2011 has not extended the tax holiday for STP units beyond Mar 31, 2011.	19
Tax holiday extended to STPs of many companies has expired.	18
Minimum Alternative Tax (MAT) has been extended to SEZs	16
For them, the only benefit available is the one under the SEZ scheme	15
On the other hand, their effective income tax rate has been rising	14

All the 19 respondents point out that the Finance Act, 2011 has not extended the tax holiday for STP units beyond Mar 31, 2011; 18 of the respondents point out that the tax holiday extended to STPs of many companies has expired; 16 respondents

regret that MAT has been extended to SEZs. 15 of the respondent's state that the only benefit available to them is the one under the SEZ scheme; and 14 respondents state that their effective income tax rate has been rising.

Table No. 8 Changes in the Environment that can Impact the Sector Favourably

Impact	Number of Respondents
Improved infrastructure can help the sector price the products more competitively	48
Bringing down inflation can boost the morale of FIIs and domestic investors	45
A more or less consistent INR-USD parity can help the sector hasten further capitalisation of the existing business	43
A more stable policy regime can help the sector consider additional investments	42
A stable government represents a stable policy regime and hence boosts the morale of the investing community	41
Bringing down inflation can help the sector reduce the country's imports and increase the country's exports thereby easing the current a/c deficit (CAD) in the country's Balance of Payments (BoP)	38
A more effective protection of IPR can promote investment in the sector	35
Cheaper funds can help the sector advance capacity expansion plans	25
A more effective protection of IPR can help the sector price the products more competitively	22
Labour law reforms can help the sector create more jobs without incurring additional financial burden.	21
Easier access to funds can help the sector hasten infusion of additional capital	20

According to 48 of the respondents, improved infrastructure can help the sector price the products more competitively; 45 of the respondents state that bringing down inflation can boost the morale of the FIIs and domestic investors; 43 of the respondents state that a more or less consistent INR-USD parity can help the sector hasten further capitalisation of the existing business; 42 of the respondents state that a more stable policy regime can help the sector consider additional investments; 41 of the respondents state that a stable government represents a stable policy regime and hence boosts the morale of the investing community; 38 of the

respondents state that bringing down inflation can help the sector reduce the country's imports and increase the country's exports thereby easing the current a/c deficit (CAD) in the country's Balance of Payments (BoP); 35 said that a more effective protection of IPR can promote investment in the sector; 25 of the respondents state that cheaper funds can help the sector advance capacity expansion plans; 22 state that a more effective protection of IPR can help the sector price the products more competitively; 21 of the respondents said that labour law reforms can help the sector create more jobs without acquiring

additional financial burden; 20 of the respondents state that easier access to funds can help the sector hasten infusion of additional capital.

FINDING

1. The unanimous view of the respondents is that they expect the client company to agree to arbitration by a recognized arbitration court like the International Court of Arbitration of the International Chamber of Commerce in Paris since India is not a signatory to CIGS.
2. The protection of IPRs in India has been rated as 'Neither good nor bad' by the respondents.
3. India's economic freedom in terms of business freedom has been rated as 'neither good nor bad' by the respondents. Because the maximum frequency is 31
4. As per the analysis the India's economic freedom in terms of monetary freedom has been rated as poor.
5. From the above information the India's economic freedom in terms of fiscal freedom has been rated as 'neither good nor bad'.
6. As per the analysis that many of the respondents have agreed that the legal, political and economic environment influenced by various issues.
7. From the above information 19 respondents point out that the Finance Act, 2011 has not extended the tax holiday for STP units beyond Mar 31, 2011
8. According to 48 of the respondents, improved infrastructure can help the sector price the products more competitive and also 45 of the respondents state that bringing down inflation can boost the morale of the FIIs and domestic investors

SUGGESTION

- * Protection of Intellectual Property Rights (IPRs) is critical in the offshore business model. There have been many cases where companies lost their market share because of loss of intellectual property. Because of these the vendor country must be serious about protection of IPRs.
- * Business freedom is a quantitative measure of the ability to start, operate, and close a business that represents the overall burden of regulation as well as the efficiency of government in the regulatory process should be made liberal.
- * Monetary freedom is a combined measure of price stability with an assessment of price controls because inflation and price controls should shape market activity.
- * The tax burden imposed by government on IT Industries should be reduced.
- * A favourable environment is necessary if an industry is to succeed and the IT industry can be no exception to this rule.
- * The government's policy actions as well as technological innovations should help the growth of the industry leading to its maturity.

CONCLUSIONS

This is to conclude that Legal and Economic Environment will have a more impact on IT Industries in relating to Business Freedom, Monetary Freedom, Protection of Intellectual Property Rights, Tax burden etc., the reduction in foreign institutional investments (FII) as a result of the meltdown had an adverse effect on the various sectors of the Indian economy. While the stock and forex markets crashed,

exports of software and IT services too suffered a set-back. But the process of the Indian Economy was constrained by the barriers to trade and investment and financial flows initiated in the nineties has progressively lowered the barriers.

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