
UNIT 1 NATURE AND DIMENSIONS OF BUSINESS ENVIRONMENT

Structure

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1.0 OBJECTIVES

After studying this unit, you should be able to:

- describe the nature and meaning of business environment
- explain the significance of business environment in the realm of managing business
- acquire **the** knowledge of various components like economic, political and legal dimensions of business environment
- analyse the implications and impact of business environment at various geographical **levels**
- provide an insight into how the **environment** affects the managerial dimensions of business.

1.1 INTRODUCTION

Any activity which has the objective of earning profit is called business. Such activities are **termed as** economic activities. They may take the **form** of consumption, production, distribution or exchange. **The basic** function of business is to **optimize the** outcome of the **economic** activities. **This** is the **concept** at the macro level. When we consider the issue from micro view point, we find that a business firm is an economic unit. Its **primary** function is to **transform** a set of inputs into output which includes both goods as well as services. **The** objective of a firm carrying on **business** is the same **i.e.** to **earn profit**. **The firm, therefore,** has to plan **very** carefully the allocation of resources so as to **get the optimum** results. **The** entire process of creation, **mobilisation** of **resources,** and **utilisation** of surplus constitutes the business activity.

In performing such **economic** activities various decisions have to **be taken**. **Decision** making involves a choice of **the** best alternative from among **various** alternatives. **The** choice is made and affected by various variables, **Some** of **the variables** are controllable

and others uncontrollable. **Controllable** variables are those which are within **the control** of the individual business firms. **Uncontrollable** variables are those which are external to the business firms. Such **uncontrollable** factors are termed as environmental factors because they constitute part of the environment. The environment **may** be economic, social, political and **legal**. Each of these constituents may also be domestic or international. Thus the business policy, business strategy and also their implementation depends on the environmental variables.

1.2 MEANING AND SIGNIFICANCE OF BUSINESS ENVIRONMENT

The business environment provides the macro-economic context within which a business firm which is a micro-economic **unit** operates. The term 'environment' refers to a set of external factors and forces which are outside the control of the firm. A **firm** individually cannot influence the **external** environment.

It is difficult to classify the external variables because **all** the variables are interdependent and mutually exclusive. Based on the relevance of these **economic** or **non-economic** factors, we may specify economic and non-economic environment of business. Economic variables are economic in nature and are directly related with various economic issues like income, financial policy, fiscal measures, etc. Non-economic environment serves those factors which are non-economic in nature but have bearing on the economy of the business. Culture, traditions, history, political, sociological, and other dimensions would be the examples of **non-economic** factors.

Since the economic and **non-economic** factors have mixed response, sometimes both these are mixed together. For example, we call socio-economic factors where effect of social conditions on the **economy** and the impact of economic factors on the society are **analysed**. Similarly, when we talk of politico-economic environment we scan both political situation and the **economic issues** with a view to get clarity as to how the political conditions affect the economic scenario **and** how the economic changes bring out political revolution. For example, the basic objective of business is to earn and maximize profits. The social and political revolution terms profit **maximisation** as a social sin and businessmen who aim at earning maximum profits are branded **as** profiteers. But profit earning is the very essence of business. The **businessman** therefore has to **respond** to the requirements of social factors. Thus he does not talk in terms of maximisation of profit, instead he talks about **optimisation** of satisfaction. The word optimisation is viewed not **as** maximising any thing but bringing about **equilibrium** between the two parties **i.e.** business **and** the **society**. The **businessmen** get satisfaction by earning profit and the society gets **satisfaction** when social norms are achieved by the business through its various activities. The **balance** between these two will bring the optimum level. Thus business **firm** While **planning** its operations will have to screen the social environment and will have to operate **within** and as per the norms of the society. **This** explains the relevance and significance of business environment.

The business environment is highly **dynamic** and **has** several **dimensions**. It may be classified on different **criteria**. These are: time, space, forces and factors. In terms of 'time', we **may talk** of past, present **and** future **environment**. **When** we talk of 'space', the business **environment** can be local, regional, national or **international**. Similarly, based on 'forces' the **environment depends** on market **forces**, political events **and** happenings and social ups **and** downs. Because of such **forces** it **becomes** very difficult to **identify**, **describe** or explain **either** the present or future environment. **Element** of uncertainty is so **deep** rooted that precise **prediction** and estimation of **environmental** variables becomes a herculean **task**. But the business and more particularly manager can not adopt or adapt unless he forecasts the likely changes in the **immediate** future in terms of both magnitude and direction. **Thus forecasting** brings in the **uncertainty** element thereby exposing to risks. For **meaningful exercise** the environmental factors are scanned and the focus is limited to important ones. Finally based on the 'factors', we may **specify** economic and non-economic environment of business. The **economic and** non-economic variables are not visible **separately**. They **are** so closely related, **interact** with each other and the task of identification **appears to** be more **complex**. Therefore the proper understanding of the

environmental factors becomes highly crucial for the business.

Check Your Progress A

1. What is "Business Environment"?

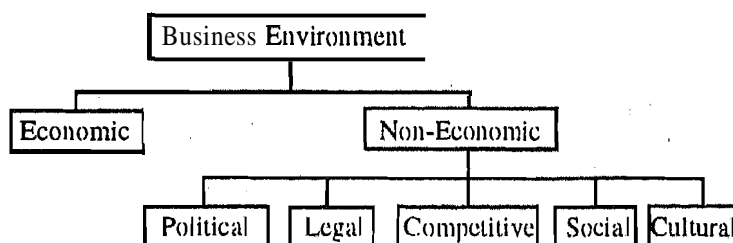
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2. Give the definition of politico-economic environment.

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1.3 COMPONENTS OF BUSINESS ENVIRONMENT

Business environment broadly consists of internal as well as external environment. When we talk of the internal environment we mean those factors which are within the control of the firm and such factors are concerned with firm's resources, policies and objectives. But by and large whenever business environment is talked it is taken to be in the sense of external environment i.e. those variables which are independent of the firm and therefore uncontrollable. The components of external environment can be depicted in the following diagram:



1.3.1 Economic Environment of Business

Economic environment consists of three elements: 1) Economic conditions; 2) Economic policy, and 3) The economic system. By economic conditions we mean the nature of the economy, economic resources, the level of income, the distribution of income and wealth and the stages of development of the economy. All these factors have a direct bearing on the strategies to be adopted by a business firm. In terms of nature of the economy there could be free market economy or capitalist economy where the economy remains in the hands of private sector. At the other extreme there may be centrally planned economy which is also called as the communist economy. Here the entire economy remains in the hands of the state. In between these comes mixed economy where both private and public sectors co-exist. However, in mixed economies there may be wide variation. In some cases private sectors may occupy more significant place while in some situations public sector may have the upper hand.

In a free market economy private enterprise has the maximum freedom, and (i) the factors of production (land, labour, and capital) are owned by the private enterprise and the initiative for production comes from the private businessmen, (ii) the economy is guided by profit consideration and income is derived from the production and sale of goods and services in the open market without any restriction or regulation by the society or state, (iii) there is complete freedom of choice in matters of production, consumption, savings, investment, and even occupation, (iv) there is no interference, regulation or control by the government. Such a type of economy does not exist in reality. Even the so called free economies like USA and Great Britain do not have complete freedom. Even in these countries government regulations are there to regulate the economy.

Under communist form of economy all the factors of production and distribution are owned and controlled by the state. There is hardly any private entrepreneurship. Even the consumption pattern is determined and implemented by the state. The Soviet Union, China, Hungary, Poland were the examples of this type of economy which is also called as centrally planned economy.

In between the two extremes, comes the mixed economy. Here both public as well as private sectors exist. But the extent of the mixture differs widely. The basic fact remains that the state regulates the overall structure of economy. Within the control and regulation exercised by the government private enterprise functions, India is an example of mixed economy. After independence predominant role of government was accepted. But gradually the private sector started assuming vital role. With the initiation of New Economic Policy in 1991 the concept of privatisation and liberalisation has been given more prominent role.

What economic system will exist in a particular country is determined by the people and the government. The firm has no control over it. However, the firm's policies and practices depend upon the type of economy in vogue. Thus the economic environment is a very important external factor on which the working of business firms depends. Management cannot overlook the market oriented or non-market oriented nature of environment. The management has to keep in view the objectives of national planning or the economic policies of the government. In other words while planning its operation the firm has to keep in view the pattern, structure and even the rate of changes occurring on the economic scenario.

1.3.2 Non-Economic Environment of Business

The country's history, culture, sociology, political system and legal structure are the elements of non-economic environment. Non-economic environment variables have also very important economic implications and they affect the business in multi-dimensional ways. For example, the ideology of the government in power exercises very significant impact on tax laws, distribution mechanism, existence and development of big companies, and so on. As a matter of fact non-economic factors and economic factors are interdependent. Sometimes these factors are grouped together and referred to as socio-economic or politico-economic factors. We now discuss the various non-economic factors in detail.

Sociological Factor\$

Sociological factors are the important part of non-economic variables. By this, it is meant the attitude of the society towards managers, authority, responsibility, delegation, workers' participation, achievement, wealth, income, status and spending. Whether the customs of the society are rigid or flexible? The attitude towards scientific methodology, and religion is also important. Class structure, labour mobility, and caste system are also important aspects. Attitude towards education and acquisition of knowledge, vocational and technical training and other similar factors also exercise strong influence on business activities. Thus the sociological variables could be either socio-cultural or socio-educational. In addition the buying and consumption habits, spending habits of the people, their beliefs and values could also be significant in business planning.

For a business to be effective and successful it is necessary that its' strategy is in accordance with the socio-educational-cum-cultural environmental variables. The marketing mix will also be such as to suit the environmental characteristics of the market which in turn depends on sociological factors. Social inertia sometimes come in the way of promotion of certain products. For example, in marketing of family planning ideas or the use of bio-gas for cooking are affected by social stigmas. In such cases the marketing personnel will have to apply dual approach. On the one hand, it will have to adopt strategy to be in tune with social stigmas and in the long run it may take concrete steps even to change the value system,

Consumerism is also a very important social movement. It exercises a considerable influence on the socio-economic environment of business, It aims at augmenting the rights and powers of the consumer in relation to sellers. The state at which the consumers movement prevails affects the marketing policies of the firm. The concept of consumer

welfare will lay emphasis on social and ecological considerations in the product and market planning. The social responsibility of the business is an added dimension of social environment. More educated the society becomes more social responsibility falls on the business.

Political and Legal Environment

Political and legal factors are very closely related. Legal enactments depends on the political climate. These include: (i) Ideology of the political organization ruling the country (ii) Role and attitude of bureaucracy (iii) Political stability or instability (iv) Legal rules and enactments (v) Flexibility of constitutional amendments (vi) Foreign policy and relations (vii) Image of the country (viii) The attitude of legal machinery, etc.

In India most of the statutory controls have very comprehensive and pervasive influence on the various aspects of the business concerning location, licensing, pricing, expansion, distribution and labour relation. Therefore the chief executive and the managerial personnel have to devote a considerable attention to ensure the observance of various legal enactments.

Competitive Environment

Competition is another external variable which affects the business strategy of a firm. However, there are three different types of competition- perfect competition, monopolistic competition, and oligopoly. Each of these have their own characteristics. Under perfect competition there are more number of firms and hence the market power of a single firm is of no use. But under monopoly since there is no competition a firm would enjoy enormous power. Under oligopolistic market number of firms remains limited hence there is the possibility that firms may take joint decisions concerning price, output, etc. This provides them monopolistic power. Thus the power which a firm can enjoy would depend on the type of competition prevalent in the market. However, it has to be noted that in several countries there are laws to regulate competition. The objectives behind such regulation are: elimination of competition and dilution of monopoly power. In India we have Monopolies and Restrictive Trade Practices (MRTP) Act which has the objective of controlling monopolistic undertakings and preventing the concentration of economic power in few hands. Laws enacted with a view to regulate competition in the public interest have significant impact on the competitive environment.

Demographic Environment

By demographic environment we mean the size and growth rate of the population. It also includes sex, composition, family size, religion, etc. All these factors have direct bearing on the demand. When, the population is increasing it results in increase in labour supply, It also brings about a steady rise in demand. When labour supply increases with the growth of population labour intensive techniques of production get encouraged. On the contrary, labour shortage results in the adoption of labour-saving technologies, Another implication of demographic environment could be explained in the growth of multinationals in developing countries. Cheap labour and a growing market are the two most important features which have motivated multinationals to invest more and more in such countries.

Physical and Technological Environment

Physical, geographical and technological factors also play a very significant role in the realm of non-economic environment. Physical factors (geographical factors) very often call for modification in the product mix so that the product mix may suit the environment. Availability of physical facilities also affect the business prospects. For example, the demand for home appliances and other electrical goods is affected by the extent and magnitude of electrification and supply of power. Similarly, the rate of growth in LPG connections will affect the demand for stoves.

Technological factors bring about rapid economic growth, but sometimes at social costs, Different technological environment affect the designing of the products. For example, in USA and several other countries electrical appliances and instruments are designed for 110 volts. But when they are sold in India they are made of 220 volts. Similarly, technological developments may create demand for several new products. For example in

India there is too much and too frequent voltage fluctuation, therefore the market for stabilizers is quite rosy. But this is not the situation in other countries.

Technological developments thus, bring about rapid economic development, but at a huge social cost in terms of pollution and other areas. Biologists, ecologists and sociologists are therefore concerned about social costs. Much is being talked about the social responsibilities of business. The business has to develop awareness about social cost-benefit analysis with a view to cope with the fast changing technological environment.

1.3.3 Interaction between Economic and Non-Economic Environment

So far we have discussed factors constituting economic and non-economic environment which exercise a strong influence on business activities. Now let us consider the interaction between economic and non-economic environment. Economic and non-economic environment can neither be separated nor identified exclusively. Both interact with each other. This is so because their treatment in isolation is neither feasible nor of any significance. The economic environment is said to be both exogenous as well as endogenous. It determines the non-economic environment and at the same time it is determined by non-economic environment. The economic condition is affected by sociological factors and similarly social norms and values are shaped by the income of the people. Thus individually each critical element of economic environment interacts with each critical element of non-economic environment.

Since business environment is dynamic and uncontrollable, the business policies and strategies have also to be dynamic and subject to review periodically. The success of any business would depend on the ability of the business to foresee the nature, extent, and dimensions of changes likely to occur in both-economic and non-economic environment. Further the extent to which the business adopts itself to the likely changes by altering its strategies would determine the probability of its success.

1.4 BUSINESS ENVIRONMENT AT VARIOUS LEVELS

We have defined business environment as a set of external factors and forces which are outside the control of a firm. We have also explained the different components of business environment, viz., political, legal, competitive, social, cultural and economic. The various components keep on changing; they differ from place to place and time to time. Obviously, the environment that obtained in the past would have been different than the one that obtains in the present; one can only expect a different business environment in future. Economic conditions, economic policies and even the systems keep on changing in response to changes in the economic situation of the community and the country. Likewise, the political, legal, competitive, social and cultural milieu also undergoes a change when one moves along the time frame.

The movement of time is obvious, and hence it is also apparent that the conditions, in which a business firm works would be different along different time frames.

Equally important are the changes in business environment at different places. A business firm is not, and cannot be, point-centric. A business firm operating, say from Tamil Nadu or Andhra Pradesh, cannot afford to concentrate all of its energies on analysing the business conditions as they obtain in Chennai or Hyderabad. Equally important for the firm is to keep a watch on the events and developments not only in other parts of the state but also in the rest of the country, as also internationally.

In short, a business firm does not close itself to events and situations occurring elsewhere. The space, in which a business firm operates can be classified in three distinct categories, i.e. 1) Regional, 2) National, and 3) International.

1.4.1 Regional Level

Environmental analysis at the regional level will require an analysis of the different conditions that obtain in the region of operation of a business firm. Of course, if a business firm is planning and contemplating to expand its business operations to new regions, it shall have to scan the environmental conditions there also.

Environmental analysis at the regional level, once again, would rely on different

components of business environment as explained in section 1.3. However, what is important here is that the analysis would be a region-specific. For example, if a business firm has its area of interest limited to North India; it would have to equip itself well with the necessary information relating to the social and cultural habits of the North Indians, their living styles, their spending habits, the festivals and the customs, the income levels, the political activities, the local laws, etc. Now this milieu may be entirely different than the one that obtains say in East, West or South India. Any business practice that may be found useful in a specific region may be found wanting in other regions. The social, political, cultural and economic milieu is specific to a given region, and hence it needs to be analysed accordingly.

1.4.2 National Level

A nation is a bigger entity than a region. As a matter of fact, a nation is an aggregate sum of individual disparate regions. Environmental analysis at the national level looks at the disparities between different regions, and makes out a common view about the whole. Individual trees do not count; it is the whole forest that is looked at and scanned.

Of course, when we are looking at the national environment, the broad components that we need to analyse remain the same as above. But here, for obvious reasons, our perception will change. We are no more interested in local-level political changes, or local-level diversities in income levels and spending habits. Our outlook is much broader. Our perceptions are much wider, these encompass the whole of the nation as one unit.

1.4.3 International Level

Business is influenced as much by events and conditions that obtain domestically as by what happens in the rest-of-the-world. With the information-technology revolution underway and the whole of the world gradually shrinking to become a global village, any event or a change, however small, leaves its impact world-wide. For example, the Delhi stock exchange may be affected as much by poor corporate results of domestic companies as by a political showdown in Tokyo or New York. No business can remain immune to events elsewhere in the globe.

To prepare itself for any challenge or opportunity, a business firm has to undertake international environmental analysis. International environmental analysis, again, would rely on the same economic and non-economic components. One has to look at all these components from a global perspective and not from a region's or a nation's perspective. Just as the national analysis differs from the regional analysis, international environmental scanning would take a more broader view than the national analysis.

Check Your Progress B

1. What are the critical elements of economic environment?

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2. List the various factors of non-economic environment.

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3. What do you understand by the interaction between economic and non-economic environment.

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1.5 BUSINESS AND ENVIRONMENT INTERFACE

Business environment **influences** business and elements of business. When there is business recession the production is curtailed. When the market is faced with competition either directly or through substitutes, aggressive advertisement and promotion may be resorted. **When** the interference from the financial institutions starts coming either in the form of credit **squeeze** or increase in the interest rate, business will have to depend on its internal funds **rather** than on debt capital. When minimum wage legislations are passed or when the government **provides** for social security measures for permanent employees, the business may start thinking in **terms** of casual workers. These examples show that whenever shocks are generated by the Government, absorbers are **arranged** by the business. As a matter of fact the environment act either as a stimulant or as a constraint. When the environment is **favourable** and conducive for business prosperity and growth **the** business have to respond positively and **formulate** strategy accordingly. For instance, **when** subsidy is announced for small business, they **feel** encouraged. Similarly when high rate of taxation is imposed on corporate **profits**, small business gets boost. Therefore the business environment changes may act **as stimulant** to one group and as constraint to the other group.

There are indirect interactions also. Sometimes the business **has** to take measures not only to **protect** its own interest but also the interests of other parties. The interface of the business and business environment is at two levels. One at the level of business environment interest and the other between the two.

Thinking in terms of interface we find that business environment has two broad **divisions**-economic and non-economic. The economic environment affects the non-economic environment and non-economic environment affects the economic environment. For example the politico-legal environment and the **economic** environment of business are interdependent. When there is political stability business grows as businessmen venture to take more and more risks. But under conditions of political instability business uncertainties prevail and businessmen do not come forward to undertake risks. In the same way ideologies of the ruling party and the business are interlocked. When socialist ideology **prevails** which emphasises on nationalisation, the private business gets discouraged. On the contrary, sometimes various legislations are enacted to deal with the prevailing environment. For example during industrial recession or when the private business ignores its social responsibility **the government through** legislation comes forward to streamline the functioning of business. This has been done in India by passing Consumer Protection Act, **MRTP** Act, etc.

The educational-cultural environment and the **economic** environment of business are also linked. The stage of economic development affects the educational system. When the economy is developed costly higher education will be available. Similarly lack of vocational training or professional courses will lead to unemployment problem and affect the economy adversely.

The sociological environment also affects and gets **affected by** the economic environment of the business. The social attitude towards the business, to a very considerable extent, will decide whether people will get attracted towards private business. **If** business gets social sanction as a respectable profession, people **will feel** interested in boosting **the** business activities. On the contrary if society, say labour, has the negative attitude towards business, a repressive system may be needed to cope up with **the situation** of economic disorder.

The **interaction** between physical environment and **the economic** environment in **any** particular country is also very **significant**. With a view to conserve natural resources and protect physical resources **government enacts** laws which may impose a constraint on **the** growth and expansion of business. On **the** other hand, the **scale** of output, the **size and** location of plants and **organisational** set up sometimes may bring either **improvement or** decay in the environment. This is the reason why the business has to take care of environmental impact' of the technological advancement through **social responsibility**.

The other dimension of interface between the business and environment is its **stability**. The critical elements of business are-planning, direction, organisation, control and coordination. Similarly production, finance, **marketing** and purchasing are its main functions. **All** these

are influenced by the business environment. For example, in times of recession, the management may decide in favour of cutting down production, cutting down promotional efforts and keeping the financial operations at the low level. Similarly when the business environment changes and the government liberalises the control over the business, the business activities then get a boost. For example after the announcement of liberalisation, privatisation and globalisation under the New Industrial Policy in 1991 the private sector activities in the country have started growing and the international dimension of business has also shown a rising trend.

Business environment (consisting of economic and non-economic environment) and business operations (management) therefore influence each other. The environmental factors affect the business, the corporate level planning, formulation of business strategy and tactics. At the operational levels, the success of business would depend on the capacity of the business to adjust itself to various environmental factors. When the organisational culture changes, business ethics and practices change and standards of business philosophy are reformulated. The government, labour and society start viewing the affairs with the renewed attitude. The process thus ceases to be linear. It takes a circular shape. Business affects environment and the environment in turn brings out changes in the business. There is no sequence just as in a circle there is no starting point and no ending point. Similarly in the interface situation it is difficult to say where the interaction starts or where the interaction ends. It's a continuous process.

The challenge of macro economic management is to adjust established policies in the light of changing domestic and international economic environment. Thus challenges can be met successfully by observing the following guidelines:

- o Flexibility in policy formulation to changing environment
- Stabilising efforts which permits adjustments and increases efficiency.
Managing the system of incentive conducive to environmental happenings.
- Continuous consultation with government and public with a view to get feedback,
- o Improving the information system to keep better track of the various developments,

Check Your Progress C

1. Give an example on how the environment acts as a stimulant to business.

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2. Explain how the physical environment is significant for business activities.

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3. List out the guidelines to be followed by the business management to meet the challenges of macro economic environment.

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116 LET US SUM UP

The business environment provides the macro-economic context within which a business firm operates. Business is an activity carried on with a view to earn profit. Environment consists of various uncontrollable factors within which a business operates. The environment may be economic or non-economic. Economic environment consists of monetary, fiscal and economic policies of the government. Non-economic environment

includes **legal**, political, social, physical **and** cultural variables. Each element of the environment is **not** absolute but each **interacts** with one another.

Business policies and strategies have to be dynamic both at the macro as well as micro levels. Dynamism has to be in terms of adaptation to the changing environment at various levels. The success of the business would depend on the ability of the business to foresee the **environmental** changes and to modify its business policies and strategies accordingly. Its success would also depend upon its ability to **make** the environment manageable by making the environment **amenable** to business **changes**.

1.7 KEY WORDS

Consumerism : A movement of the **consumers** to get their rights protected and enforced,

Decision-making: The process of identifying and selecting a course of action among various alternatives to solve a specific problem.

Delegation : The act of assigning formal authority and responsibility for completion of specific activity to a subordinate.

Economic-variables : **General** economic factors and trends which affect the activities of an organisation.

Inputs : Environmental resources which enter into an organisational system.

Management : The process of planning, **organising**, leading and **controlling** the work of an organisation.

Mixed economy : An economic system **characterised** By the co-existence of **private** and public sectors.

Policy : A standing statement which establishes general **guidelines** for **decision** makers.

Planning : The process of **establishing** objectives and suitable courses of action before taking action.

Private sector : That sector of the **economy** where means of production are privately owned and **production** is carried out with **profit** motive.

Profit Motive : The profit earning objective which activates a **producer** to carry on business.

Socialism : An economic system in which means of production **belong** to the state.

Strategy : The broad programme for defining and achieving an organisation's objectives.

Technological variables : New Developments in products or processes as well as in science which may affect the organisation's activities.

1.8 TERMINAL QUESTIONS

1. Discuss the nature and significance of Business Environment.
2. What **are** the three components of business environment? Discuss,
3. Explain how environment affects the business and how environment is **affected** by business?
4. **Explain** various levels of business environment with suitable examples.

Note: These questions will help you to understand the Unit **better**. **Try** to write **answers** for them, but do not **send** your answers to the University, **These** are for your practice **only**.