
PROBLEMS, PROCEDURES AND PRACTICES IN IMPLEMENTING CORPORATE GOVERNANCE IN INDIAN SMEs

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ABSTRACT

One of the significant characteristics of a prosperous and rising economy is a booming and blooming small and medium enterprises (SMEs) sector; In India SMEs account for almost 45% of industrial output and 40% of India's total exports. However the real picture leaves many challenges faced by Indian SMEs. Corporate governance, as, can be viewed as a mechanism to mobilize and combine resources and competence and inculcates a sense of responsibility among the management, it can possibly have greater role to play in responding to the challenges and would seek better results in the long run. This research paper depicts the various problems faced by SMEs in the sample districts and the extent to which corporate governance is being implemented and the views of various SME entrepreneurs in the sample districts on corporate governance. This paper also throws a light on various reasons which prevent the SMEs in implementing governance practices and some suggestive measures to make the implementation process successful.

1. INTRODUCTION

The general definition of corporate governance most widely used is "the system by which companies are directed and controlled" (Cadbury Committee, 1992). The OECD Principles of Corporate Governance states: "Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, the means of attaining those objectives and their monitoring performance is determined."

Corporate Governance is based on the principles of uprightness, justice, equity, transparency, answerability and pledge to values. Good governance practices branch from the culture and mindset of the organization. It is all about balancing individual and societal goals, as well as, economic and social goals. It deals in the manner of how do the providers of finance, guarantee themselves of getting a fair return on their investment. It helps in

determining the ways to take effective strategic decisions. This ensures transparency which ensures strong and balanced economic development. Corporate governance often confines to various internal control activities like monitoring by the board of directors, balancing power, internal audit etc., as well as external control activities like competition, take over etc.

Small and Medium enterprises (SMEs) are the engine of growth in prosperous and growing economy and play an important role in creating economic growth. As companies globally face issues relating to transparency, accountability and timely disclosure of material information, the concept of corporate governance and business ethics has gained significant importance. This has been a major cause of the study.

EVOLUTION OF CORPORATE GOVERNANCE IN MODERN INDIA:

On account of the interest generated by Cadbury Committee Report, the Confederation of Indian Industry (CII), the Associated Chambers of Commerce and Industry (ASSOCHAM) and, the Securities and Exchange Board of India (SEBI), constituted committees to recommend framework for good Corporate Governance. The final draft was widely circulated in 1997 and in April 1998, CII released, a Desirable Corporate Governance Code. Later many committees were set up by SEBI in order to promote and raise the corporate governance standards chairmened by Kumar Mangalam Birla, Naresh Chandra, and Narayana Murthy.

In 2004, the Government constituted a committee under the Chairmanship of Dr. J.J. Irani, Director, Tata Sons, with the task of advising the Government on the proposed revisions to the Companies Act. The Department of Public Enterprises (DPE) which is the nodal Department for laying down policies and guidelines concerning Central Public Sector Enterprises (CPSEs) has issued the Guidelines on Corporate Governance for Central Public Sector Enterprises in 2010. Keeping in view the feedback from stakeholders, review of 2009 Guidelines was undertaken by the Guidelines Drafting Committee (GDC) constituted by the Indian Institute of Corporate Affairs, resulting into the formulation of “National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business”. These Guidelines were released by MCA on July 8, 2011.

IMPORTANCE OF CORPORATE GOVERNANCE IN SMEs:

Possibly, corporate governance has greater role to play in responding to various challenges faced by the SMEs in developing nations.

- ❖ Sound governance practices lead to improved internal control systems, lesser probability of frauds, better accountability and higher profitability.
- ❖ Good Corporate Governance practices helps in reducing conflicts between business owners and management.
- ❖ Raising capital becomes easier for SMEs by implementing good corporate governance practices.
- ❖ SMEs implementing corporate governance allow the financial markets, which face the problem of irregularity of information, to overcome the difficulty of evaluating quality of firm’s management and protection against ethical hazards.

Corporate governance can therefore be viewed as mechanism to mobilize and combine resources and competences.

CORPORATE GOVERNANCE IN SMEs IN DEVELOPED NATIONS:

There has been an unprecedented growth and development in recent decades in many developed nations. The general picture, however, hides a great diversity of economies' development experiences and challenges. One characteristic of this vast and diverse development is the presence and importance of a large SMEs sector comprising the majority of enterprises in all the economies. However, there are also some challenges faced by SMEs in developed nations, for example, in terms of access to various factors like finance, technology, human resources, market information and, above all, in adjusting to both the opportunities and threats of globalization. At the other end of the economic spectrum in Asia, in Japan for example, SMEs account for about 99 percent of all firms, 70 per cent of total employment and 50 per cent of GDP output. This may be accounted by various advancements on one hand and on the other is the awareness of advantages in implementing corporate governance.

Most of the developing and under developed nations follow the corporate governance principles without naming them as so. This is mainly due to the unawareness of specifications. However the adoption of governance principles in developed nations is also because of the customer's insistence or their education, legal policies and their general bodies associated with the check of implementation of corporate governance practices. Corporate governance in SMEs in developed nations results in

- ❖ A strong culture of core values, ethics, integrity, reliability and fair dealings amongst Corporate
- ❖ Achieving a balance between providing protection to investors and fostering fair and efficient capital markets and confidence in capital markets making them a strong contributors towards economic growth.
- ❖ Various other micro and macro environmental factors play a vital role in making the SME's adopt governance policies, which is completely a contrasting scenario in the adoption of governance in developing countries.

REVIEW OF LITERATURE

Josheva Abor and Charles K.D.Adjasi published a conceptual paper in which they emphasized the extent to which corporate governance framework can be applied to small and medium enterprises. They also discussed the issues further within Ghanian context. Dr.Indrajeet Dube, Dr.Dipadube, Dr.Palak Mishra, Indian institute of Management, Kharagpur prepared a report for national foundation for corporate governance, and suggested some corporate governance norms for SMEs and the benefits that they get by implementing them. Amarjith S.Gill, HarvindS Mand, Neil Mathur have published an article on "corporate governance and the growth of small business firms in India" in which they examined the relationship between corporate governance and growth of small business service firms in India. They concluded that small business firms should consider changing board size with respect to the firm size.

Enrich Yacuzzi in his publication stated that the key to SME management and strategy is the design of performance management systems, which allow the board of directors, the implementing and monitoring of sound governance systems. Thomas Clarke, Alice Klettner conducted a survey of the regulation of corporate governance in SMEs and

highlighted a number of policy conclusions like- The need for corporate governance guidelines to include flexibility, particularly for companies early in their lifecycle. He also stated that there is a need to reinforce the robustness of the “if not-why not” approach and educate the market that disclosure, not uniformity, is important.

Shanthy Rachagan, Elsa Satkunasingam, emphasized and addressed an issue saying, it is imperative that the corporate governance practices of SMEs are enhanced by assurance that the appropriate monitoring occurs and procedures are in place. Parthasarathi Banerjee said that Small firms have been suffering from poor managerial know-how, poor access to rich factors and poor governance. He argued that small cluster-based exchanges can change this state of affairs. Firms can enhance corporate governance and consequently afford higher resource mobilization with increasing strategic competitiveness if, transactions between cluster firms are encouraged to take place on price and through market clearance.

METHODOLOGY

The SME sector in India includes cottages, khadi village and many agro based industries. Very few SME entrepreneurs are aware of the advantages of implementing good governance practices. Indian SME entrepreneurs are very enthusiastic, challenging and ready to cope up with any changes in the market. The best example could be that, 95% of SMEs in India have successfully defended the global economic crisis without loosing their market share. SME sector is the backbone of Indian economy in the way of exports, employment, regional balanced development etc.

There are several advantages of implementing corporate governance practices. So, I found it suitable to do a qualitative research on this topic and conducted various ethnographic studies like interviews with entrepreneurs, group discussion with SME association members, observation and reflection field notes and reviewing the earlier studies conducted by various national level bodies. In this juncture, I identified three districts of interest, Vizianagaram (backward district), Visakhapatnam (developed district), and Srikakulam (developing district) of north coastal Andhra Pradesh. The information about governance practices in the sample districts was collected, by personally visiting some of the units in these three districts and interacting with the entrepreneurs where I recorded their opinions and suggestions. The details of the existing SMEs in these three districts are depicted in the table-1 of annexure-I.

ROLE OF SMEs IN INDIAN ECONOMY:

One of the significant characteristics of a prosperous and rising economy is a booming and blooming small and medium enterprises (SMEs) sector. SMEs contribute to economic development in various ways. According to Ministry of Small and Medium Enterprises:

- ❖ SMEs account for about 45% of India’s manufacturing output.
- ❖ SMEs account for about 40% of India’s total exports.
- ❖ The sector is projected to employ about 73mn people in more than 31mn units spread across the country.
- ❖ SMEs manufacture more than 6,000 various products ranging from traditional to high tech items.
- ❖ For FY11, total production coming from SME sector was projected at 10,957.6bn, an increase of more than 11% over the previous year.

SMEs recently introduced a practice namely corporate governance practices with a target of about 0.18mn during the fiscal year 2011-12 in order to create a sustainable position in this competitive market. SMEs have shown consistent growth in terms of number of Entrepreneurs Memorandum filed every year. This distribution of entrepreneurs according to the type of the industry has seen a constant growth from 2007-08 to 2011-12 which is shown in table-1 and graph-1 in annexure-II. SMEs have outperformed in IIP and GDP growth rates in the past five years. The variation of production to the county's GDP and Industrial production is represented in the graph-2 in annexure-II.

CHALLENGES FACED BY INDIAN SMEs

The last few decades have experienced quite a lot of changes in the world economic system. It was believed that market economy will be the 'strategy' for all nations, either developing or under developed, to achieve economic salvation. Economic descent indicated further that it is not the big companies, which are only efficient machineries to rotate the economic circle; rather SMEs are the most reliable vehicles that will lead any economy towards recovery.

But that real picture has probably not brought everything best for the SMEs; rather it has opened up many challenges like advent of Information Technology, opening up of a market dominated by medium and big domestic companies, transnational companies; which has brought new stroke of business strategies. Apart from the above mentioned challenges, SMEs face certain internal challenges while setting up of the business, during their growth and in progression of the organizational headship.

The Liberalization, Privatization, and Globalization (LPG) processes have brought many challenges especially to the Indian small scale units in the form of increased foreign direct investments, threat to domestic market and many others which have a negative impact on small business industry. Many of these challenges can be faced through good corporate governance to some extent. Therefore, there is a need for corporate governance in small business firms.

CORPORATE GOVERNANCE PRACTICES IN INDIAN SMEs

As per the study, many people are not aware of corporate governance but many people follow them without knowing that they are. In India different companies try to adopt different practices in a way to implement corporate governance practices, may it be from protecting the environment, which happens to be a macro factor, to, protecting the employees, who happen to be one of the micro factors that influence the sustainability of the organization.

These different practices can be summarized under the broad heads as follows.

Privileges and fair treatment of partners/shareholders

Partners/shareholders in SMEs are protected under the company's rules of corporate governance, which ensures that their privileges are duly respected and that their interests are duly protected which in turn would indulge a sense of diligence among them.

Administrators

The members of the Board of Directors and the chief executive officer are company's administrators, who act in good conviction, with the faithfulness and due circumspection of good businessmen. They act in the company's best interests, bearing in mind the interests of its partners/shareholders.

Conflict management

Companies establish efficient mechanisms to help avert and smoothen the progress of the management and confession of any eventual conflicts of interest between members of the Board of Directors, partners/shareholders, executives and interest groups.

Social responsibility

Small businesses instigate confidence among the members of the local community and set goals that serve common good, without neglecting their purpose of maximizing financial returns for their partners/shareholders. They try to launch mechanisms planned to help them meet the requirements of the liberalization, privatization and globalization processes, commerce policies and international agreements with a view to intensify their competitive advantages and promote foreign investment

Transparency, free flow and truthfulness of information

Businesses strive to establish mechanisms for ensuring the perfect, regular and timely reporting of company's information. Small businesses see to it that such information disclosure mechanisms do not place an overly administrative or financial burden on corresponding firms instead; they create a positive impact on the forward and backward integrating factors.

FINDINGS AND ANALYSIS OF THE OPINIONS OF THE RESPONDENTS

It was observed during the study in the sample districts(Visakhapatnam, Vizianagaram, Srikakulam), that the opinions of the respondents with respect to implementing corporate governance practices in their SMEs vary to a wide extent and that each have a different perception to the concept which are summarized below.

- ❖ More that 60% of the respondents are not aware of the advantages of implementing corporate governance practices like, availability of easy finance, easy access to global market, easy marketing of goods or services, creating good will with customers, suppliers, creditors etc.
- ❖ 65% of respondents are of the opinion that corporate governance practices are meant for MNCs and public sector enterprises but not for SMEs.
- ❖ Many of the respondents are of the view that implementing corporate governance practices is associated with high costs with no income.
- ❖ 62% of the respondents opine that implementing corporate governance practices requires some qualitative and specialized people and may not be possible by existing human resources.
- ❖ Some of the respondents are of the opinion that they have faced many problems in marketing and establishment of the firm and, are in a view of profitability but nothing else.

- ❖ One of the Jute mill's owner in Srikakulam district have questioned the need to follow corporate governance practices when it increases neither his selling price nor his profitability.
- ❖ Some entrepreneurs in Vizianagaram district have asked the meaning of corporate governance, details, and the authoritative body concerned with such practices.
- ❖ 65% of respondents in Visakhapatnam district have questioned the need to maintain corporate governance when they are under the unorganized sector.
- ❖ It was observed from the study that most of the SMEs were not updated with the latest IT versions.
- ❖ Some of the respondents are in a misconception that corporate governance practices are confined only to maintain proper records, transparency and accountability which may not be that important or possible in small enterprises.

SUGGESTIONS TO IMPLEMENT CORPORATE GOVERNANCE PRACTICES IN SME SECTOR

Corporate governance and SMEs are the two important sectors of Indian economy. However it is the responsibility of the government, general bodies etc. to create awareness regarding the importance of implementing corporate governance practices in SMEs in a cost effective manner. Following are some of the suggestions to implement governance practices in SMEs with the help of some private services that are available or by managing the resources available within the organization; as some SMEs cannot afford to approach private services. Some more are quoted below

- ❖ As corporate governance can be implemented in the firm's own way, attempts should be made to take out the misconceptions that it is not difficult to implement corporate governance practices. It should be emphasized that it can be implemented in any of the possible ways like branding of the product, packing, pricing, implementation of quality standards, ISO certification, etc. which remain in the hands of the SMEs alone.
- ❖ It is the responsibility of the governing authorities of SMEs to inculcate the implementation of corporate governance practices and that governance is not only confined to maintain transparency or accountability but also pertains to some social issues like going green, power saving etc.
- ❖ Large organizations or public enterprises can take the responsibility of making the small enterprises that act as ancillaries, to implement corporate governance practices by explaining them the advantages of implementing governance in SMEs.
- ❖ The responsibility of the audit services can be assigned to the senior managers, who can maintain a basic measurement system and analysis, in developing business plans or feasibility report, for securing formal credit and preparation of bankable proposals; when the enterprises is not in a situation to maintain a specializes auditor available by external audit services in order to make the process cost effective.
- ❖ They should be updated with latest IT versions and MIS systems that would help enrich the employee knowledge with the goings-on around the world.
- ❖ The governing bodies should constrict the clause of governance so that the SMEs feel it mandatory to follow governance practices in the sample districts.

CONCLUSION

Corporate governance allows SMEs to prepare for their future expansion and sustainable growth. The core values of transparency and accountability will be embedded in their business culture. This culture of transparency and accountability will also indicate professional management and good governance for successful and well organized companies. As it was discussed, the implementation of corporate governance might open up a sea of challenges for the SMEs. The SMEs should stick to some norms quoted above which might pave the way to success of the business as well as the economy. By implementing corporate governance practices in Indian SMEs in an effective manner, they can easily become future MNCs.

ANNEXURE-I

TABLE-1 REPRESENTING THE NUMBER OF MEDIUM AND SMALL SCALE INDUSTRIES IN THE SAMPLE DISTRICTS

		VISAKHAPATNAM		VIZIANAGARAM		SRIKAKULAM	
		NO.OF UNITS	EMPLOYEMENT	NO.OF UNITS	EMPLOYEMENT	NO.OF UNITS	EMPLOYEMENT
1	AGRO BASED	3016	49438	1017	12673	1412	14671
2	COTTON TEXTILE	1524	16275	13	256	194	1192
3	JUTE& JUTE BASED	0	0	18	2426	3	1140
4	READYMADE GARMENTS & EMBROIDERY	127	745	26	1991	15	1119
5	WOOD WOODEN BASED FURNITURE	204	2142	493	5412	0	0
6	PAPER & PAPER PRODUCTS	186	1097	110	859	33	877
7	LEATHER BASED	566	5141	97	832	95	386
8	CHEMICAL/CHEMICAL BASED	1008	8562	76	842	490	4919
9	RUBBER and PLASTIC	463	3256	95	508	21	390
10	MINERAL BASED	1036	13724	125	1899	145	2410
11	METAL BASED(STEEL FAB..)	206	5473	189	3051	141	1907
		8336	105853	2259	30749	2548	2881

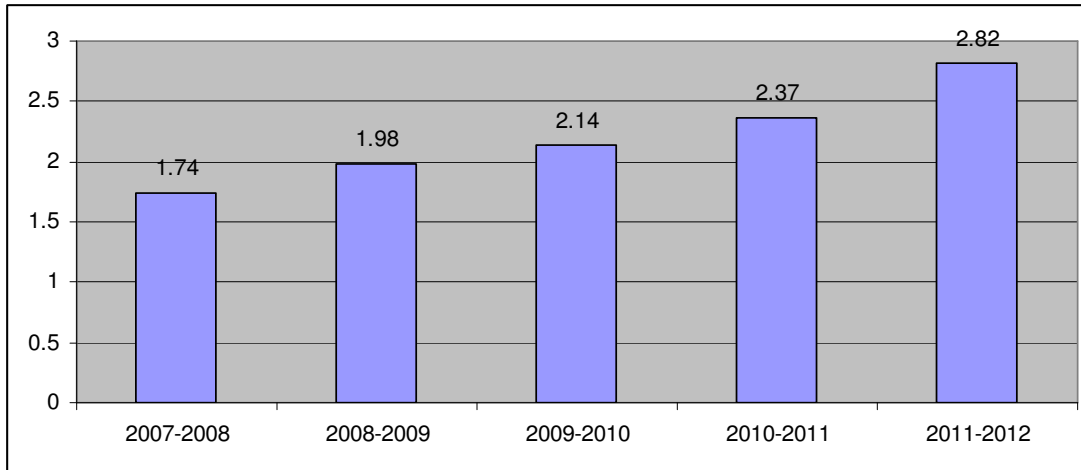
Source: district industries corporation, Visakhapatnam, Vizianagaram, Srikakulam.

<http://dcmsme.gov.in/dips/Visakhapatnam%20profile.pdf>

<http://dcmsme.gov.in/dips/srikakulam%20profile%20.pdf>

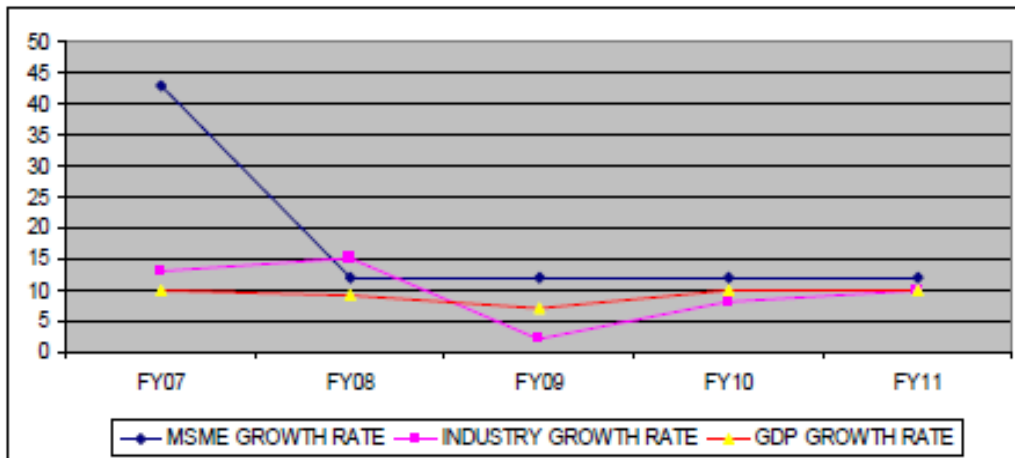
ANNEXURE-II

GRAPH-1: GROWTH IN TERMS OF NUMBER OF ENTREPRENEURS MEMORANDUM FILED EVERY YEAR FROM 2007-08 TO 2011-12.



source:Annual Report 2011-12 of Ministry Of Micro,Small.and Medium Enterprises GOI Economic Survey 2011-12

GRAPH-2: GRAPH SHOWING COMPARATIVE GROWTH RATE OF MSME WITH COMPARISION TO INDUSTRY AND GDP GROWTH RATE



source: Annual Report 2011-12 of Ministry Of Micro, Small and Medium Enterprises GOI Economic Survey 2011-12

Table-1: Growth rate of MSMEs from 2007-08 to 2011-12

Year	Number of EM-II filled pertaining to following segments-			
	Micro	Small	Medium	Total
2007-08	156,051	17,777	491	174,319
2008-09	171,031	18,757	690	193,077
2009-10	186,126	23,999	1,412	213,894
2010-11	204,064	29,101	1,260	237,263
2011-12	242,606	34,192	2,939	282,496

Source: - The States/UTs Commissioner ate/Directorates of Industries

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