

Leveraging Corporate Governance for building sustainable MSMEs

- *Dr. S.K. Gupta, MD, ICMAI Registered Valuers Organization*

Abstract

Corporate governance (CG) is the term used to describe a set of internal policies, rules, and procedures that a business regularly adheres to in order to make sure that it functions in a fair, equitable, and proper manner for the benefit of the business, its management, and its stakeholders. It is virtually always considered in relation to large publicly traded firms. However, it is imperative that MSME's should also follow sound CG principles and procedures. One of the reasons is because, in the majority of the countries, they are responsible for creating jobs and serving as major economic engines. However, a lot of SME companies do not always pay attention to the ideas of CG. The majority of them even lack the framework and understanding needed to create and advance it. This paper addresses how CG relates to MSME businesses. It explains the processes involved in establishing good CG architecture in MSMEs, such as well-designed and implemented policies, procedures, and processes, risk management systems, strategic planning, transparency, and disclosure, etc., and provides guidance for implementing CG structures and mechanisms in MSME's.

The Perspective

The MSME (Micro, Small, and Medium Enterprise) sector forms the backbone of the Indian economy, providing employment to approximately 120 million people and accounting for 45 per cent of overall exports. With 20 per

cent of such enterprises being based in rural India, it is also seen as a major driver for rural entrepreneurship and economic inclusivity. The MSME sector is characterized by limited resources, which also makes them vulnerable to various business risks. It has been established in research studies on MSMEs that understanding the crucial roles of effective leadership and robust CG is necessary for a business to succeed. Although improved CG of MSMEs is unquestionably a key component of their success and is favorably associated with both growth and long-term sustainability, it is not a solution to every issue that MSMEs encounter.

Corporate Governance

Corporate Governance is a very broad concept. It involves running the company ethically while upholding the interests of all stakeholders. Corporate governance has grown in importance around the world during the last few years. There is growing awareness that good corporate governance not only reduces the risk of crises but also supports long-term economic growth by improving business performance and facilitating access to outside finance. No matter the size of the business, whether it is a proprietary, partnership, or private limited company, corporate governance is equally important.

By putting in place an appropriate CG system, MSMEs are able to attract more investment, highly skilled employees, and build long-term, mutually beneficial partnerships. The global

trend toward using CG solutions in MSMEs is growing. Such a strategy aids MSMEs in adopting not only distinct CG policies or procedures, but also facilitates overall attractiveness of MSMEs to investors and stakeholders, as well as enhance its potential for growth and the ability to withstand competition. A good CG structure takes time to implement. It requires deliberate, purpose and action driven activity.

Literature Review

Dube et al (2011), while small businesses lack governance and competency, large businesses have CG in place. Majority of the SMEs studied did not have a board committee, while some MSMEs did not have an idea about what a board committee was and very few MSMEs had external directors as researched by David (2015). Mahmood Shahnawaz in their study “Corporate Governance and Business Ethics for SMEs in Developing countries: Challenges and Way Forward” analysed the challenges faced by SMEs in developing countries. The Main challenges faced by the SMEs are access to domestic and international capitals, increase in globalization and dynamic Business Environment. The implementation of Corporate Governance will ease the processes of transparency, accountability and disclosure of timely material information. The paper provides a framework for implementing CG and guidelines for introducing it in MSMEs. In their study "Corporate Norm in MSME," Dube et al. (2011) examined the viability of establishing CG in the MSME sector and offered workable options based on the findings. The Study emphasized that the sector needs to be informed and an awareness has to be created about the future benefits of implementing CG.

Corporate Governance: A key imperative for MSMEs

A crucial element of corporate value generation strategy is corporate governance. MSMEs must begin running their businesses according to a set of guiding principles of corporate governance. Research studies demonstrate that well-governed businesses exhibit noticeably better long-term financial success and develop more quickly and sustainably. MSMEs may utilise greater governance as a primary value proposition to draw in investors. MSMEs should focus on the following key issues:

- **Strategic development:** Adopting a long-term strategy, making investment decisions, succession planning;
- **Control environment:** Formation of control mechanisms and accountability system for the implementation of strategic goals;
- **Formation of favourable relations with stakeholders:** Recognition of stakeholders, identification of their expectations and integration into the strategy.

Good corporate governance means the MSME board is providing an independent perspective as well as oversight to make sure that the interests of the stakeholders are being appropriately balanced with the day-to-day actions and judgments of the management team.

Dimensions of CG for MSMEs

It is important to note that today's MSME's are tomorrow's big corporations. Long term sustainability cannot be achieved without good corporate governance. By implementing Good Corporate Governance, MSMEs can be transformed from 'informal organizational form' to 'formal organizational form'. Following are the key dimensions good governance for MSMEs:

- **Transparency:** Transparency of financial statements through separation of company and personal finance, transparency of rights and obligations of employees,
- **Accountability:** Human resources function, marketing function, financial function and operation function
- **Responsibility:** business legality, waste management and Product Certification,
- **Independency:** Profitability and autonomy in managing the business,
- **Fairness:** Equal opportunity in a company career and a fair compensation system.

Implementing CG Mechanism in MSMEs

The MSMEs: small is beautiful.. Small may be beautiful, but small is not strong

Company culture is impacted by the "tone" of the top management, which in MSMEs is typically the owner. It is crucial to see how top management responds to constraints like budget control or earnings expectations. Therefore, top management (and the owners) should not only understand the company's long- and medium-term strategy and risk appetite, but they should also send out clear signals that they fully support the governance mechanisms, including the policies, and procedures in place, as well as the employees' honesty, integrity, and professionalism.

One size does not fit all, but the following are the recommended practices for progressively improving CG practices in MSMEs while bearing in mind that the implementation of good corporate governance is a gradual process.

- Corporate governance helps every business to scale in the most structured

format and drives the company's growth. It is important to inculcate a careful composition of experienced board of directors with a common vision beneficial for both the company and the investors.

- MSMEs Partners' and shareholders' rights and obligations should be clearly set out.
- Delegation of authority should be formalized in writing defining the role of the management and specifying matters reserved for shareholders and the board of directors.
- Succession planning should be aligned with the MSMEs business objectives, growth and potential exit strategies of owners.
- All shareholders should be treated equitably and companies should establish clear lines of communication with their shareholders.
- An effective engagement mechanism to gauge the views of shareholders should be established.
- MSMEs may wish to set up an "advisory" board with no formal decision making powers but which offers its expertise and networks to guide and support the business
- A formal board of directors should be established with formal procedures.
- MSMEs should consider appointing independent board members
- New directors should undergo a tailored induction program
- The role of the board should be defined in clear terms. it should be ensured that it has the resources and receives the information it needs to fulfil that role.

- A professional MSME board with independent non-executive directors, meeting on a regular basis, should be responsible for monitoring and evaluating management's performance
- MSME Boards should undergo regular performance evaluation process and regularly review the composition of the board
- MSMEs should follow credible accounting practices from day one and utilize a reputable independent accounting firm to prepare a complete set of financial statements
- MSMEs should formally evaluate the effectiveness of the external audit and formulate policies on preserving the independence of the audit function
- MSMEs should establish a formal process for identifying significant business risks and the management should adopt formal control mechanisms.
- MSMEs should consider establishing an internal audit function.

Listed MSMEs and Corporate Governance

BSE launched operations of its SME Exchange platform with the first listing ceremony of BCB Finance Ltd on 13th March, 2012. By assuring regulation and organisation in an otherwise unorganised sector, the Bombay StockExchange (BSE) fosters an investor-friendly environment for MSMEs and increases the potential for SMEs to acquire funds from the public. CG requirements are outlined in Clause 52 of the Listing Obligations and Disclosure Requirements: Audit committee provisions are the same as for listed companies; Report of corporate governance to be included in annual report; 1/3 of the Board of Directors must consist

of independent directors; 1/2 if the chairman is not independent. For the top 1,000 listed companies, SEBI requires the creation of risk management committees; however, there are no regulations in place for small enterprises. With limited resources at their disposal, many small businesses may view the setting up of risk management committees as an unnecessary burden. However, this is a short sighted approach, which leaves them vulnerable to risks and ill-prepared to face the challenges that can arise in pursuit of their business goals. While banks and investors are more inclined to favor organizations with a strong ERM framework in place, the implementation of ERM can increase their chances of raising money.

Conclusion

MSMEs are crucial to the economies of developing nations. The majority of SMEs still lag behind in terms of awareness among the enterprises regarding corporate governance. A strong corporate governance framework would result in transparency, improved business environment and protection of the investors. Implementing corporate governance structures calls for a strong commitment of the MSME owners and top management. Recognition of good governance principles and procedures is vital for the future sustainable growth of MSMEs. It is imperative that Indian MSMEs must adopt and implement CG structure and practices.

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About the Author



Dr. SK Gupta, has over 42 years of Corporate and Academic experience. He was Former MD & CEO - Insolvency Professional agency of ICAI and Currently MD – ICAI Registered Valuers Organization Group CEO – AIHP and Director – PHD Chamber of Commerce Group Company Secretary and head of Legal / Internal Audit Finance. He is visiting faculty at IIM Shillong, Indian Institute of Corporate Affairs. He is Member of the Committee of experts in Valuation, DIPAM, Govt. of India and on the Editorial Board of International Journal of Auditing and Accounting Studies & DMIMS Journal of Commerce & Management Sciences. He is Editor-in-Chief of the Truth and Youth Law Journal and The Valuation Professional, Journal of ICAI RVO. Mr. Gupta is Reviewer of the APJ Journal of Management and Technology; NICMAR Journal of Construction Management and HSB Research Review.