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   RESEARCH METHODOLOGY

   RESULTS & DISCUSSION

   FINDINGS

   RECOMMENDATIONS/SUGGESTIONS

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EFFECTIVE GOVERNANCE FOR SUSTAINABLE GROWTH OF INDUSTRIAL UNDERTAKINGS AND MSME's IN INDIA

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ABSTRACT

The objective of this topic is to discuss the the role of effective governance for the sustainable growth and development of the industrial undertakings and MSMEs in India. As we know after recovering to a growth of 9.2 per cent in 2009-10 and 2010-11, growth of value added in industrial sector, comprising manufacturing, mining, electricity and construction sectors, slowed to 3.5 per cent in 2011-12 and to 3.1 percent in the current year. The manufacturing sector, the most dominant sector within industry, also witnessed a decline in growth to 2.7 per cent in 2011-12 and 1.9 per cent in 2012-13 compared to 11.3 per cent and 9.7 per cent in 2009-10 and 2010-11, respectively. The growth in electricity sector in 2012-13 has also moderated. The growth of the mining sector in 2012-13 is estimated at 0.4 per cent, though it showed an improvement over a negative growth of 0.63 per cent recorded in 2011-12. So with good governance and regulation we can expect the growth of industrial and MSME sector.

KEYWORDS

MSME's, effective governance.

INTRODUCTION

Corporate governance refers to the system by which corporations are directed and controlled. The governance structure specifies the distribution of rights and responsibilities among different participants in the corporation (such as the board of directors, managers, shareholders, creditors, auditors, regulators, and other stakeholders) and specifies the rules and procedures for making decisions in corporate affairs. Governance provides the structure through which corporations set and pursue their objectives, while reflecting the context of the social, regulatory and market environment. Governance is a mechanism for monitoring the actions, policies and decisions of corporations. Governance involves the alignment of interests among the stakeholders.

LITERATURE REVIEW

According to the Financial Stability Forum (2001), among the main factors the support the stability of any country's financial system include:

- good corporate governance effective marketing discipline
- strong prudential regulation and supervision
- accurate and reliable accounting in financial reporting systems
- a sound disclosure regimes
- the enforcement of effective laws
- an appropriate savings deposit protection system.

of particular interest to this study is corporate governance. Corporate governance has been looked at and defined variedly by different scholars and practitioners; however they all have pointed to the same end hence giving more of a consensus in the definition. For example, the Financial Times (1997) defines corporate governance as the relationship of the enterprise to shareholders or in the wider sense as the relationship of the enterprise to society as a whole, however,

The Financial Stability Forum (2001) offers a definition with a wider outlook and contends that it means the sum of the processes, structures and information used for the directing and overseeing the management of an organization. The OECD on the one hand, has defined corporate governance as a system on the basis of which business companies are directed and managed. It is upon this system that specifications are given for the division of competencies and responsibilities between individual included parties, such as the board of directors, the supervisory board, the management and majority and other shareholders and formulates rules and procedures for adopting decisions on corporate matters.

In another perspective, Arun and Turner (2002f) contend that there exist a narrow approach to corporate governance which views the subject as the mechanism through which shareholders are assured that managers will act in their interests.

Shleifer and Vishny (1997), Vives (2000) and Oman (2001) observe that there is a broader approach which views the subject as the methods by which suppliers of finance control managers in order to ensure that their capital cannot be expropriated and that they earn a return on their investment. There is a consensus, however that the broader view of corporate governance should be adopted in the case of banking institutions because of the peculiar contractual form of banking which demands that corporate governance mechanisms for banks should encapsulate depositors as well as shareholders.

Arun and Turner (2002) joins the consensus by arguing that the special nature of banking requires not only a broader view of corporate governance, but also government intervention in order to restrain the behaviour of bank management. They argue further that the unique nature of the banking firm, whether in the developed or developing world, requires that a broad view of corporate governance, which encapsulates both shareholders and depositors, be adopted for banks. They posit that, in particular, the nature of the banking firm is such that regulation is necessary to protect depositors as well as the overall financial system.

GROWTH OF INDUSTRIAL SECTOR

The index of industrial production (IIP) with 2004-5 as base is the leading indicator for industrial performance in the country. Compiled on a monthly basis, the current IIP series based on 399 products/ product groups is aggregated into three broad groups of mining, manufacturing, and electricity. The IIP as an index shows both the level of production and growth. Overall industrial performance, as reflected by the IIP continued to moderate from Q1 of 2011-12 with growth turning negative in Q1 of 2012-13, before improving to 2.1 per cent in Q3 of 2012-13. The Mining sector production has contracted in the last six quarters. The contraction in the current year was largely because of decline in natural gas and crude petroleum output. Manufacturing, which is the dominant sector in industry, also witnessed deceleration in growth, as did the electricity sector (Table 9.1). There was, however, a sharp pick-up in growth in October 2012 with manufacturing growth improving to 9.8 per cent, the highest recorded since June, 2011. Growth, however, turned negative in November and December, 2012 and was placed at (-) 0.8 per cent and (-) 0.6 per cent respectively.

WHY HAS GROWTH MODERATED?

The moderation in industrial growth, particularly in the manufacturing sector, is largely attributed to sluggish growth of investment, squeezed margins of the corporate sector, deceleration in the rate of growth of credit flows and the fragile global economic recovery.

INVESTMENT IN THE INDUSTRIAL SECTOR

Gross capital formation (GCF) in the industrial sector comprising mining, manufacturing, electricity and construction recorded an average growth of per cent during 2004-5 to 2011-12. Growth turned negative during 2008-9 and again in 2011-12. The combined industry sector in 2007-8 accounted for 55 per cent of total GCF (excluding valuables) in the country, which declined 44.4 per cent in 2011-12 (Table 9.3). 9.9 The decline in overall share of GCF in industry in the total GCF for the economy and overall negative annual growth during 2008-09 and 2011-12 was largely due to a negative growth in GCF in the registered and unregistered manufacturing sector. Share of the registered manufacturing sector in overallGCF declined from a peak of 38.1 per cent in 2007- 8 to 27.9 per cent in 2011-12. As percentage of GDP originating from industry, the share of GCF reached 78.7 per cent in 2007-8, though it moderated to 62.4 per cent in 2011-12. The GCF of the registered manufacturing sector in 2008 had reached a level of over 97 per cent income of this sector. 9.10 Investment in industry has generally been buoyant and witnessed an increase in its share in overall GCF of the economy. The share peaked to reach 56.2 per cent of total GCF in the economy in 1995-6 in the post reform period. The rate of growth of GCF, however, moved with the rate of growth of industry. This sector has continued to allocate a significantly high share of its income to the capital formation .

CREDIT FLOW TO THE INDUSTRIAL SECTOR

Moderation in investment was largely because of two factors: decline in profitability and deceleration in the rate of growth of credit to the industrial sector. Overall rate of growth of credit flow to industry moderated from 26.48 per cent on an average in 2010- 11 to an average15.52 per cent in Q3 of 2012-13. The moderation in the growth was even shaper for the construction sector with overall growth in credit disbursement declining from 16.3 per cent in 2010- 11 to 6.6 per cent in Q3 of 2012-13. Mining and electricity sectors also suffered a decline in the growth of credit disbursement. The momentum of credit growth to the industrial sector based on seasonally adjusted annualized rate indicates a downward trajectory suggesting that credit pick up may be slow.

CORPORATE PERFORMANCE

Sluggish industrial performance also affected corporate performance. The rate of growth of sales of the corporate sector particularly in respect of listed manufacturing companies for the private sector, declined from an average of 28.8 per cent in Q1 of 2010-11 to 11.4 per cent in Q2 of 2012-13, the latest quarter for which comparable set of data are available. There was a significant increase in the rate of growth of interest expenditure with year on year growth peaking at 41.5 per cent in Q2 of 2011- 12. Together with a deceleration in the rate of growth of sales, the ratio of net profit to sales also moderated. The ratio of profit to sales which averaged 8 per cent in the first two quarters of 2010-11 has also moderated to 3.6 per cent in Q3 of 2011-12 and has been in the range of 5 to 6 per cent in the last three quarters (Table 9.6).The growth of interest payments moderated to 10 per cent in Q2 of 2012- 13, reflecting stabilization of the interest rate with repo rates remaining unchanged from April, 2012 to January, 2013. Consequently, profit in Q2 2012-13 grew somewhat, in part also because of a sharp increase in other incomes. As has already been indicated in Chapter 4, the corporate sector has only had limited pricing power, with inflation for non-food manufacturing recording a sharper deceleration than headline inflation. Inflation for capital goods remained relatively low.

COMPARATIVE PICTURE OF INDIA AND WORLD MANUFACTURING PRODUCTION

India is one of the top ten manufacturing countries though its share in total manufacturing value added (MVA) is only about 1.8 per cent. The impact of the post-crisis slowdown on industrial growth has been relatively mild on developing countries including India yet the downward trend in MVA has been significant. The intensity of the slide did vary across countries as shown in Figure in the box. The growth rate of world MVA had declined from 5.4 per cent in Q1 of 2011-12 to 2.2 per cent in Q2 of 2012-13. During the same period China's MVA growth rate declined from 14.3 per cent to 7.3 per cent but the deceleration rate has been sharper in the case of India as the rate of growth dipped from 7.3 per cent to 0.2 per cent. Analysis of the sub-group level MVAs shows sharp differences between India vis -a -vis other major manufacturing countries. The production of machinery and equipment, one of the key segments of the capital goods sector, has been growing at faster rate in the United States, Canada, China, Malaysia as compared to the deceleration in India's case. A similar pattern is observable in other capital goods segments and high technology sectors. The reason is India's competitive disadvantage owing to low- level technology, higher input costs and poor quality infrastructure. A long term trend analysis from 1995 to 2009 shows that India has lagged behind in increasing its share in MVA of sophisticated products. It has fared better in medium-low technology products in labour-intensive sectors such as textiles, wearing apparel and leather products. Even in these three sectors India's share was low as compared to China, which dominates all three sectors. A two-digit industry level analysis of world manufacturing shows that in recent years the five fastest- growing sectors were - office accounting and computing; radio, TV and communication equipment; electrical machinery and apparatus, other transport; and basic metal. Other than basic metal all these sectors are medium and high technology activities. India's performance in recent years has been dismal in some of these fast moving sectors. In contrast, China accounted for more than 50 per cent of the developing economies total MVA in 15 out of the 22 industrial sectors -- India's share was significant only in a few of these sectors. The latest competitive industrial performance index (CIP) compiled by the United Nations Industrial Development Organization (UNIDO), ranks India 42nd out of 118 countries the same as in 2005. China is ranked 5th..

MICRO, SMALL AND MEDIUM ENTERPRISES (MSME) SECTOR

The MSME sector covers both the registered and informal sectors. The classification of micro, small and medium enterprises at present is basedon the criterion of investment in plant and machinery by each enterprise. Detailed information for the registered MSMEs on the various economic variables such as employment, investment, products, gross output, and exports is available based on the Fourth Census of MSME (2006-07). The size of the registered MSMEs was estimated to be about 15.84 lakh units with sub-sector wise composition in the proportion of 94.9 per cent micro enterprises, 4.89 per cent small and 0.17 per cent medium enterprises. The total registered MSME sector comprised of 67.1 per cent manufacturing enterprises and 32.9 per cent services enterprises. About 45 per cent of these registered enterprises were located in rural areas. More detailed information based on the Fourth Census on the unorganized sector units, constituting about 94 per cent of the entire MSME sector is awaited.

In the recent past the Prime Minister's Task Force on MSMEs and the Twelfth Plan Working Group on MSMEs have discussed issues related to the MSME sector. The Twelfth Five Year Plan policy framework is guided by the recommendations of these key committees. The Plan covers various aspects of the MSME sector and its key recommendations fall under six broad verticals, viz. 1) finance and credit (ii) technology (iii) infrastructure (iv) marketing and procurement (v) skill development and training, and (vi) institutional structure. The Plan has a separate set of recommendations for the khadi and village industries and the coir sector. In order to boost the MSME sector, several schemes are under operation including the following ones.

1. **PROCUREMENT POLICY**: The government has notified a Public Procurement Policy for GoodsProduced and Services rendered by Micro & Small Enterprises (MSE) order, 2012 effective from 1st April, 2012. The policy mandates that all the central ministries / departments / central public sector undertakings (CPSUs) shall procure a minimum of 20 per cent of their annual value of goods / services required by them from MSEs. Further, policy has earmarked a sub-target of 4 per cent procurement out of this 20 per cent from MSEs owned by scheduled caste/ scheduled tribe (SC / ST) entrepreneurs.
2. **MSE**: Cluster Development Programme (MSE- CDP): The Ministry of MSME has adopted a cluster approach for holistic development of MSE in a cost effective manner. To build capacity of MSMEs for common supportive actions, soft interventions are undertaken in the existing clusters/new industrial areas/ estates or existing industrial areas/estates. To ensure transparency and speedy implementation of the MSE-CDP, office of the Development Commissioner, MSME has started an online application system from 1 April 2012. Hard interventions are taken up to create/upgrade infrastructure facilities and setting up of common facility centres in new/ existing industrial estates/clusters.
3. **CREDIT GUARANTEE SCHEME**: The Government is implementing the Credit Guarantee Fund Scheme for MSEs with the objective of facilitating flow of credit to the MSEs, particularly to micro enterprises by providing guarantee cover for loans upto ` 100 lakh without collateral / third party guarantees. For making the scheme more attractive to both lenders as well as borrowers, several modifications have been undertaken which, inter alia, include: (a) enhancement in the loan limit to `100 lakh; (b) enhancement of guarantee cover from 75 per cent to 85 per cent for loans upto ` 5 lakh; (c) enhancement of

guarantee cover from 75 per cent to 80 per cent for MSEs owned/operated by women and for loans in north eastern region (NER); (d) reduction in one-time guarantee fee from 1.5 per cent to 1 per cent and annual service charges from 0.75 per cent to 0.5 per cent for loans upto ` 5 lakh and (e) reduction in one-time guarantee fee for NER from 1.5 per cent to 0.75 per cent.

4. **CREDIT LINKED CAPITAL SUBSIDY SCHEME FOR MICRO AND SMALL ENTERPRISES (CLCSS) FOR MSEs**: The scheme aims at facilitating technology up-gradation of MSEs by providing 15 per cent capital subsidy (limited to maximum ` 15 lakh)for purchase of plant & machinery. Maximum limit of eligible loan for calculation of subsidy under the scheme is ` 100 lakh. Presently, 48 well established and improved technologies/sub sectors have been approved under the scheme. The CLCSS is implemented through 11 nodal banks/agencies including the Small Industries Development Bank of India (SIDBI), National Bank for Agriculture and Rural Development (NABARD) and Tamil Nadu Industrial Investment Corporation (TICC), Chennai (TIIC) and National Small Industries Development Corporation (NSIC) Ltd.

CORPORATE GOVERNANCE PRINCIPLES FOR SUSTAINABLE GROWTH

Contemporary discussions of corporate governance tend to refer to principles raised in three documents released since 1990: The Cadbury Report (UK, 1992), the Principles of Corporate Governance (OECD, 1998 and 2004), the Sarbanes-Oxley Act of 2002 (US, 2002). The Cadbury and OECD reports present general principles around which businesses are expected to operate to assure proper governance. The Sarbanes-Oxley Act, informally referred to as Sarbox or Sox, is an attempt by the federal government in the United States to legislate several of the principles recommended in the Cadbury and OECD reports.

Rights and equitable treatment of shareholders:Organizations should respect the rights of shareholders and help shareholders to exercise those rights. They can help shareholders exercise their rights by openly and effectively communicating information and by encouraging shareholders to participate in general meetings.

Interests of other stakeholders: Organizations should recognize that they have legal, contractual, social, and market driven obligations to non-shareholder stakeholders, including employees, investors, creditors, suppliers, local communities, customers, and policy makers.

Role and responsibilities of the board: The board needs sufficient relevant skills and understanding to review and challenge management performance. It also needs adequate size and appropriate levels of independence and commitment.

Integrity and ethical behavior: Integrity should be a fundamental requirement in choosing corporate officers and board members. Organizations should develop a code of conduct for their directors and executives that promotes ethical and responsible decision making.

Disclosure and transparency: Organizations should clarify and make publicly known the roles and responsibilities of board and management to provide stakeholders with a level of accountability. They should also implement procedures to independently verify and safeguard the integrity of the company's financial reporting. Disclosure of material matters concerning the organization should be timely and balanced to ensure that all investors have access to clear, factual information.

CORPORATE GOVERNANCE MODELS AROUND THE WORLD

There are many different models of corporate governance around the world. These differ according to the variety of capitalism in which they are embedded. The Anglo-American "model" tends to emphasize the interests of shareholders. The coordinated or Multistakeholder Model associated with Continental Europe and Japan also recognizes the interests of workers, managers, suppliers, customers, and the community. A related distinction is between market-orientated and network-orientated models of corporate governance.

CONTINENTAL EUROPE

Some continental European countries, including Germany and the Netherlands, require a two-tiered Board of Directors as a means of improving corporate governance. In the two-tiered board, the Executive Board, made up of company executives, generally runs day-to-day operations while the supervisory board, made up entirely of non-executive directors who represent shareholders and employees, hires and fires the members of the executive board, determines their compensation, and reviews major business decisions.

INDIA

India's SEBI Committee on Corporate Governance defines corporate governance as the "acceptance by management of the inalienable rights of shareholders as the true owners of the corporation and of their own role as trustees on behalf of the shareholders. It is about commitment to values, about ethical business conduct and about making a distinction between personal & corporate funds in the management of a company." It has been suggested that the Indian approach is drawn from the Gandhian principle of trusteeship and the Directive Principles of the Indian Constitution, but this conceptualization of corporate objectives is also prevalent in Anglo-American and most other jurisdictions.

UNITED STATES & UNITED KINGDOM

The so-called "Anglo-American model" of corporate governance emphasizes the interests of shareholders. It relies on a single-tiered Board of Directors that is normally dominated by non-executive directors elected by shareholders. Because of this, it is also known as "the unitary system"Within this system, many boards include some executives from the company (who are ex officio members of the board). Non-executive directors are expected to outnumber executive directors and hold key posts, including audit and compensation committees. The United States and the United Kingdom differ in one critical respect with regard to corporate governance: In the United Kingdom, the CEO generally does not also serve as Chairman of the Board, whereas in the US having the dual role is the norm, despite major misgivings regarding the impact on corporate governance.

CONCLUSION

Corporate governance affects the development and functioning of capital markets and exerts astrong influence on resource allocation. In an era of increasing capital mobility and globalisation, it hasalso become an important framework condition affecting the industrial competitiveness and economies ofMember countries. This paper set out to further develop our understanding of corporate governance and itsaffect on corporate performance and economic performance. In doing so, it addresses some of theunderlying factors that promoteefficient corporate governance, and examines some of the strengths,weaknesses and economic implications associated with various corporate governance systems. It alsoprovided a survey of empirical evidence on the link between corporate governance, firm performance and economic growth, identifying areas in which a consensus view appears to have emerged in the literatureand areas in which further research is still needed.

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