

Corporate Governance Standards and Their Influence on MSMEs Performance in India

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Abstract - Corporate governance has traditionally been associated with large, publicly listed corporations. However, its relevance to Micro, Small and Medium Enterprises (MSMEs) is increasingly recognized, particularly in emerging economies. Although MSMEs often operate under owner-managed structures with minimal separation between ownership and control, governance mechanisms remain essential for ensuring transparency, accountability, access to finance, and sustainable growth. This study conceptually examines the applicability of corporate governance principles to MSMEs. It analyses the theoretical foundations of governance, including agency theory and stakeholder theory, and evaluates how governance structures can enhance managerial efficiency, reduce financial constraints, and support long-term expansion. The paper also explores the transition of MSMEs into larger enterprises through structured governance mechanisms. The findings suggest that the adoption of governance practices, even in simplified forms, significantly strengthens the managerial and financial foundation of MSMEs.

Keywords: Corporate Governance, MSMEs, Agency Theory, Stakeholder Theory, Entrepreneurship, Financial Accountability.

I. INTRODUCTION

Corporate governance refers to the framework of principles, systems, rules, and institutional mechanisms through which business organizations are directed, controlled, and monitored. Traditionally, corporate governance has been associated with large listed corporations where ownership and management are separated. However, in recent decades, the concept has gained importance in Micro, Small and Medium Enterprises (MSMEs) because these enterprises significantly contribute to economic development, employment generation, industrial production, and entrepreneurial growth.

In India, MSMEs play a vital role in the growth and development of the economy. They contribute significantly to

the GDP and account for a major share of industrial production in the country. MSMEs are considered the second largest source of employment after the agriculture sector, providing job opportunities in both rural and urban areas.

Key Characteristics of MSMEs:

- Ownership and management responsibilities are closely integrated, with the owner actively involved in overseeing day-to-day operations.
- Capital is primarily sourced from personal savings or financial support from family members rather than formal institutional channels.
- The scope of business activities is generally confined to local or regional markets.
- Management practices tend to be informal, often lacking standardized systems and structured procedures.
- Furthermore, decision-making authority is highly centralized, typically concentrated in the hands of the owner or a small group of key individuals.

In the context of MSMEs, corporate governance does not merely refer to compliance with legal requirements; rather, it encompasses ethical business conduct, accountability, transparency, efficient managerial practices, financial discipline, stakeholder protection, and long-term sustainability. Although many MSMEs operate under owner-managed structures with informal decision-making processes, governance mechanisms become increasingly important as enterprises expand, diversify operations, seek institutional finance, or involve external investors.

II. RESEARCH OBJECTIVES

- To explore the theoretical foundations and structural dimensions of Micro, Small and Medium Enterprises (MSMEs) and understand their key operational characteristics.
- To study the importance of corporate governance in developing economies, particularly in enhancing transparency, accountability, and institutional efficiency.

- To study the growth trajectory of MSMEs and examine the factors influencing their transition into large-scale enterprises.
- To assess the advantages and constraints of adopting corporate governance practices in MSMEs

III. RESEARCH METHODOLOGY

This research adopts a doctrinal methodology. The study relies on:

Primary sources such as statutory provisions and regulatory frameworks. Secondary sources including books, journal articles, research papers, and institutional reports. The approach is analytical and conceptual in nature.

IV. CORPORATE GOVERNANCE: CONCEPTUAL FRAMEWORK

Corporate governance can be defined as the system by which companies are directed and controlled. It determines the distribution of rights and responsibilities among shareholders, directors, managers, and other stakeholders. The theoretical foundation of corporate governance in MSMEs is primarily supported by several important theories, namely:

- Agency Theory
- Stakeholder Theory
- Stewardship Theory
- Resource Dependency Theory
- Institutional Theory
- Transaction Cost Theory

V. AGENCY THEORY

Agency Theory is one of the most influential theories in corporate governance literature. The theory was developed mainly by Jensen and Meckling (1976), who explained the relationship between principals (owners/shareholders) and agents (managers). According to Agency Theory; conflicts arise when the owners of a business delegate decision-making authority to managers. Since managers may pursue personal interests rather than organizational objectives, governance mechanisms become necessary to monitor managerial behaviour and protect shareholder interests.

Relevance of Agency Theory to MSMEs

Although MSMEs are often owner-managed enterprises, agency issues still exist in various forms. Initially, ownership and management may remain unified, reducing traditional agency conflicts. However, as MSMEs grow, governance challenges emerge due to:

- Hiring of professional managers

- Participation of external investors
- Partnerships among multiple owners
- Family succession issues
- Delegation of operational authority
- Financial management by non-owners

Agency Theory therefore supports the implementation of governance practices in MSMEs such as: Proper accounting systems, Internal financial controls, Regular audits, Role clarity, Transparent reporting, Monitoring mechanisms, Strategic supervision. These governance mechanisms reduce opportunistic behaviour and improve organizational efficiency.

VI. STAKEHOLDER THEORY

Stakeholder Theory was primarily developed by R. Edward Freeman (1984). Unlike Agency Theory, which focuses mainly on shareholders, Stakeholder Theory argues that organizations are responsible to all stakeholders affected by business activities. Stakeholders are employees, customers, suppliers, creditors, investors, government, local communities and society at large.

According to this theory, organizational success depends on maintaining balanced relationships with all stakeholders rather than focusing solely on profit maximization.

Relevance of Stakeholder Theory to MSMEs

Stakeholder Theory is highly relevant to MSMEs because these enterprises usually maintain close relationships with local communities, employees, suppliers, and customers. Unlike multinational corporations, MSMEs often operate within localized environments where reputation, trust, and social relationships directly influence business sustainability.

MSMEs depend on employee loyalty, supplier relationships, community support, customer trust, local networks, Informal credit arrangements.

Therefore, governance practices in MSMEs must ensure fairness, ethical conduct, transparency, and social responsibility.

Governance Mechanisms under Stakeholder Theory

Stakeholder-oriented governance encourages MSMEs to maintain ethical labour practices, ensure fair treatment of employees, follow transparent financial practices, build long-term supplier relationships, protect consumer interests, fulfil tax and legal obligations, engage in environmentally responsible practices and such governance improves organizational reputation and strengthens stakeholder confidence.

VII. STEWARDSHIP THEORY

Stewardship Theory provides an alternative perspective to Agency Theory. While Agency Theory assumes that managers may act opportunistically, Stewardship Theory assumes that managers are trustworthy stewards who work toward organizational goals.

According to this theory, managers are motivated by achievement and responsibility. Organizational success is prioritized over personal gain. Cooperation is more effective than excessive monitoring. Empowerment improves managerial efficiency.

Relevance of Stakeholder Theory to MSMEs

Stewardship Theory is particularly relevant in family-owned MSMEs where owners and managers often share common goals and values. In many small enterprises owners directly supervise operations, employees maintain long-term relationships, family members participate in management, organizational loyalty is strong.

Under such conditions, governance mechanisms focus not only on control but also on leadership development, strategic planning, succession management, organizational culture, Long-term vision

Stewardship Theory therefore supports collaborative governance structures that encourage commitment, trust, and shared organizational objectives.

VIII. RESOURCE DEPENDENCY THEORY

Resource Dependency Theory explains that organizations depend on external resources for survival and growth. These resources are Capital, Technology, Market information, Skilled labour, Strategic partnerships and Institutional support

According to this theory, governance structures help organizations access critical external resources.

IX. INSTITUTIONAL THEORY

Institutional Theory states that organizations adopt structures and practices in response to social expectations, legal frameworks, industry standards, and institutional pressures. Businesses implement governance systems not only for efficiency but also to gain legitimacy and social acceptance.

MSMEs increasingly face institutional pressures from Government regulations, tax compliance systems, banking institutions, investors, industry associations, international trade standards, environmental regulations

For example, MSMEs seeking export opportunities must comply with international standards related to accounting, transparency, quality assurance, and ethical business conduct. Thus, governance adoption helps MSMEs to improve legitimacy, meet regulatory requirements, enhance market access, increase investor confidence and strengthens organizational reputation.

X. TRANSACTION COST THEORY

Transaction Cost Theory explains that organizations seek to minimize the costs associated with business transactions. Transaction costs include: negotiation costs, monitoring costs, contract enforcement costs, information costs, coordination costs

Relevance of transaction cost theory to MSMEs

MSMEs often operate through informal agreements and personal relationships. Although such systems may initially reduce operational complexity, they can create disputes, inefficiencies, and financial risks over time. Weak governance increases transaction costs because stakeholders lack trust and transparency.

XI. IMPORTANCE OF CORPORATE GOVERNANCE IN MSMEs

Theoretical perspectives collectively establish that governance is essential for MSMEs despite their smaller scale of operations. Corporate governance in MSMEs contributes to:

Financial Discipline: Governance promotes systematic accounting practices, financial transparency, budgeting, and internal controls. This reduces fraud, improves financial planning, and enhances credibility.

Strategic Decision-Making: Structured governance encourages long-term planning, risk assessment, and professional decision-making.

Access to Finance: Financial institutions and investors are more willing to provide funding to enterprises with transparent governance structures.

Risk Management: Governance mechanisms help identify, monitor, and mitigate operational, financial, and strategic risks.

Business Continuity: Succession planning and organizational structure improves stability and reduces dependence on individual owners.

Professionalization of Management: Governance supports the transition from informal owner-based management to professional organizational systems.

Sustainable Growth: Good governance creates organizational discipline necessary for expansion, mergers, partnerships, and public investment opportunities.

XII. GOVERNANCE CHALLENGES IN MSMEs

Despite its advantages, governance implementation in MSMEs faces several practical challenges:

Financial Constraints: Many MSMEs lack resources to establish formal governance systems, hire professionals, or maintain compliance mechanisms.

Informal Organizational Culture: Traditional family-managed enterprises may resist formalization and external supervision.

Limited Awareness: Small business owners may perceive governance as relevant only to large corporations.

Lack of Professional Expertise: MSMEs often face shortages of trained managers, accountants, and governance professionals.

Administrative Burden: Compliance requirements may increase documentation and reporting responsibilities.

XIII. FINDINGS AND SUGGESTIONS

Corporate governance plays a crucial role in transforming MSMEs into large and sustainable enterprises. As MSMEs business expand, operational complexity increases, requiring effective delegation of authority, professional management practices, financial accountability, proper risk management systems, and strategic planning help MSMEs to achieve long term stability and competitiveness.

Early adoption of corporate governance practices reduces managerial conflicts and supports better decision-making processes. Good governance practices enhance the ability of MSMEs to attract Venture capital investment, Institutional lending, public-private partnerships and facilitates international business expansion. It improves market competitiveness and strengthens the overall performance of MSMEs.

XIV. CONCLUSION

The theoretical foundations of corporate governance clearly establish its relevance and importance for MSMEs. While Agency Theory highlights the need for monitoring and accountability, Stakeholder Theory emphasizes balanced

stakeholder relationships and social responsibility. Stewardship Theory supports collaborative leadership, Resource Dependency Theory explains the importance of external credibility, Institutional Theory stresses legitimacy and regulatory adaptation, and Transaction Cost Theory focuses on efficiency and trust.

Collectively, these theories demonstrate that corporate governance is not limited to large corporations but is equally significant for MSMEs. Effective governance strengthens transparency, accountability, managerial efficiency, financial credibility, stakeholder trust, and long-term sustainability.

Although MSMEs may face financial and structural challenges in adopting formal governance systems, proportionate and flexible governance frameworks can substantially improve organizational performance and growth potential. Therefore, the implementation of suitable governance mechanisms is essential for ensuring the sustainable development and competitiveness of MSMEs in emerging economies such as India. Government and financial institutions should promote awareness programs on corporate governance among MSMEs.

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Citation of this Article:

Sravani Maddileti, & Gautami S. (2026). Corporate Governance Standards and Their Influence on MSMEs Performance in India. *International Research Journal of Innovations in Engineering and Technology - IRJIET*, 10(5), 700-704. Article DOI <https://doi.org/10.47001/IRJIET/2026.105093>
