

## Exploring the Influence of Corporate Governance on Organizational Culture in SMEs: A Comprehensive Review

M. Ibrizuna Dzaky Mahfuzh<sup>1</sup>, Rohmawati Kusumaningtias<sup>2\*</sup>

<sup>1,2</sup>Universitas Negeri Surabaya

\*Email: rohmawatikusumaningtias@unesa.ac.id

### ABSTRACT

The success of small and medium enterprises (SMEs) hinges on establishing a robust corporate governance structure and fostering a positive organizational culture. A strong organizational culture can enhance performance, motivation, satisfaction, and corporate image. However, SMEs often require assistance in establishing an organizational culture, mainly due to limited resources and the relatively straightforward nature of their structural design. By implementing corporate governance principles such as transparency, accountability, responsibility, independence, and fairness, SMEs can create a work environment that is not only transparent and accountable but also responsive and fair. This study examines SMEs' most influential corporate governance principles, specifically those that positively impact performance and sustainability. These principles have the potential to foster a positive work environment, thus fortifying their organizational culture. Transparency is achieved through financial recording activities and payroll transparency, while effective communication among stakeholders and alignment with employee interests support the implementation of corporate governance. An exemplary organizational culture can elevate employee performance, sustain customer relationships, foster employee loyalty, and bolster trust and the company's reputation. Challenges in adopting corporate governance principles in SMEs include family relationships and relaxed regulations.

### INTRODUCTION

The correlation between corporate governance and organisational culture in Small and Medium Enterprises (SMEs) has garnered increasing attention in contemporary academic discourse. This connection is particularly intriguing given SMEs distinct challenges, such as the need to navigate the intricacies of instituting a corporate governance framework while nurturing a supportive organisational culture. Within this context, practical internal control elements play a crucial role in upholding the corporate governance framework and fostering an ethical environment. Syofyan, in his publication "Good Corporate Governance (GCG)," underscores that the control environment, encompassing integrity and moral principles, forms the basis for companies to establish a robust code of ethics and ensure all employees' universal comprehension and adherence to it. Consequently, an organisational culture grounded in ethical principles can be enhanced through a sound governance framework, thereby fortifying the moral climate and improving decision-making processes within SMEs.

The significance of this subject is not solely theoretical but also practical. Hence, the author examines the current literature on the subject, elucidating the interdependent connection between corporate governance mechanisms and the cultural dynamics that define SMEs. Through this exploration, we can enhance our comprehension of how SMEs can

utilise corporate governance to improve organisational culture and ultimately attain the intended success.

## **LITERATURE REVIEW**

### **Agency theory**

Agency theory is a foundational concept in corporate governance, providing an understanding of the connection between principals and agents, especially within the organisational structure framework. It posits that within any organisation, the owner (principal) entrusts decision-making power to managers (agents) responsible for acting in the company's best interests. Nonetheless, conflicting interests frequently emerge, giving rise to the agency problem. This misalignment may lead to agents prioritising personal benefits over the company's well-being, necessitating a mechanism to guarantee that agents act in the company's best interests (Mallin, 2013).

### **Corporate governance is essential for ensuring organisational transparency, accountability, and ethical decision-making.**

Corporate governance encompasses the systems, principles, and processes that direct and control an organisation. It involves various stakeholders, including shareholders, management, and the board of directors, each of whom plays a crucial role in influencing the corporate governance landscape. This assertion aligns with Oyana's perspective (2021) that corporate governance oversees the relationship between owners, the board of commissioners, and the board of directors to establish the company's objectives and evaluate performance. As external mechanisms, owners have a significant role in monitoring and overseeing management. Broadly, the corporate governance framework aims to unite or serve as the focal point for all parties' interests within the company (Yuliastutik, 2016).

In small and medium enterprises (SMEs), corporate governance often takes on a less formal structure than more giant corporations, yet its significance remains paramount. The corporate governance framework SMEs embrace can profoundly impact operational efficiency, risk management strategies, and ethical standards. Moreover, SMEs are inclined towards more organised management, fostering transparency and accountability within their operations (Yuliastutik, 2016). Furthermore, the owner or manager's personal values and leadership style play a pivotal role in shaping corporate governance practices and company development (Boubakary, 2015). This dynamic can cultivate a closer and more direct link between corporate governance and organisational culture. While this personal touch can nurture a sense of ownership and dedication among employees, it may also present challenges if governance practices lack formalisation. Hence, recognising the distinct governance requirements of SMEs is crucial for crafting an efficient framework tailored to their unique attributes.

### **The role of organizational culture**

Organisational culture encompasses shared values, beliefs, and assumptions that steer members' actions within a company, shaping a distinctive social atmosphere that encourages innovation or stifles creativity (Schein, 2010). This notion is crucial in defining the internal milieu of small and medium-sized enterprises (SMEs). As per Hofstede et al. (2010), a robust organisational culture can enhance employee engagement, innovation, and communication efficiency. Conversely, a weak organisational culture may result in disengagement, elevated employee turnover, and diminished organisational performance.

The correlation between corporate governance and organisational culture is notably apparent in small and medium-sized enterprises (SMEs), where the informal nature of governance structures often exerts a more direct influence on cultural dynamics. Moreover, harmonising corporate governance practices with the prevailing organisational culture can bolster ethical standards and accountability, as Tricker (2015) emphasises, who asserts that an efficient governance framework must consider the cultural context to ensure that ethical conduct is promoted and ingrained in the organisational framework. Hence, the interplay between corporate governance and organisational culture is crucial for SMEs aiming to navigate the intricacies of the contemporary business environment while upholding a competitive edge.

## **METHODS**

This study involves qualitative research conducted through a literature study approach. According to Sugiyono (2010), qualitative research is employed to investigate the characteristics of natural phenomena, with researchers serving as the primary tool. The literature study approach, or library research, entails gathering data from diverse information sources about the research subject, including research abstracts, indexes, reviews, journals, and reference books (Sugiyono, 2010).

This study seeks to investigate the current literature on the impact of corporate governance on organisational culture in small and medium enterprises (SMEs). The process involves identifying prevalent issues and pertinent, trustworthy literature to facilitate finding solutions. Additionally, the literature and issues are assessed to generate impartial and precise analyses. Case studies of SMEs that have adopted a corporate governance structure and cultivated a positive organisational culture will offer detailed perspectives on this approach's obstacles, achievements, and consequences.

## **RESULTS**

### **The Interconnection of Corporate Governance and Organizational Culture**

The correlation between corporate governance and organisational culture can be elucidated by considering key elements such as ethical governance, stakeholder involvement, and decision-making.

#### **Ethical governance**

Ethical governance is the adherence to moral principles and standards in an organisation's decision-making process. In small and medium enterprises (SMEs), where leadership is often more personal, the ethical stance taken by management can significantly influence the organisational culture. Prioritising ethical considerations in governance practices fosters a culture of integrity and accountability among employees, as research conducted by Brown & Treviño (2006) indicates. Ethical governance establishes an environment emphasising integrity and accountability, boosting employee morale and commitment. Conversely, the absence of ethical governance can lead to a culture of unethical behaviour, threatening the organisation's long-term viability. Maak & Pless (2006) research underscores that organisations guided by ethical governance are likelier to cultivate a culture of trust and collaboration, which is essential for fostering innovation and adaptability in the dynamic SME landscape. Ethical governance goes beyond compliance with laws and regulations; it entails creating an environment where ethical behaviour is recognised and

promoted. This can be accomplished through training programs, transparent communication of ethical standards, and mechanisms to report unethical behaviour without fear of reprisal. By integrating ethics into the governance framework, SMEs can establish a culture that meets legal requirements and instils a sense of moral responsibility among employees.

### **Engagement of stakeholders**

Stakeholder engagement is crucial in the connection between corporate governance and organisational culture. Effective governance structures in small and medium-sized enterprises (SMEs) often highlight the significance of involving various stakeholders, such as employees, customers, suppliers, and local communities (Freeman & McVea, 2001). This involvement enhances transparency and trust while promoting an inclusive and collaborative culture. When stakeholders feel appreciated and listened to, it can enhance loyalty and dedication, reinforcing a favourable organisational culture. Moreover, stakeholder engagement can manifest in various ways, from regular feedback sessions and surveys to cooperative decision-making processes. By actively engaging stakeholders in governance dialogues, SMEs can ensure that diverse viewpoints are considered, leading to more well-informed and efficient decision-making. Furthermore, effective stakeholder engagement can enhance organisational performance by fostering collaboration and innovation, ultimately contributing to a more resilient organisational culture (Agle et al., 1999). This collaborative approach bolsters relationships with stakeholders and nurtures a sense of shared responsibility and dedication among stakeholders (Harrison & Wicks, 2013). Therefore, integrating stakeholder perspectives into the corporate governance framework is crucial for cultivating a positive organisational culture in SMEs.

### **Decision-making process**

When analysing the decision-making process in small and medium enterprises (SMEs), examining the interplay between corporate governance structure and organisational culture is crucial. As McNulty & Pettigrew (1999) emphasised, a robust governance framework enables transparent and accountable decision-making, nurturing a culture of trust and collaboration among employees. Organisations with governance systems that promote participatory decision-making empower employees and engage them in the outcomes of their efforts. This empowerment can cultivate an innovative culture, encouraging employees to contribute ideas and solutions. Conversely, a top-down decision-making approach can hinder creativity and initiative, fostering a culture resistant to change. Moreover, implementing technology and data analytics can optimise decision-making processes in SMEs. By utilising data-driven insights, SMEs can make well-informed decisions that align with their strategic objectives and cultural principles. This strategy enhances decision quality and promotes a culture of continuous enhancement and learning, fostering an environment where employees are motivated to experiment and innovate. Consistent with the perspective of Brennan & Solomon (2008), integrating governance principles into the decision-making process not only influences the strategic trajectory of SMEs but also significantly shapes their cultural dynamics.

### **Challenges in Aligning Corporate Governance and Organizational Culture**

Aligning corporate governance with organisational culture can offer significant benefits, yet small and medium enterprises frequently encounter various challenges.

**Resource constraints**

Resource constraints pose a significant challenge for small and medium enterprises (SMEs), hindering the establishment of a practical governance framework. Research by Baird & Thomas (1985) suggests that such constraints may lead to a reactive rather than proactive governance approach, impeding innovation and adaptability. Unlike giant corporations, SMEs often lack the financial and human resources to develop a robust governance structure. This insufficiency can lead to a reliance on informal governance methods, which, though flexible, may not adequately address the complexities of ethical decision-making and stakeholder engagement. Moreover, limited resources can restrict SMEs' capacity to invest in essential training and development initiatives for nurturing a sound governance culture. As Hoskisson et al. (2000) highlighted, resource constraints can compound SMEs' difficulties in establishing a robust governance framework, impacting their ability to cultivate a positive organisational culture. Insufficient training may result in employees not fully grasping their governance role or the significance of ethical conduct, potentially resulting in compliance and accountability gaps.

**Change resistance**

A significant challenge is the inherent resistance to change that could disrupt the organisation's existing culture. In some small and medium-sized enterprises (SMEs), established norms and practices may be deeply entrenched, making it challenging to implement new governance initiatives. This resistance can stem from various factors, including anxiety about the unknown, lack of understanding of the benefits of governance reform, and potential disruption to established power dynamics within the organization (Kotter & Schlesinger, 2008). Oreg (2006) also emphasised that individual differences, such as personality traits and prior experiences, significantly influence the level of resistance encountered during organisational transformation. This resistance can take many forms, from passive noncompliance to active resistance, making it challenging to implement governance frameworks designed to improve organisational culture. To overcome this resistance, SMEs should prioritise a change management strategy communicating the reasons for change and the benefits. Involving employees in the change process and providing support can help reduce fear and foster a more receptive culture to new governance practices. As highlighted by Armenakis & Bedeian (1999), effective change management strategies must address the underlying issues of employees to reduce resistance and promote a more adaptive organisational environment.

**Balancing autonomy and control**

Small and medium-sized enterprises (SMEs) often must balance autonomy and control. Autonomy refers to the independence of employees and teams in decision-making, while control involves mechanisms and policies for compliance with organisational goals. Balancing autonomy and control is crucial for fostering innovation and responsiveness without compromising accountability or stifling creativity. By calibrating these elements effectively, SMEs can create an environment conducive to innovation and engagement, leading to improved organisational performance (Bennett & Lemoine, 2014). Implementing a flexible governance framework that allows decision-making flexibility while maintaining accountability is essential. Recognising that autonomy and control dynamics are dynamic and require continuous assessment and adjustment is critical to meeting evolving organisational

needs and stakeholder expectations (Finkelstein & Hambrick, 1996). This approach promotes innovation while ensuring alignment with organisational values and goals.

## **DISCUSSION**

### **Enhancing Corporate Governance and Organizational Culture Strategies**

To tackle the mentioned challenges, SMEs might contemplate implementing various strategies to enhance the alignment between corporate governance and organisational culture.

#### **Establish transparent governance protocols**

Establishing clear and well-defined governance policies is essential for SMEs aiming to establish a cohesive and efficient governance structure. According to Tricker (2015), robust governance policies form the basis for ethical conduct and responsibility, which play a crucial role in shaping an organisation's culture. These policies should clearly outline the organisation's values, ethical norms, and decision-making procedures, offering employees guidance in fulfilling their duties. Malline (2019) highlights that outlining governance policies enhances transparency and fosters employee trust, promoting a unified work environment. Furthermore, it is essential to regularly review and revise these policies to adapt to changes in the business landscape and meet stakeholder expectations. Involving employees in the policy formulation can also enhance their endorsement and dedication to the governance framework.

#### **Promote transparent communication**

Another effective strategy is promoting open communication within the organisation. Men & Stacks (2013) suggest that effective communication practices enhance the work environment's cohesion and empower employees to express their ideas and concerns. Facilitating dialogue between management and employees can foster idea exchange and feedback, ultimately boosting stakeholder engagement. Regular meetings, feedback sessions, and anonymous surveys are helpful methods to assess employee sentiment and tackle governance and cultural issues within the organisation.

A study by Clampitt & Downs (1993) emphasised that organisations embracing open communication typically exhibit increased trust and commitment among employees, crucial elements of a robust organisational culture. Hence, SMEs need to adopt approaches promoting transparent communication and nurturing an environment of respect and comprehension that propels organisational achievement—moreover, fostering a culture of open communication aids in the early detection of issues, enabling proactive resolution and cultivating trust and collaboration among employees.

#### **Investing in training and development**

Research indicates that organisations prioritising employee development enhance individual competencies and cultivate a sense of belonging and loyalty among their workforce (Sparrow et al., 2016). Investing in training and development programs can align corporate governance and organisational culture effectively. By providing employees with the knowledge and skills to navigate the governance framework, SMEs empower their workforce to make ethical decisions and contribute to a positive organisational culture. Training programs focusing on ethical leadership, stakeholder engagement, and effective communication are crucial in fostering a culture of integrity and collaboration. Continuous professional development opportunities help employees learn governance and ethics best

practices, ensuring organisational adaptability and responsiveness to change. Training initiatives significantly boost employee job satisfaction and engagement, essential for maintaining a robust organisational culture (Kirkpatrick & Kirkpatrick, 2006). Consequently, SMEs that invest in comprehensive training programs tend to have a more cohesive and motivated workforce, leading to enhanced organisational performance (Noe, 2020).

## **CONCLUSION**

The correlation between corporate governance and organisational culture in small and medium-sized enterprises (SMEs) is a complex yet crucial area of research that warrants further investigation. This correlation is defined by various factors, such as ethical governance, stakeholder engagement, and decision-making processes, each playing a pivotal role in moulding organisational climate. While the research underscores the substantial influence of effective governance structures in nurturing a positive organisational culture, it is essential to recognise the inherent limitations of this study. The review's scope is confined to a specific set of case studies and empirical analyses, potentially failing to fully encompass the diverse governance practices and cultural dynamics prevalent across different sectors and geographical contexts. Consequently, the applicability of these findings may be somewhat restricted, necessitating caution when extrapolating these insights universally to all SMEs.

Moreover, the methodologies employed in the examined studies exhibited significant diversity, as some leaned towards qualitative methods while others utilised quantitative measures. These methodological discrepancies could have led to partiality or discrepancies in the data, potentially impacting the conclusions' robustness. Subsequent research endeavours would benefit from embracing a comprehensive methodological structure that combines qualitative and quantitative data, thus offering a more comprehensive insight into the influence of corporate governance on organisational culture in SMEs.

Given the constraints outlined earlier, authors may propose recommendations for future research. Initially, investigating the enduring impacts of corporate governance on organisational culture would be beneficial. This exploration can enhance our comprehension of the evolving interplay between governance and organisational culture. Furthermore, comparative analyses of small and medium-sized enterprises (SMEs) across various sectors or cultural contexts could yield valuable perspectives. Such analyses may unveil contextual elements that impact the correlation between governance and organisational culture. Subsequent research should also contemplate the influence of external stakeholders, including investors and boards of directors, on moulding governance strategies and organisational culture.

The findings presented in this review suggest that small and medium enterprises (SMEs) aiming to enhance their organisational culture should prioritise establishing a robust corporate governance framework. These companies can cultivate an environment that promotes ethical behaviour, accountability, employee engagement, and innovation. The correlation between corporate governance and organisational culture is not merely theoretical; it is a practical consideration that significantly influences the sustainability and success of SMEs in a competitive business environment. Hence, comprehending and addressing this correlation is crucial for practitioners and academics, as it can guide strategies to enhance governance and cultural results within these essential economic entities.

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