

# Business Ethics in SMEs under the Shelter of Corporate Governance- A Way Forward

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## Abstract

This paper revolves around three basic concepts that are corporate governance, corporate responsibility and business ethics. These three concepts are correlated and interconnected with each other. These three dimensions of governance may lead to a healthy business environment and can maximize profits when implemented the framework. In addition, this paper also discusses the framework of corporate governance, problems faced by SMEs and the concept of social responsibility. Organizations can fulfil the role of the facilitator when the suggested framework is practiced in the organization.

**Keywords:** Business Ethics, SMEs, Corporate Governance

**EL Codes:** G30, L70

## 1. Introduction

SMEs play a crucial role for the countries in development phase as they provide a number of job opportunities to the individuals & hence boost up economic activity, resulting in poverty reduction. However, the basic problems faced by entrepreneurs is getting access to finance, building up connections to the international level & getting appropriate knowledge & access in technology. The main issue behind the bulk of problems is that these companies do not run under proper governance.

With the growing trend of SMEs, competitiveness within the sector is getting tough, therefore there is a prior need to inject the strategies of corporate governance to strengthen the competitiveness of small and medium-sized enterprises. Corporate governance is important if developing countries take serious steps for meeting the challenges faced by these companies. This document incorporates the need to develop a governance system or framework that is based on incentives, to encourage companies to adopt good governance practices through tax incentives and the allocation of the annual trophy. This document recommends that the rooms of small and medium-sized enterprises should be backed up and empowered in order to strengthen the concept of business ethics from the perspective of corporate governance (Fassin, Rossem, & Buelens, 2011)

CG has important implications for the prospects of a growing economy. CG practices to lessen the risks for investors, to attract capital investment and improve business performance. Especially at the time of rapidly increasing competition and mobility of capital, corporate governance has become an essential element in the industrial competitiveness of countries ( Spanos, 2005)

Risk is also an eminent factor that entrepreneurs face while setting up their business. These companies and individuals should be encouraged and empowered by the government bodies for sustainable development and for achieving market focused results, resulting in productive and ethical business environment.

### 1.1 Importance of SME's in developing countries

According to one of the literature reviews, a general observation is that approximately 80 percent small and medium enterprises jobs were associated with the services sector in the year 1990 that raised to 82 percent in the year 1999. Manufacturing sector where-ever garbs 15 percent of the total SME jobs, and hardly four percent jobs were associated with the primary section of SMEs. Further, same literature suggests that upon the available evidences, SMEs provide greater than 70 percent of job opportunities in the market. Nearly seven percent SMEs shuts down or go bankrupt each year whereas, about eight percent new firms come into existence each year that comprises of five to nineteen. Apart from this, about six percent of the SMEs increases their job share in the market and raise employment opportunities. (Sinha, 2003)

### 1.2 Most pressing problems faced by SMEs

#### 1.2.1 Lack of technical support

Currently, most of the small and medium enterprises are dependent on old and obsolete technologies. Coupled with this is that there is lackness in technical skills required to produce quality products. Most of the SMEs does not have knowledge of upgraded technology and opportunities regarding their business. This disadvantage is a major obstacle on the way to modern technology based SME system. It is associated to the inability of small and medium-sized enterprises to bring required equipment and facilities for the purpose of research and development.

This inability may directly or indirectly affect the efficiency and productivity of labor and hence may result in lower productivity as well as lower economic efficiency in the big picture.

Typical Pakistani companies still used old and traditional machineries for management and production in their business. This results in producing low-quality products at higher cost selling it at low prices.

There is a prior need to develop a system to bridge this gap and to address existing technological gaps that can be established by developing a system of industrial information network for SMEs.

#### 1.2.2 Illiteracy

One of the literature reviews suggest that level of education is directly proportional to the growth of business of an entrepreneur. Turnover growth and labor growth are highly interdependent and associated with the educational background. When it comes to their business, there are lots of issues that may become a hurdle in the growth of business just due to the lack of knowledge because of illiteracy. Strong educational backgrounds may lead to profitable results (Ahmed, Ali, & Ka, 2015)

#### 1.2.3 Lack of financial resources

Small businesses face the greatest obstacles to growth and have minimum access to formal ways and methods of external financing, which could explain the absence of the contribution of the growth of SMEs. Institutional and financial development assists in speeding up SME growth. Therefore, it is crucial to provide them access to finance externally and thus balance the area of opportunities irrespective of the sizes of the enterprises. Factoring and leasing can be used as funding tools as they provide better access to finance even if well developed institutions are not present, such as the CAN-sharing systems of information credit and highly competitive banking structure (Beck & Demirguc-Kunt, 2006)

#### 1.2.4 Lack of knowledge of appropriate formal procedure

It has been observed that in most of the cases in Pakistan, entrepreneurs establish their business, but due to the lack of knowledge about formal procedure, they become unable to cater the needs of their business in the competitive environment. Most of the business owners in SME sector does not know how the formal procedure to meet legal requirements and internationalization process. This may be because of lack of training and development sessions held by government bodies for the sake of entrepreneurial growth.

#### 1.2.5 Global approach

Small and medium-sized enterprises (SMEs) play a crucial role in today's global growth and prosperity. All over the globe, entrepreneurs respond in significantly different manner to opportunities and threats in the international market. ( Zahra, Neubaum, & Naldi, 2007)

There is a need for improved international entrepreneurship framework. Research studies should be exchanged among the states to improve international linkages between the small and medium enterprises across the globe (Coviello & Jones, 2004). These international linkages are important for the following reasons:

- 1) Access to International Markets
- 2) Access to latest technology
- 3) Access to international investors
- 4) Higher exports

### **1.3 Purpose and Scope of the Study**

This study is all about ethics briefings. The main purpose of this article is to give complete and easy to understand instructions on engagement of ethicists on amendments effects on climate globally. There are some studies which provide dataset about the interest of different researchers in change of climate. At the end there are some value added instructions which should be quoted here. As per my recommendations, political ethical and issues are affected by change in climate. Short term outcomes can be climate change in terms of politics and public are sometimes based on one-dimension, confusing, complicated and unclear conceptually. These issues fully attention of ethicists and philosophers as it needs confrontation and defense for support. Ethicists and philosophers must clarify it as soon as possible. These issues have been highlighted by us in the following study. We expect that our respectable philosophers, researchers and ethicists will consider it and clarify it soon. (Gardiner, 2004)

## **2 Family Ownership**

Family property businesses can be viewed as an opportunity or a threat, according to the variety of factors. The family members together when controlling the business, are considered more committed and this is an additional advantage to the company. Due to the sincerity and commitment to the firm, family owners are more concerned towards the business growth and hence respond better to the investment communities. In addition to it, family owners are more involved into the internal insights and process of the firm and hence, can meet the challenges more efficiently (Brunninge, Nordqvist, & Wiklund, 2007).

However, contrary to it investors including shareholders and creditors does not trust on such companies. They may feel insecure when it comes to investment because of the expected risk. The family owners may not follow the agreement or may not do justice with the right of shareholders. Therefore, investors analyze the risk in

these companies critically before taking the decision of investment. Most of the time, family owned companies are seen with the eye of distrust because of absence of accountability and lack of transparency, as such companies are run by highly concentrated business owners and therefore, there is a risk that these owners may break the rules and abuse the rights of minority shareholders. With a view to addressing the rights of shareholders and to assure them of their security, family businesses need to be run under the roof of strong corporate governance, so that investors may trust the owners and can invest on their business without feeling a sense of insecurity.

One of the benefits of family owners is that the organization stands upon the pillars of trust, love, care and respect. Business owners inherit family traits, commitment to their ancestors, atmosphere of love and the spirit to grow their business.

Apart from the theoretical explanations, research conducted by Biekpe concludes the result that family ownership is statistically significant and positive to the business growth. The research was conducted in Ghana where it was found that SMEs with greater percentage of internal shareholding exhibits efficient and effective performance compared to the randomly selected directors. Family owners are likely to have sound knowledge and good command over the internal operations and problem solving within and outside of the organization.

Similarly, managers who are shareholders as well, understand the needs of the business and are often able to make decisions that are in the favor of maximizing value, instead of indulging in opportunistic behavior. The result of the result conducted further by Biekpe suggests that in SMEs having a smaller percentage of the family ownership, managers are more interested in engaging in casual and take decisions in their favor at the expense of outside shareholders. Managers as owners of the company have a source of motivation to take decisions to improve the performance and efficiency of the organization ( Biekpe, 2007)

### ***2.1 Need to inject corporate governance in SME sector***

Strong governance in the organization can greatly affect the internal operations of a company. The four basic and essential aspects of internal operations includes

- strategic direction of business
- financial expectations
- transparency within the company
- shareholder activism

The strategic direction of the company is decided by the board of directors. These board members are selected under the head of corporate governance and how these directors governs the organization decides the long term commitment to the organization. The appointment of the board should bring efficient individuals in the organization in order not to damage the entrepreneurial direction of the company. The appointment of right-thinking people in the company usually causes a greater focus on innovation and R & D in SMEs and corporate governance framework (K.D. Adjasi, 2007)

### ***2.2 Development and implementation of Corporate Governance framework***

Regarding the guidance towards corporate governance and SMEs implication, discussion among stakeholders must be the very first step to take. It will be very much useful for development of framework and creation of awareness. Participation of each and every stakeholder is mandatory for its mechanism.

Corporate governance national codes have tendency of change with the passage of time, it all depends on stock exchange requirements, Professional bodies' rules, and legislation etc. it all has huge impact on reformation of corporate governance from higher to lower level.

Development of code will be 2<sup>nd</sup> step. Team consisting of securities exchange commission and SME chamber's representatives will take the responsibility to start the process. Associations of business, association of banking, chartered accountant institutes and many other stakeholders will et all the information provided by team of securities exchange commission and SME chamber's representatives.

Process must be very much co-operating, concise and easy to understand. So that it will be very much helpful to get healthy and extended discussions with stakeholders in process building. In December 1998 Institute of Chartered Accountants of Pakistan (ICAP) initiated to build an excellent corporate governance framework. After some time, SEC representative's committee and SEC supported the initiative taken by ICAP as well. Institute of Cost and Management Accountants of Pakistan (ICMAP) and three other stock exchanges were built in Pakistan. For the formation of corporate governance 1<sup>st</sup> ever code ("the Code"), team of an enthusiastic individuals was made. In 2000 first code draft was prepared by the committee. After that there were many debates on that code by SEC. Many seminars were held in Lahore, Islamabad and Karachi to get awareness of the code. ICAP circulated many draft codes among various companies. Data was also spread through internet in the form of website to get as accurate feedback as possible. It worked really very well, as the suggestion received from that system helped a lot in the process of finalization of code. Code was ready for corporate government. Capacity building of stake holders was remaining. It started after development of code. Different training sessions, seminars and workshops were arranged where SME'S owners and stakeholders were invited to get the awareness of the code.

Following basic principles are mentioned below about the code.

- I. Adaptability is more important than enforcement.
- II. Associate important requirements of SME's.
- III. Flexibility is very much important in order to adapt code in all sectors of SME's
- IV. Code should be user friendly for all stakeholders.
- V. There must be the trend of benefits, bonuses and increments.

Informal enterprises will be attracted towards corporate governance system due to incentives. Here informal enterprises meant unregistered enterprises. In developing countries, informal enterprises played big role due to its large number. That is why it is important to build a professional system to formalize them. It is will directly affect taxation in positive way. Fiscal deficit of these countries will be considered. There will be positive impact of incentives in corporate governance framework.

(Ijeoma & A., 2013)

### **3. Need to develop ethics code**

Study about morality issues is known as "ethics". Justice & injustice, right & wrong and good & bad notions are dealt by morality. It all depends on an individual to set these core values in life. As morality and ethics are correlated but of these terms have some differentiations as well. Investigations and outcomes of investigations of one's values are discussed in ethics. Matter of subject investigated by ethics is known as "morality".

If we look into ethical values in business world, to make a balance between ethics and morality in terms of generating revenues as well as long term growth of company is the biggest challenge. Codes of conduct which has unethical values can be the cause of failure in business. Importance of business ethics has been recognized by giants of business world. Ethical values have been included in business operations to make it as ethical as possible. Decision making process is purely depend on ethics of decision maker and that decision maker can be manager or owner. That is how ethics affects business operations (Sharma & Dudeja, 2013)

Many different psychologists, researchers and philosophers have already done huge amount of work on distinctive character traits, morals, values, behaviors, and attitude. But it is not very much beneficiary as determination of these factors is way too difficult as it varies from person to person. As per our expectation which we have from an individual usually that behavior of person will always be same in same or slightly different situation constantly. But as per our findings it is not as easy as it looks. There are very less chances that person will behave same in the same situation 2<sup>nd</sup> time. But in different conditions, standard behavior for such conditions and behavior of the person meet at that point. Highly qualified and expert give reason that situation of people is main and most reliable factor to judge their behavior. Their character does matter a lot in these scenario but behavior is the key point to resolve this mystery that how do actually people behave differently. There is more clarity than before that different character traits, which are the findings of experiments, are basically do not actually interlinked with the behaviors of an individual. Different psychologists are not satisfied with this character conception. They are looking for another substitute which will help them in finding all characteristics in one traditional virtual ethics. As per traditional virtue ethicists, virtues are not the reason behind performances of stereotypical actions with the association of following trait usually. Instead appropriate response, proper actions rational feelings and clear judgment are the outcomes. It varies from situation to situation. There is an extremely urgent requirement an agent, his reasoning power will be his key to unlock all these mysteries. (Kamtekar, 2004)

#### **3.1 Value of Ethical Business Environment**

There is always contradiction among needs of business, duty towards society, personal ethics and personal beliefs. Most of the time business environment is highly affected by owner. Personality of owner will decide the core values of business. (Vyakarnam, Bailey, Myers, & Burnett, 1997)

An individual's personality also carries strains of its family, peers and friends. We can say that friends, family and the people with whom individual lives, designs individual's personality. (Spence & Lozano, 2000)

Relationship of stakeholders and management is slightly different if we compare it from the relationship of other parties as such customers, suppliers, vendors, employees and consumers. It is the main factor which is actually not noticed by approach of multi-fiduciary. If it would not happen then there are many chances that private sector institutions would have been ceased by the corporations. In a sense the corporations would have been stopped their self in the conversion of private sector institution. The term business ethics would have been converted into most fundamental analysis of the scenario than ever before, economically. At that stage we have clear and concise study of Milton Friedman. Relationship between stakeholders and management has moral values as well. There are some ethical grounds which have been covered by both of them. That is where the strategic approach is applied. It states that fiduciary and the relationship in question are different from each other. They both have their own characteristics. There is no such offer of "return on investment" from management to their suppliers, employees, vendors and customer etc. but there are legal obligations of the management that; cheating, lying, deceiving and procrastination of their rights is strictly prohibited. If we consider stakeholders to management



relation, basic characteristics of life of business must have been identified undeniably. Competence and mission which is based economically is owned by any corporation. Some obligations as such general obligations with the law and fiduciary obligations onto different stakeholders cannot be neglected to any extent. There are possibilities of some factors which are mentioned. Corporate stewardship is disrespected and huge businesses who can abuse his powers economically to gain profitability. Slightly involvement of laws and obligations are bounded. With the help of clear understanding of the nature of moral obligation and the boundaries which focus on relationship between agent and principle, there is possibility that paradox of stakeholders can easily be neglected. There is a need of our understanding towards the topic that there is always a way to identify values and morals of ethics shared by corporation and stakeholders. Practical space is always there to help us in those grounds. Strategic self-interest is gone so far from that space's boundaries. It can be stopped on certain extent neutrally. There is requirement of hard work to fill that space. (Goodpaster)

### **3.2 Governance of Business Ethics**

Six-step which can be used to govern ethical performance are mentioned below. These six steps are recommended by an African researcher.

1. Identification of wants of stakeholder can be found by his opinion about company's ethical values.
2. Determination of company's ethical values defines company's standards.
3. On strategic and system levels ethical codes must be systemized officially.
4. There must be zero tolerance level in evaluation of ethical codes.
5. Ethical performance must be judged on the basis of international ethical codes.
6. Relevant stakeholders must have all information about ethical performance.

(Rossouw, 2004)

It is all dependent on an organization to maintain and change the image of corporation. Organizations can do it by monitoring business activities in terms of ethical and moral values and beliefs. It will be really very helpful in gaining trust of investors and stake holders as well as the customers and consumers and to enhance performance and productivity of the organization. Reputation of an organization can be maintained by ethical programs. It will be value added step. Now a day reputation is everything. It is really very helpful in making business relations, strengthening business, and gaining loyalty of client in any organization. There are many benefits as well. As such risk of corruption will be decreased because there will be many set of ethical tools to conduct honest business deals. Another most important advantage of ethics can be that fosters team work and structure of organization can be controlled and organized, as it decreases chances of conflict among employees of an organization. In the last decade there were many cases of scams and scandals but there is possibility to reduce number of scams and scandals by good governance. It will play main role in growth of an organization economically, which will directly affect growth of the nation positively. It is the time when organizations must consider ethics as its core value and start practicing it in management of the organization. it is the basic need to run business in this era. (ARIF SULTAN, 2011)

### **3.3 Corporate Social Responsibility under Ethics code of corporate governance**

Many organizations are going through the same issue of corporate social responsibility (CSR). No any particular research has been done on CSR of small or medium sized enterprises (SMEs). Many researchers have done researches on gigantic business units. (Perrini, Russo, & Tencati, 2007)

Interaction between society and business is done by social demands. It provides rights to society to do good for people through corporate world. Management of corporate world is accountable to fulfill social demands. Business operations should also be operated in accordance of society's social demand's instruction. (Baldo, 2012)

Undoubtedly there are some cases where there is a difference between employer's objective and employee's objectives. Some people of group of people might have got the vision to build a corporation for charity propose there are some examples as such a school, a hospital and an orphanage etc. the main objective of these type of organization is not to earn billions of profit, but to provide or execute related services. These services are totally based on type of that non-profitable organization. In some case, the main purpose is that responsibility of corporate executive is to be an agent of the owner of corporation. There is another responsibility regarding the establishment of that non-profitable or charity based institution. There are very few and difficult parameters to judge the performance of the corporate executive of charity based organization. But performance of that executive is straight forward at least. The persons who have responsibility to volunteer contractual arrangement are clearly stated. Undoubtedly corporate executive also has his own rights. He does have responsibilities which may be considered as voluntarily responsibilities in his point of view, as such responsibility towards his conscience, his family, his religious values, his peers, his city and his country etc. compelled by those responsibilities sometimes he tends leave everything behind and make strict life changing decisions. For example joining of his respective country's armed force, to serve his country on borders and to protect his people from danger etc. we may also state

all of these responsibilities as “social responsibilities”. Because the main objective of social responsibility is, to serve society and its people, that objective is being fulfilled in those responsibilities really very well. (Friedman, 1970)

#### 4. Conclusion and Recommendations

Small and Medium Enterprises (SMEs) are considered as the backbone of every developing country as it plays a vital role in poverty reduction. Small and medium enterprises are the important chunks of economy that deserves attention in order to bring prosperity within the state. Organizations become transparent, accountable and trustworthy for investors when they are run under the head of right governance. At the same time corporate governance injects ethical codes in SMEs that brings profitable results in the organization. SME sector in developing countries face a numerous problems including access to finance, globalization, external threats, lack of knowledge and literacy issues both at national and international level. The main underlying constraint to profitability of the firm is the growing competition. One of the challenges faced by SMEs is the deficiency in corporate governance structure. Apart from it, there is also lack of awareness regarding corporate governance policies, structure and framework among the board of director and owners. There is a general wrong perception among the SMEs that these policies may implement high cost. This paper discusses the main issues faced SMEs on a global perspective and how these problems and issues can be solved by embracing ethical business practices and by implementing corporate governance framework. CG also has the solutions to the problems related to the market by providing venture services by existing companies that can address the problem directly and provide solutions. This paper also discusses the suggested CG framework via the Code of ethics developing a sense of social responsibility. This development of framework can be done with participation and engagement between the venture firms and SMEs. The code and practices of business ethics are also discussed in this paper.

Into management decision making there are many more discussion on the topic of the relationship between stake holders analysis and ethical beliefs and moral values. Both of them are directly linked with each other. The following assumptions are mentioned here in study briefly which is shedding light on this relationship and decisions driven through these modes of ethical values. Stake holder synthesis and stake holder analysis are different from each other. Strategic and multi fiduciary are two top most and natural types of synthesis of stake holder. Ironically, to yield business without any ethical beliefs and moral values are appeared previously, and at the end performing ethical practices without business. This study is all about the thought that there is need to develop stake holder’s thinking as third part, Which should be neutral and take unbiased decisions. That is how ethical paradox can be removed and decreased. Member of that third part must be decision maker as manager, corporate executives and directors etc. who make sure to consider ethical beliefs and moral values in monitoring business operations as well.

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