



An Examination of The Link Between Business Ethics and Corporate Governance Principles of Smes in Kwazulu Natal, South Africa: Application of Shareholder Theory

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Abstract

This study examines the relationship between business ethics and corporate governance principles in small and medium-sized enterprises (SMEs) in the KwaZulu Natal region of South Africa. It aims to understand how ethical behavior and practices within SMEs can promote good corporate governance, using the framework of shareholder theory. The study employs a quantitative research design, collecting data from a sample of 217 active SMEs through a close-ended questionnaire. The data is analysed using statistical methods, including chi-square tests, Spearman ranked correlation coefficient, and regression analysis. The results indicate a significant positive correlation between business ethics and corporate governance in SMEs, emphasizing the importance of ethical conduct in maximising shareholder value while considering broader ethical implications. Based on the findings, several recommendations are provided. SMEs should prioritise the development of robust ethical frameworks, promote a culture of integrity and accountability, and invest in ethical leadership development. Collaboration and knowledge-sharing among SMEs can facilitate the adoption of ethical practices. Policymakers and regulatory bodies should recognise the significance of business ethics and corporate governance in SMEs and provide support and incentives for their implementation.

Keywords: Business ethics; corporate governance; SMEs; Ethics; Shareholder theory

1 Introduction

1.1 Background

Considering the significant socio-economic role played by small and medium-sized enterprises (SMEs), it becomes imperative to explore the link between business ethics and corporate governance principles of SMEs KwaZulu Natal, South Africa. While previous research (Seda, 2016) has highlighted access to finance as a crucial factor for success, studies conducted in other countries have also underscored the pivotal role of entrepreneurial ethical values in SMEs' achievements (McFarlane, 2013; Khomba & Vermaak, 2012). Hence, it is essential to investigate the relationship between the ethical values of SME owners-managers and the performance of their enterprises in the aforementioned region.

The importance of corporate governance in enhancing stakeholder value and societal well-being is widely recognized (King'wara, 2013). Stakeholders, particularly socially responsible ones, have leveraged their power to guide board decisions towards greater ethicality (Gill et al., 2018). Business ethics, as a normative science, provides the moral guidelines and standards that shape individual behaviour within a cultural context (King'wara, 2013). However, achieving a universal understanding of ethics can be challenging, and some firms substitute ethics with responsible business codes or integrity (Gensler, 2017). Business ethics aims to instill a sense of responsible conduct within organisations and requires a trade-off between economic growth and social obligations (King'wara, 2013).

SMEs in Africa face unique challenges when implementing corporate governance practices, such as pyramid ownership structures, relation-based governance, and protecting minority shareholders' rights (Reddy et al., 2017). These challenges include finding active owners and skilled managers in disseminated ownership structures and depoliticizing decision-making processes (Leopizzi et al., 2021). While the subject of corporate governance gained momentum in the Arab region as early as 2001, studies on corporate governance in SMEs have predominantly focused on developed countries, neglecting the context of developing economies (Khatib et al., 2016). SMEs and family-owned enterprises constitute a significant portion of the corporate universe in South Africa, highlighting the need to examine corporate governance in SMEs (Reddy et al., 2017).

1.2 Problem statement

South Africa is confronted with significant socio-economic challenges, particularly concerning high levels of unemployment and various social issues. Despite the country's recognition of the crucial role played by small and medium-sized enterprises (SMEs) in addressing these challenges, the survival and sustainable growth rates of SMEs have been problematic and below expectations (May, 2014). While SMEs worldwide have been instrumental in reducing unemployment and poverty, South Africa has experienced lower survival rates for such businesses (Pedersen & Gwozdz, 2014). Consequently, the potential of SMEs to effectively contribute to reducing unemployment in the country has diminished (Abor & Quarty, 2010). The magnitude of the socio-economic challenges in South Africa is further evidenced by the official unemployment rate of 32.9%, which increases to 40% when considering individuals aged 16 to 60 seeking employment (Statistics South Africa, 2023).

Lack of adherence to good corporate governance structures has led to major corporate scandals and financial crises of SMEs in KwaZulu Natal, resulting in global instability (Leopizzi et al., 2021). The absence of moral compasses for good governance has plagued society at large, including shareholders and stakeholders, and has deteriorated governance systems in the SME

sector and worldwide (King'wara, 2013). Thus, examining corporate governance from a moral perspective is crucial for ensuring effective governance (Lail et al., 2017). Ethical principles and moral values are essential for creating an ethical culture that fosters effective corporate governance (King'wara, 2013). Effective corporate governance necessitates accountability, responsibility, and transparency in the activities and structures of management, board of directors, and audit committee (Lail et al., 2017).

1.3 Research aim and objectives

The study aimed in examining the relationship between business ethics and corporate governance principles in small and medium-sized enterprises (SMEs) in the KwaZulu Natal region of South Africa. It focuses on the application of shareholder theory to understand how ethical behaviour and practices within SMEs can promote good corporate governance. The study is guided by the following was the specific objectives supported by the null and alternative hypotheses.

The research objectives of this study are as follows:

- ✓ To evaluate the determinants of corporate governance principles of SMEs
- ✓ To ascertain the correlation of ethical values of owner-managers on the corporate governance principles of SMEs
- ✓ To provide recommendations that will improve the interdependence between corporate governance principles and business ethics of SMEs

1.3.1 Research hypothesis

The null and alternative hypotheses were formulated to assess the business ethics and corporate governance principles in small and medium-sized enterprises (SMEs). Testing of the hypotheses were conducted at p- value of 0.05.

H01: Different determinants does not affect the corporate governance principles of SMEs.

HA1: Different determinants does affect the corporate governance principles of SMEs.

H02: There is a no correlation between ethical values of owner-managers and application of corporate governance principles by SMEs

HA2 There is a positive correlation between ethical values of owner-managers and application of corporate governance principles by SMEs.

2 Literature review

2.1 Business ethics

The terms "morality" and "ethics" are often used interchangeably, but in a business context, subtle distinctions emerge. Morality can be understood as the individual's internal compass, guiding personal actions that impact others, even when resisting personal gain (McDonald, 2010). On the other hand, ethics involve external justification for choices and behaviours that affect others, shaping judgments of right and wrong (Hamington, 2017).

Business ethics focuses on the ethical dimensions of an organisation's activities, encompassing commercial operations at various levels: systemic, organisational, and intra-organisational (Abiodun & Oyeniyi, 2014). This framework emphasizes understanding what constitutes "good" and "right" within specific economic contexts, enabling moral analysis and assessment of business practices (Turyakira, 2018). Underlying this concept is the idea of ethics as a set of

principles defining appropriate conduct, aiding in differentiating facts from beliefs, and guiding decision-making processes in morally complex situations (Meier, Favero, & Zhu, 2015). These principles are derived from broader societal values and serve as impartial guidelines for behaviour within a community (Hamington, 2017). Hamington (2017) further highlights the significance of unselfishness in ethical business conduct. Striking a balance between the interests of the organisation and the well-being of its stakeholders becomes a defining characteristic of ethical behaviour within the business landscape.

2.2 Corporate governance

Corporate governance encompasses the systems, principles, and processes that guide and control a business (Du Plessis, Hargovan, & Harris, 2018). Its essence lies in answering three key questions: who holds power, how is it wielded, and who benefits from its exercise? (Abdoush, 2017). This intricate framework operates within a dynamic landscape influenced by legal, economic, societal, political, and historical factors, making the pursuit of good corporate governance a complex, multifaceted endeavour (Aguilera, Judge, & Terjesen, 2018). At its core, corporate governance defines the distribution of rights and responsibilities within a corporation. It clarifies the roles and relationships between shareholders, boards of directors, management, and other stakeholders (Muswaka, 2017). Through established rules and procedures for decision-making, it defines the path towards setting and achieving the company's objectives, while also ensuring effective performance monitoring.

Good corporate governance principles emphasize the significance of a company's relationship with its diverse stakeholders. Transparency, fairness, and accountability in decision-making become crucial factors in strengthening these relationships (Ibrahim, 2019). This ensures that not only key stakeholder groups, but also minority voices, have their interests considered when charting the company's course. The emphasis on accountability extends to aligning business operations with ethical considerations for the benefit of all stakeholders. Ethical responsibility becomes an integral element of effective corporate governance, ensuring that decisions and actions prioritize the well-being of the collective, not just select interests (Ibrahim, 2019).

2.3 The link between business ethics and corporate governance

The realm of corporate governance necessitates the integration of ethical considerations to prevent the misuse of managerial power (Newton, 2015). Sharing power among diverse stakeholders within a company's structure is crucial for transparency and accountability, benefiting not only shareholders but all stakeholders (Ibrahim, 2019). This aligns with the growing trend among investors who recognize the value of incorporating social and environmental criteria alongside financial goals (Su, 2014).

At its core, ethical governance involves managing collective actions for the greater good, avoiding detrimental practices like fraud and prioritizing responsible decision-making (McMurrian & Matulich, 2016). Establishing transparency, responsibility, and professionalism as core values fosters stakeholder alignment with the company's ethical framework (Wang & Chen, 2018). This requires translating values into concrete systems, through laws, regulations, or company charters, guiding ethical behaviour at all levels (Eisenbeiss et al., 2015).

However, embracing ethical governance demands a shift in mindset and behaviour among all stakeholders (Cheung et al., 2018). Conflicts of interest pose particular challenges, highlighting the need for strong connections between business ethics and corporate governance principles (Rudyanto & Veronica Siregar, 2018). Addressing these challenges involves owner-manager reflection and the formalization of ethical approaches grounded in organisational values, professionalism, and clear principles of action (Yuhertiana et al., 2017).

Going beyond mere codes of conduct, ethical institutionalization within companies requires additional structures and procedures like internal ethics committees, dedicated personnel, and regular ethics audits (Yuhertiana et al., 2017). While profitability remains essential, prioritizing ethical considerations is crucial for preserving reputation, maintaining stakeholder trust, and achieving sustainable development goals (Vazquez, 2018).

Ethical corporate governance emphasizes accountability, fiduciary duty, robust auditing mechanisms, and unwavering ethical compliance (Nyilasy et al., 2014). Striking a balance between profitability and ethical behaviour often requires trade-offs, with executive management prioritizing ethical conduct (Nyilasy et al., 2014). Managers are ultimately accountable for the impact of their actions on all stakeholders, including shareholders, employees, and the community, while ethical investors demand transparency and honesty from corporations (Crowther, 2017).

In a competitive environment, ethical business practices foster positive behaviours and repeat business, building upon values like integrity and openness (Arora & Sharma, 2016). Fostering an enlightened investing community and implementing strict regulatory regimes are crucial to protecting the rights of all participants and creating a business environment that upholds moral, ethical, and regulatory frameworks (Fung, 2014).

Global economic integration has facilitated the dissemination of good corporate governance practices, with stakeholders playing an active role in this process (Ahmed & Uddin, 2018). In the context of small and medium-sized enterprises (SMEs), implementing corporate governance must focus on value creation, acknowledging the critical role of creativity and innovation in these young and dynamic companies (Ahmed & Uddin, 2018). Striking a balance between robust governance and entrepreneurial spirit is crucial for SMEs to not only survive but also thrive beyond their initial growth phase.

2.4 Application of Shareholder theory

Kershnar (2017) defines Shareholder Theory as a moral stance granting business owners exclusive rights to a company's net assets, while managers bear the moral duty to protect them. This theory prioritizes wealth creation for shareholders, often neglecting social responsibility and other crucial relationships within the business ecosystem. Shareholder Theory restricts managers to primarily safeguarding owner interests, raising questions about its suitability for ethical considerations and corporate governance in small and medium-sized enterprises (SMEs) (Queen, 2015). Its application to SMEs in business ethics and governance has been a subject of ongoing discussion (Donaldson & Davis, 1991; Jensen & Meckling, 1976).

At its core, Shareholder Theory advocates for maximizing shareholder wealth or value as a business's primary objective (Friedman, 1970). When applied to SMEs, this theory presents both advantages and disadvantages for ethical conduct and governance. Adopting Shareholder Theory can encourage accountability and transparency within SMEs. By prioritizing shareholder value maximization, SMEs may be motivated to implement robust governance practices and ethical decision-making frameworks (Cha & Abebe, 2016). This could involve mechanisms like regular financial reporting, independent audits, and open communication with shareholders (Lipton, 2004), fostering trust, stakeholder confidence, and long-term sustainability. Adherence to Shareholder Theory may incentivize SMEs to prioritize profitability and growth, leading to potential benefits like job creation, economic development, and improved living standards in their communities (Nyoni et al., 2017; Ainsworth, 2014). This aligns with the socio-economic goals of many SMEs, particularly those aiming to contribute to local employment and poverty reduction.

A singular focus on maximizing shareholder value can lead to a narrow perspective that neglects the interests of other stakeholders, such as employees, customers, suppliers, and the local community (Freeman, 2010). SMEs, often operating in close-knit geographical areas, maintain direct relationships with these stakeholders, making their well-being crucial for long-term success (Spence, 2016). Prioritizing shareholder value above all else may lead to ethical dilemmas that jeopardize relationships and reputations (Donaldson & Preston, 1995). Decisions favouring short-term profits at the expense of employee well-being or environmental sustainability could have adverse long-term consequences (Waddock, 2004). Neglecting stakeholder ethics may result in a loss of trust, increased regulatory scrutiny, and potential reputational damage (Hillman & Dalziel, 2003). While Shareholder Theory can promote accountability and financial performance in SMEs, its exclusive application poses ethical concerns and risks neglecting other stakeholders. To achieve sustainable long-term growth and profitability, SMEs may benefit from adopting a balanced stakeholder approach that considers the interests of all stakeholders, aligning with the principles of stakeholder theory (Donaldson & Preston, 1995; Waddock, 2004).

3. Research design and methodology

The study is quantitative for the results were measured numerically and analyzed. The study adopted a positivist philosophical approach and applied descriptive cross-sectional research design. The target population constituted 500 active SMEs (with employment volume between 21 and 200 full-time employees) in the Durban South area in KwaZulu Natal, South Africa. According to the Morgan sample size table, developed by Sekaran & Bougie (2014) a sample size of 217 was used was selected through random sampling. Data was collected using a close-ended questionnaire and analysed using SPSS version 29.0. Chi square test, spearman ranked correlation coefficient and regression analysis were conducted to establish the factors affecting corporate governance and to establish linkages between business ethical values and corporate governance.

3.1 Validity and Reliability

Reliability, as defined by Kumar (2019), pertains to the stability and consistency of scores obtained from an instrument. It implies that when the instrument is administered multiple times at different instances, the scores should remain unchanged and exhibit consistency. On the other hand, validity, as described by Creswell and Creswell (2017), concerns the meaningfulness of individual scores obtained from an instrument, enabling researchers to draw accurate and valuable conclusions regarding the sample population under study. An average Cronbach's alpha score of 0.813 was recorded on all the statements/questions of the questionnaire. This highlights a good level (81.3%) of internal consistency in the questionnaire regarding all the items of the questionnaire.

3.2 Ethical considerations

This study strictly adhered to all ethical guidelines set forth by Durban University of Technology, including human science ethical considerations. The research process underwent a thorough review and gained approval from the relevant department and faculty, ensuring compliance with ethical requirements. Prior to participation, informed consent was obtained from all participants, and the researcher-maintained confidentiality and privacy throughout the study, respecting the confidentiality of the participants' information.

4. Results and discussion

4.1 Descriptive statistics

Table 1: Demographic Characteristics

Characteristic (s)		Frequency	Percent
Business Size	21 to 50 employees	99	50,8%
	51 to 100 employees	47	24,1%
	101 to 150 employees	23	11,8%
	151 to 200 employees	26	13,3%
Total		195	100%
Age group	25 years and below	12	6,2%
	26 to 35 years	45	23,1%
	36 to 45 years	52	26,7%
	46 to 55 years	54	27,6%
	56 to 65 years	26	13,3%
	66 years and above	6	3,1%
	Total		195
Gender	Male	88	45,0%
	Female	107	55,0%
Total		195	100%
Business Age	Less than 5 years	40	20,5%
	Between 5 and 10 years	78	40,0%
	Between 11 and 15 years	59	30,3%
	Between 16 and 20 years	15	7,7%
	Over 20 years	3	1,5%
Total		195	100%
Education	Up to Grade 12/ std 10	16	8,2%
	Diploma/ Degree	56	28,7%
	B-Tech/ Honours	73	37,4%
	M-Tech/Masters/MBA	32	16,4%
	D-Tech/ Doctorate	18	9,3%
Total		195	100%

Source: Own field work

This section analyzes the influence of various determinants on corporate governance principles within small and medium-sized enterprises (SMEs). Based on the provided data, four key factors emerge as significantly impacting corporate governance practices: business size, business age, business ethics, and gender.

4.2 Results of hypothesis testing

H01: Different determinants does not affect the corporate governance principles of SMEs

Table 2: Chi square test results

Determinants of Corporate Governance	Value	df	Asymptotic Significance (2-sided)
Business Size * Corporate Governance	18,604 ^a	9	0,029
Gender * Corporate Governance	4,570 ^a	6	0,600
Business Age * Corporate Governance	25,879 ^a	12	0,011
Education * Corporate Governance	16,964 ^a	12	0,151
Business ethics * Corporate Governance	23,362 ^a	9	0,005

Source: Own field work

The results in Table 2 indicated that business size as a determinant had a significant impact on the corporate governance principles in SMEs (*Chi square* = 18.604) and *df* =9 at *p*- value= 0.029. This suggests that the size of a business has an impact on the implementation and effectiveness of corporate governance practices. The Chi-square test indicates that larger businesses tend to have a more pronounced influence on the implementation and effectiveness of corporate governance practices compared to smaller enterprises. This finding resonates with the studies conducted by Johnson et al. (2013) and Vandchali et al. (2022), which underscore the notion that older SMEs often exhibit more comprehensive and robust governance structures. These findings underscore the importance of scaling corporate governance practices to fit the specific needs and resources of SMEs, ensuring their effectiveness across different business sizes. These studies emphasize the importance of scaling corporate governance practices to fit the specific needs and resources of small and medium-sized enterprises (SMEs) to ensure their effectiveness.

The statistical analysis in Table 2 reveals a significant relationship (Chi square =25.879 and *df* =12 at *p* = 0.011) between business age and corporate governance. This indicates that the maturity and experience of a business play a role in shaping its corporate governance practices. The Chi-square test demonstrates that the maturity and experience of a business significantly influence its governance practices. Older and more established SMEs tend to have well-developed governance mechanisms compared to younger firms, as supported by research conducted by Anderson and Reeb (2003) and Ahmed and Duellman (2013). This highlights the importance of implementing appropriate governance practices as businesses evolve and grow over time, ensuring the alignment of governance frameworks with the changing needs and dynamics of the organisation.

The statistical analysis shows a significant relationship (*p* = 0.005) between business ethics and corporate governance. This suggests that ethical considerations play a crucial role in the implementation and effectiveness of corporate governance practices in SMEs he findings suggest that ethical considerations play a crucial role in driving the implementation and

effectiveness of governance practices. Studies by Treviño et al. (2014) and Aguilera et al. (2007) emphasize the importance of ethical values, integrity, and responsible decision-making in the governance framework. These findings underscore the need for aligning ethical principles with governance mechanisms to foster ethical behavior, accountability, and stakeholder trust within the SME sector.

The statistical analysis reveals significant relationships between business size, business age, business ethics, and corporate governance. These findings are consistent with prior research conducted by various scholars, including Johnson et al. (2013), Vandchali et al. (2022), Anderson and Reeb (2003), Ahmed and Duellman (2013), Treviño et al. (2014), and Aguilera et al. (2007). Understanding these relationships is crucial for policymakers, regulators, and practitioners in designing and implementing effective corporate governance frameworks tailored to the specific characteristics and needs of different businesses. By incorporating factors such as business size, age, and ethics into governance practices, organisations can enhance transparency, accountability, and long-term sustainability, ultimately contributing to the overall success and resilience of SMEs in the marketplace.

H02: There is a no correlation between ethical values of owner-managers and application of corporate governance principles by SMEs

Table 3: Spearman's rho

Variable		Corporate Governance
Business ethics	Correlation Coefficient	,203**
	Sig. (2-tailed)	0,004
	N	195

The correlation analysis presented in Table 3 utilizing Spearman's rho coefficient unveils a significant positive correlation ($r = 0.203$, $p = 0.004$) between business ethics and corporate governance in SMEs. This implies that as the level of business ethics increases, there is a corresponding enhancement in corporate governance practices. A robust ethical foundation is pivotal for effective corporate governance in SMEs as it serves to guide decision-making, foster transparency, and ensure accountability. SMEs that prioritize ethical conduct are inclined to establish robust governance frameworks that adhere to principles of fairness, integrity, and responsible behavior. This finding is supported by the comprehensive study conducted by Treviño et al. (2014), which underscores the positive influence of a strong ethical culture on the implementation and effectiveness of corporate governance mechanisms.

Moreover, the research by Aguilera et al. (2007) emphasizes the importance of integrating ethical considerations into governance structures to bolster stakeholder trust and organisational performance. Similarly, Ramakrishna Velamuri et al. (2017) highlight the essential role of ethical leadership and a culture of ethical behavior in shaping corporate governance practices in SMEs, aligning with the principles advocated by shareholder theory. Collectively, these studies underscore the significance of integrating business ethics into the fabric of corporate governance to enhance governance practices, mitigate risks, and build long-term sustainability.

The positive correlation between business ethics and corporate governance suggests that SMEs prioritizing ethical conduct are more likely to develop stronger governance frameworks. This alignment with shareholder theory, which emphasizes maximizing shareholder value,

underscores the potential for enhancing governance practices through the integration of business ethics. By incorporating ethical considerations into governance frameworks, SMEs can effectively mitigate risks, foster stakeholder trust, and lay a solid foundation for sustainable growth. This approach not only aligns with the objective of maximizing shareholder value but also acknowledges the broader ethical implications of business decisions, ensuring responsible and sustainable business practices in SMEs.

5. Conclusions and Recommendations

The analysis of the results underscores the critical importance of fostering a robust ethical foundation to enhance corporate governance practices and drive sustainable growth in SMEs. These findings are aligned with the principles of shareholder theory, emphasizing the intrinsic value of ethical conduct in maximizing shareholder value while considering broader ethical implications. To capitalize on these insights and foster positive change, several practical recommendations can be proposed.

SMEs should prioritize the development and implementation of comprehensive ethical frameworks that serve as guiding principles for decision-making processes. This entails promoting a culture of integrity, transparency, and accountability across all levels of the organisation. By embedding ethical values into the organisational culture, SMEs can fortify their corporate governance practices and uphold ethical standards in their operations.

Moreover, investing in ethical leadership development is crucial for SMEs. Ethical leaders play a pivotal role in shaping organisational values and driving ethical behavior. Therefore, SMEs should implement training programs and mentorship initiatives aimed at cultivating ethical leadership capabilities among their management teams. By nurturing ethical leaders who lead by example and champion ethical behavior, SMEs can foster a culture of responsible decision-making and integrity.

Additionally, fostering collaboration and knowledge-sharing among SMEs can yield valuable insights and promote continuous improvement in ethical practices and corporate governance. Establishing networking platforms and industry associations where SMEs can exchange experiences, challenges, and best practices related to business ethics and corporate governance can be highly beneficial. This collective approach enables SMEs to learn from each other's experiences and enhance the ethical fabric of the SME sector as a whole.

Furthermore, policymakers and regulatory bodies have a crucial role to play in supporting and incentivizing ethical practices in SMEs. Recognizing the significance of business ethics and corporate governance, policymakers should provide guidance, support, and incentives for SMEs to adopt and maintain ethical standards. By creating a conducive regulatory environment and offering incentives for ethical behavior, policymakers can contribute to the overall economic and social development of the region while promoting responsible business practices.

For future studies, it is recommended to conduct longitudinal research to explore the long-term effects of ethical leadership development and the implementation of ethical frameworks on corporate governance practices in SMEs. Additionally, comparative studies across different industries and regions could provide valuable insights into the contextual factors influencing the relationship between business ethics and corporate governance. Furthermore, qualitative research methods such as interviews and case studies can offer a deeper understanding of the mechanisms underlying the relationship between business ethics and corporate governance in SMEs. By addressing these areas of inquiry, future studies can contribute to advancing

knowledge and understanding in the field of business ethics and corporate governance in the context of SMEs.

Declarations of Conflict of Interest

Author contributions As the only author, everything was done by me. I contributed to the study conception, design, data collection and analysis. Furthermore, I wrote the first draft of the manuscript, and read and approved the final manuscript.

Availability of data and materials The datasets generated and/or analysed during the current study are available from me, Tinaye Mahohoma, as the main author, on reasonable request.

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