

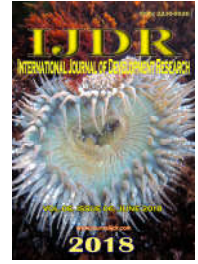


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## CULTURE AND CORPORATE GOVERNANCE, A THEORETICAL PERSPECTIVE

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### ABSTRACT

There has been a growing body of research studies between CG compliance and organizational performance. (Research on the relationship between CG compliance and organizational performance has seen robust growth in recent times.) However (Despite this), the existing research does not explore the problem of compliance in the context of a highly networked developing countries characterized by the dominant presence of influential family stakeholder groups. Hence, the aim of this paper is to demonstrate an understanding of the impact of culture on CG for minority shareholders' interests & to substantiate the relationship between CG and culture and its impact on economical developments. The conceptual framework to understand and how such highly networked culture affects minorities interests is based upon cultural value models, such as Hofstede's and Schwartz's, linking societal constructs with the legal and political milieu. As such, this paper will contribute to increase our understanding of the influence of cultural values on corporate governance practices across the global spectrum with particular reference to the protection of minority shareholder rights.

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### INTRODUCTION

The significance of reliable research in corporate governance has received increasing acknowledgement in the business world. Dean (2006) described corporate governance as an ownership responsibility rather than a legal obligation. Previously, the usual notion positions corporate governance as an externally imposed obligation among a list of criteria settings for corporate listings and continuations. However, Dean (2006, p.?) emphasized that "we needed people with vision prepared to make investments in governance because the long term returns are worth it". Such vision cannot be advanced without recognizing the fact that, globally corporate governance are influenced by different sets of cultural values (Rossouw and Sison, 2006). Further, Rossouw and Sison highlighted who would benefit from corporate governance. "corporate governance regimes around the world, shaped by different sets of cultural values, are also divided with regard to the question: for whose benefit should corporations be governed?" (Rossouw and Sison, 2006).

The association between culture and corporate governance has not been long researched in accounting due to the multidimensionality of opposing factors. Nevertheless, a consideration of economical developments in local markets worldwide in relation to their distinctive cultural value-dimensions may provide this research with the edge to highlight the adjacent areas of significance. For instance, to understand the association between corporate governance and financial performance, there is initially a need to underpin the association between cultural value dimensions and economic developments. Hence, once the strength of the association between cultural value dimensions and economic developments can be substantiated, their framework will serve as a guiding torch for further associations.

### Objective of the Study

The main aim of the paper is to substantiate the relationship between CG and culture and its impact on economical developments

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- To review the literature of the corporate governance with reference to National Cultures, Institutional Environments

- To demonstrate an understanding of the impact of culture on CG for minority shareholders' interests.
- To address the Theoretical Implications including agency theory & Institutional theory
- To address the Effects of Religions and Languages on CG, Shareholder's Perspective

### Hypothesis

- **H1:** There is a significant relationship between CG and culture and its impact on economic developments.
- **H1:** There is effects of Religions and Languages on CG towards Shareholder's Perspective

**Scope of the Study:** The scope of the present study is limited to addressing the impact of culture on CG.

## RESEARCH METHODOLOGY

The data has been gathered through secondary source i.e., reports, statistical abstracts, websites of OECD, world banks and other useful sources, reputed journals & newspapers and the present study is review based & presented in descriptive nature.

### Theoretical Background

**Postulate of Corporate Governance:** Berle and Means (1932), postulate that all large public corporations will be maturing to a capital structure that is highly characterized by the separation of ownership and control. They were systematically too enthused with their assumption to the point where they overlooked cultural obstacles awaiting around the corners of the world's continents. As the twentieth century progressed, it became clear that not all cultures are capable of convergence toward a specific capital-structure. In fact, the twentieth century witnessed the existence of the polarization of corporate structures between two dominant rivaling systems of corporate governance stemming from different cultural orientations.

### These systems, as explained by Coffee (2001) are

Coffee (2001) categorized the two rivaling systems of corporate governance into dispersed ownership system and concentrated ownership system. Dispersed ownership system refers to strong- 'bidding oriented' securities markets with highly politically leveraged accounting standards and market transparency. This concurs with Berle and Mean postulate that there is a conflicting interests between the managers and the owners. On the contrary, concentrated ownership system refers to the controlling shareholders, fragile security market, as well as low-level disclosure and market transparency. Berle and Mean postulate does not support this system because its market plays a moderately weak role in setting control mechanisms. Nevertheless, both systems seem to operate with ease on a geographical basis. Significance of each system is recognized throughout different parts of the world. However, the magnitude of each system cannot be quantified on its mechanical corporate controlling-components but rather on its contribution to the economic development of such national markets. Hence, investigating the existence of such system under the scrutiny of economic developments is more of a logical choice. For instance, looking at the economy of a country in terms of its growth in relations with its culture value

dimensions as a starting point may pay dividends in explaining the choice of adopting an existing system.

### National Cultures and Economic Developments

It has been investigated on whether national cultures distinctive traits can explain the variations in the "resource allocation efficiency" and "wealth distribution" in worldwide societies (Dodor and Rana, 2007). Dodor and Rana (2007) investigated the influence of distinctive traits of national cultures on the resource allocation efficiency and wealth distribution among countries. They found that culture traits (such as individualism, power distance, uncertainty avoidance, masculinity, and long term orientation) impact economic developments of countries in their study. In addition, their recommendations to investigate further variables such as geography, history, religion, institutions, and governments on economic developments were highly emphasized through their large sample of 53 countries. Nevertheless, further investigations into the association between national cultures and economic developments cannot be fruitfully productive without taking the two dominant schools of thoughts in socioeconomic developments into account. Modernization theorists such as Karl Marx (1873) emphasized the convergence of values with economic developments, and assumed the demise of religious beliefs in the long run. On the other hand, the opposing school of Max Weber (1904) emphasized on the persistence of traditional values despite economic and political changes. Max Weber's view conforms to the notion that values are relatively independent of economic conditions (DiMaggio, 1994). Empirical evidence rooted in a large sample of 65 societies undertaken by Inglehart and Baker (2000) subscribed to both opposing schools' points of views. Inglehart, and Baker (2000) stated,

"Economic development is associated with pervasive, and to some extent predictable, cultural changes. Industrialization promotes a shift from traditional to secular-rational values, while the rise of post industrial society brings a shift toward more trust, tolerance, well-being, and post-materialist values. If economic development continues, we expect a continued decline of institutionalized religion. The influence of traditional value systems is unlikely to disappear, however, as belief systems exhibit remarkable durability and resilience. Empirical evidence... indicates that values can, and do change, but also that they continue to reflect a society's cultural heritage". Hence, it is safer to consider the implications of both opposing schools with a level of caution.

### National Cultures, Institutional Environments, and Corporate Governance

The institutional environment is found to mediate the relationship between national cultures and corporate governance (Daniel *et al.* 2012). In a sample of 62 societies, the four Hofstede dimensions; Uncertainty Avoidance, Power Distance, Future Orientation and Performance Orientation, were found positively related to the institutional environment in any given society (Daniel *et al.* 2012). The empirical findings of Daniel *et al.* (2012) showed how certain cultural components impact corporate governance indirectly through their influences on the elements composing the institutional environment in any given society. This study also implied that corporate governance regimes around the world should reflect the cultural values of a given society in order to operate

efficiently. Otherwise, policy makers will misleadingly keep on implementing corporate governance codes of best practices superficially without adjusting the institutional environment to support further improvements in accordance with prevailing cultural values (Denis and McConnell 2003; Mintz 2005; Pedersen and Thomsen 1997; Young *et al.* 2004). The most recent financial crisis has shed some light on the weaknesses found in regulations and corporate governance practices around the world. This might be due to, "a lack of congruence between the cultural expectations and the regulatory infrastructures in the U.S. and those of other major markets" (Daniel *et al.* 2012). In addition, the existence of the bank based and market based financial systems worldwide might be beneficial. As each system found success in different regions of the world (Daniel *et al.* 2012). Notionally, norms form a pyramid that is based on cultural value dimensions' theories found in cross-cultural psychology (Licht, 2001). Hence, value dimensions' models such as Hofstede (1984) has the promise to advance our understanding of the relations between social norms, culture, and law (Licht, 2000). Moreover, value dimension frameworks such as Hofstede's (1980) are capable of providing a rigorously suitable means to unveil the causality between national cultures and the quality of the application of CG principles. Not only that, but it also "provides a theory-driven, universally validated operationalization of fundamental societal orientations and enables us to derive and empirically test hypothesis about relations between national culture and corporate governance" (Breuer and Salzmann, 2012). The findings of Licht *et al.* (2005) presented a strong association between statutory law and culture, specifically in the context of corporate governance in the area of investor protection.

In addition, the effect of a national culture on the application of CG principles is in part due to cultural values motivating policy makers and special interest groups to preferably undertake specific corporate governance arrangements (Breuer and Salzmann, 2012). These arrangements are more likely to be correspondents to dominant cultural values. Hence, the theory of culture as the mother of all path dependence will still hold. Hence, potential causality between the effects of national cultures on the quality of the application of CG principles pertaining to minority shareholders' protection is more likely to be found. Specifically, the cultural perspective is applicable of the causality between values and infrastructure of corporate governance regimes around the world. In fact, the nature of causality was found to be long term driven and responsible for shaping institutions and corporate governance practices (Williamson, 2000; Licht, 2000). Therefore, there is no doubt that "National culture is an essential determinant for the design of corporate governance systems" (Breuer and Salzmann, 2012). Moreover, Hofstede dimensions have the explanatory power to unveil differences in corporate governances worldwide (Chan and Cheung, 2012). In fact, it is common to realize weak minority shareholders protection and a low level of CG compliance in emerging markets characterized as high on Power Distance, Collectivism, Uncertainty Avoidance and low on Masculinity (Rafiee and Sarabdeen, 2012). Most importantly, the CVD framework is representative of the applicability of the institutional theory in terms of how such cultural identity has contributed to the institutional developments of the accounting profession and its existing procedures. Undoubtedly, the institutional theory "offer[s] a wide range of applicability for understanding the practice of accounting... draws on a broad variety of insights from cognitive science, cultural studies, psychology and

anthropology... draws attention to multiple levels of analysis ranging from the individual organization to society (Richard, 2001)" (Hoque, 2006, p.188). Moreover, despite of the historical significance of such security market or how long it has been in operation or whether or not it has reached maturity, the cultural dimensions are more prevalently predictive of better governance. "Age alone is not enough to make people smarter or to provide more governance protections. A "governance friendly" culture can help a newly developing country short-circuit problems that might be faced by other countries (Sweeney, 2008).

### Theoretical Implications

**Agency theory:** The use of the agency theory to explain the different corporate governance systems around the world has failed in both developed and emerging markets because, "it is not clear whether the board of directors is management or agent or owner" (Oxelheim, 2007, p. ?). Hence, the dominance of family controlled corporations around the world especially in emerging markets such as Asia, calls for the need for a new theory to investigate the concerns of minority shareholders in those markets. Daniels *et al.* (2012) asserted that efforts to change corporate governance practices around the world should be influenced by cultural as well as institutional factors.

**Institutional theory:** The institutional theory perspective is suggestive of corporations seeking legitimacy within any given society by adhering to societal norms and values (Li and Harrison, 2008). In their study, Li and Harrison (2008) concluded that corporate governance practices around the world, as found in multinational corporations they had tested, reflect prevailing societal cultural norms in order to seek societal legitimacy. In addition, exploring the agency theory conflict of relationships from a cultural perspective might prove to be more universally applicable. For example, research by Crossl and Hambrick (2007) on Japanese corporate governance suggested that the agency relationships must be modified in cultures high on collectivism.

**Ontological Conflict in Corporate Governance:** Morl and (2013) viewed corporate governance as relying on certain identity constructs needing to be questioned. He argued that "the way in which corporate governance initiatives address the various crises of capitalism, allows us to gloss over some crucial ontological questions that could precipitate a more rigorous questioning of capitalist practices" (Morl and , 2013, p. ?). He presented his questions as follow:

#### ***Problem 1: The nature of capitalism and the crisis of control***

Under this question, Morl and (2013) extensively reviewed the governance literature and concluded that it was heavily concentrated on the fiduciary duty of directors and managers to guarantee the growth of shareholders' value. Hence, the focus of such literature is on "money," rather than on the welfare of such society that is affected as a "side-product" of this pursuit.

#### ***Problem 2: Moral agency and identity crises***

Under this question, Morl and (2013) viewed capitalism as a striving force in flows. Hence, in the process, most of our humanitarian values escape as the focus is rather on production and efficiency rather than on the sovereignty of the workforce.

As a result, social classes are forcefully enlarged and we are once again confronted with the problems of inequality, disenfranchisement, and poverty.

Hence, the agency conflict becomes rather a side-product of our obsessively desired levels of productivity and efficiency. In this sense, we are constantly confronted with an identity crisis stemming from our greedy drive when assessing our "moral agency" (Morl and , 2013). Morl and (2006, p.??) (2013, p.??) concluded that:

"Therefore, corporate governance aims to contain identities, instead of engaging with the flows through which these identities spontaneously emerge. Corporate governance seems to try and engineer, direct and program these "identities," instead of fostering the couplings that in and of themselves involve relational constraint, albeit not complete control (Morl and 2006). We therefore have to address the "identity crisis" that is inherent to capitalism. Governance initiatives relying on controls institutionalized and managed by singular individuals with integrity are bound to miss the ever shifting target of flows" (Morl and , 2013).

### **Problem 3: Hierarchical governance and the crisis of structure**

Morl and (2013) employed a biological analogy, "In biology, a 'rhizome' refers to a plant form that extends itself through horizontal tube-like root system and in this way, is capable to create endless new plants". Hence, exploring corporate governance in a rhizomatic way will result in a mind-shift. Such shift will direct our attention from delineating units that operate in accordance with certain foundational principles to be open to "dimensions or rather directions in motion" (Deleuze and Guattari 1988, p.21). Morl and (2013, p.?) emphasized that "This requires a different kind of methodology as well. Where boards are typically concerned with how they can direct their corporations from where it is now, to where it wants to end up, underst and ing the rhizomatic requires starting in the middle, rather than from a beginning or end. This may entail looking at how projects are affecting people and environments, rather than whether targets are met or compliance boxes are checked" (Morl, 2013).

### **The Epistemological St and of Value Systems**

Value systems differ among nations worldwide. This diversity stems from differing system of thoughts that are not only rooted in local beliefs but extend to myriad metaphysical systems at a deeper level (Nisbett, 1993; Hutchins, 1995). Nisbett *et al.* (2001, p.??) theoretically argued that "metaphysics, epistemology, and cognitive processes exist in mutually dependent and reinforcing systems of thought, such that a given stimulus situation often triggers different processes in one culture than in another. Thus, it is not possible to make a sharp distinction between cognitive process and cognitive content. Content in the form of metaphysical beliefs about the nature of the world determines tacit epistemology. Tacit epistemology in turn dictates the cognitive procedures that people use for solving particular problems."

As a consequence, Nisbett *et al.* (2001) found that Asian systems of thought have a holistic orientation "making relatively little use of categories and formal logic, and relying on 'dialectical' reasoning". On the other hand, Western systems of thought have more of an analytical orientation that relay more on "paying attention primarily to the object and

categories to which it belongs and using rules, including formal logic, to underst and its behavior" (Nisbett *et al.* 2001). In addition, Nisbett *et als'* (2001) psychological findings are consonant with other findings: (Vygotsky, 1978; Cole & Scribner, 1974; Hutchins, 1995; Lave, 1988; Luria, 1932; Rogoff, 1990). Collectively, all of the previous studies emphasized on the fact that "tools of thought...embody a culture's intellectual history... tools have theories built into them, and users accept these theories-albeit unknowingly-when they use these tools" (Resnick, 1994, pp. 476-477).

Over the last three decades, psychologist have strived to qualify, interpret and expand the work of Nisbett (1993), and Hutchins (1995) in regard to the deeper levels of values and their rooted stances in epistemologies. Peng *et al.* (2001, p. ??) found out that the holistically dialectal epistemology of the Asian culture makes their self-concepts to be "*socially diffused in context, and relationships bound while westerners' self concepts are more concrete and abstract*". They concluded the Asians' system of inferences involves induced reasoning as compared to the westerners trait of deduced reasoning. Further, Peng *et al.* (2001) theoretically found cultural studies have diverse epistemological stances of what counts as evidence and truth. They perceived differences in epistemologies giving rise to different models of reasoning through inductions and deductions. Most importantly, they concluded that the Asian dialectical epistemological model of reasoning emphasizes the changing nature of reality along with the enduring presence of contradictions. On the other hand, they concluded that the westerners' analytical epistemological stance rather places the emphasis on the notions of truth, identity, and the non-existence of contradictions in their deductive reasoning. Collectively, Peng *et al.* (2001) perceived cultural values as a major source for theories as they guide our focus to what is essential. As a result, values along with self-concepts play a major role in shaping theories, which in turn shape the contexts in which the resulting inferences are turned into actions. It can surmised that the epistemological st and of either cultures has to be taken into account when investigating its association with economical developments as they shape the inferences upon which actions take form. Hutchins (1980) further added reasoning as inseparably 'intertwined' with cultural models. Therefore, what is widely believed to be true is a measure of our capacity to infer and judge in the light of cultural models (D' and rade, 1995).

### **Theoretical Framework**

#### ***Pyramid of Social Norm's and CG; Shareholders' Perspective***

The study of social norms and their relations with the law is beneficial. Notionally, norms form a pyramid that is based on cultural value dimensions theories found in cross-cultural psychology (Licht, 2001). Thus, various value dimensions' models have the promise to advance our underst and ing of the relations between social norms, culture, and law. By thoroughly reviewing the literature, it is true as Licht (2001) confirmed that the legal literature does not seem to recognize or be aware of this body of knowledge. Nevertheless, in management and international accounting literature, Hofstede's (1984) value dimensions' model dominates the analysis. In addition, (Licht, 2001) explained theoretically how the Cultural-Value Dimension (CVD) integrates both views of social norms. He explained, "social norms scholars tend to

define the term by specifying the mechanism that they believe engenders norms and maintains them. One can distinguish between two main lines of thought in this regard: the internal versus the external view of social norms. The key difference between these views is the identity, or location, of the factor that induces compliance with a norm. Under the internal view, this factor lies within the individual person. Depending on the situation, one feels compelled to obey the norm due to guilt or pride, namely, a "warm glow" for doing the right thing. Under the external view, people comply with social norms due to non-governmental enforcement and in light of a cost/benefit calculation of sorts."

Therefore, "as cultural values shape and inform people's internal utility functions, the theory of cultural value dimensions takes social norms analysis one step ahead...by providing an empirically validated framework with which to account for social phenomena that are otherwise difficult to reconcile" (Licht, 2001). For instance, the norm of shareholder wealth maximization stems from the cultural value dimensions of individualism found in Hofstede (Licht, 2001). Conversely, the norm of stakeholders' rights is more consistent with Hofstede's collectivism dimension (Licht, 2001). As a consequence, it can be said that "a cultural profile functions as an external mechanism for enforcement of societal norm in concurrence with internal mechanism. As societal values are so deeply rooted in such a society, they shape social institutions and environment. "This environment [in turn] gives meaning to action, defines what is socially acceptable and [ultimately] exercise social control through sanctioning" (Licht, 2001). Moreover, Licht (2001) recommended the use of the CVD framework as it addresses the need expressed by researchers in comparative corporate governance studies to "operationalize social norms and integrate them into their analysis". Even Hofstede himself witnessed the need of implementing the use of social norms through the CVD framework to address the issue of corporate legislations. "Uncertainty Avoiding countries will have a greater need for legislation than less-Uncertainty Avoiding countries" (Hofstede, 2005). Such statement deserves further testing.

Moreover, theories embedded in the CVD framework can unveil the intriguing relation between the content of the law "law on the books" and the corresponding social norm of compliance with the law "law in action" (Licht, 2001). As claimed by Licht (2001) such dilemma is likely to exist in societies that emphasize "Autonomy and Egalitarianism (in Schwartz's system) and Individualism (in Hofstede's model). Conclusively, "the pyramidal model of social norms enables one to specify conditions for effective use of the law in its expressive mode as a norm inducing means" (Licht, 2001). Even though law practitioners and scholars seem to overlook the importance of culture on laws and enforcements, there is a growing awareness among them regarding the relevance of national cultures to corporate governance's practices around the world. This can be clearly seen in the recent, but still little, amount of work that has been done in corporate governance in relation to cross cultural psychology by law practitioners. Untraditionally, Licht, (2000) theoretically sketched a cultural theory of corporate governance based on the CVD framework by "implementing it to fundamental issues like shareholding structures, the regulations of self dealing, insider trading and disclosure" (Licht, 2000). The major theoretically conclusive findings of Licht (2000) are:

- National cultures can be seen, metaphorically, as the mother of path dependent dynamics in the sense that they play a role in both the origin and in future development of corporate governance systems.
- In their very essence, values *are* social norms, as social norms affect individual behavior and social institutions.
- The social norms addressed in most of the current law and economics literature tend to be particular and context specific and may also change rather quickly. In contrast, values are more general and stable. [As it has been previously explained by the work of Max Weber in the *National Culture and Economic Development* section]
- One may thus imagine a pyramid of social norms in which cultural values constitute the foundations. Corporate governance systems build on these foundations to develop both formal and non-formal rules as well as structures.
- A very promising avenue for further research lies in the thriving field of law and social norms. This line of research recently reached corporate law too. Legal scholars generally perceive social norms as rules "governing an individual's behavior that third parties other than state agents diffusely enforced by means of social sanctions." Norms [however] guide people's behavior after having been internalized as a result of a socialization process.
- The CVD framework can lend itself to developing rigorous comparative approaches to social norms and their interrelations with the law in different cultures.
- Moreover, the use of the CVD framework in corporate governance research should provide researcher with the shield of avoiding risks of relying on social myths and stereotypes (Licht, 2000). (Rossouw and Sison, 2006)

In addition, empirical evidence about the relations between national culture and social institutions has been documented. In a study of 52 nations, 3 social norms of corporate governance such as the rule of the law, corruption, and accountability have been operationalized in accordance with the CVD framework (Licht *et al.* 2002). Their findings revealed that there were strong associations between these 3 norms with the prevailing cultures in 52 nations. Most importantly, the associations of culture with governance norms were found to be substantial even when critical economic and historical factors were considered. These findings are very helpful in assessing legal systems and economic mechanisms. Moreover, it has been recommended that research into the relations between culture, governance and economics is both timely and warranted. Additionally, in an attempt to answer the intriguing question in what ways 'law on the books' reflect cultural values, an analysis between indices of investors legal rights, as coded by La Porta *et al.* (1997), in relation to national cultural profiles, Hofstede and Schwartz, was conducted by Licht *et al.* (2005). Their findings presented a strong association between statutory law and culture, specifically in the context of corporate governance. Therefore, the national scores on cultural value dimensions from the two leading theories in cross-cultural psychology, Hofstede and Schwartz, illustrated the fact that corporate governance laws and their compliance levels systematically relate to prevailing cultures. Moreover, empirical work found private benefits of control to differ significantly depending on the legal system under which firms are incorporated (Coffee, 2001). In his thorough review of the literature, Coffee found,

“One tentative generalization may, however, be advanced: Norms may matter most when law is the weakest. When formal law does not adequately protect shareholders, the strength of social norms becomes more important, because they could provide a functional substitute for law. Conversely, when legal rights and remedies adequately protect investors, there is less need for corporations to signal their intentions to observe standards that are already legally mandated or to develop creative means by which to bond those promises through self-help corporate governance measures” (Rossouw and Sison, 200).

In a sample of nearly 90,000 stakeholders drawn from 29 countries, evidence suggested that differences in stakeholders' reactions towards bad corporate acts appear to be consistent with differences in the cultures of those countries using Hofstede's (1984) dimensions (Williams and Zinkinn, 2008). Specifically, stakeholders' in countries where individualism is strong are more likely to punish firms for bad behavior than those in countries where collectivism is high (Williams and Zinkinn, 2008). In addition, stakeholders in countries where time is considered as a scarce resource, short term-orientation, are more likely to punish firms than those in countries where the long term orientation is more prevailing (Williams and Zinkinn, 2008). In addition to that, the *Globalization* process has aided in the integration of worldwide competitive markets (Chan, and Cheung, 2012). It also has compelled firms worldwide to improve their corporate governance regimes. In fact, due to globalization, good corporate governance is expected by international investors to be a common strategy for corporations worldwide to satisfy the increasing demands of competitive markets (Chan, and Cheung, 2012). In a sample of 271 firms in 12 countries, it was found that Hofstede dimensions have the explanatory power to unveil differences in corporate governance worldwide (Chan, and Cheung, 2012). The findings suggested that the dimensions of Individualism, Masculinity, and Uncertainty Avoidance possess the explanatory power to predict CG scores for firms worldwide.

“People from different cultures will have different levels of ethical sensitivity and their levels of ethical sensitivity are influenced by the values and beliefs that are socialized by people in their cultures. In fact, we should try to understand others who have different levels of ethical sensitivity than us because they have been brought up in such a way. When discussing CG, continuous patience, education and negotiation are needed to show people who hold low ethical sensitivity to CG that inappropriate ethical sensitivity and perception in doing businesses is harmful to society. At the same time, in cultures where people have lower ethical sensitivity to CG, closer observation may be needed to ensure that they are following the appropriate ethical guidelines” (Chan, Cheung, 2012). These findings of Chan and Cheung (2012) are also supported by Armstrong (1996) and Chan and Cheung (2008). They all have found that Individualism and ethical sensitivity are positively correlated. Conformingly, the fact that individuals in high individualism countries strive for fair treatment from corporations is also supported by Hofstede (2005). Hofstede (2005) described the highly individualistic societies to prefer reward allocations based on equity and same rights for all. In turn, such view influences the corporate governance practice to reflect individualistic beliefs. Moreover, people in high masculine societies were found to have less ethical sensitivity (Blodgett *et al.* 2001). In fact,

those people are less likely to be effected by codes of ethics (Lu *et al.* 1999). Hence, people in high masculine cultures are more concerned about their personal achievements and material wealth. Unlike in a culture that possesses high level of femininity which makes it more compassionate and having a strong ethical sensitivity as found by Nadler (2002) and Hofstede (2001). Thus, feminine orientated cultures are more inclined to improve their corporate governance than highly masculine ones. Furthermore, people in high Uncertainty Avoidance cultures are highly compliant with formal rules as found by (Vitell *et al.* 1993; Husted 2000, Weaver 2001). However, those same people would not recognize the ethical dilemma in business decisions when no formal rules exist (Scheepers, 2006). In addition, those same people value ethical values set by themselves within a group member. Consequently, they find it hard to respect or comply with ethical guidelines set by outside members (Scheepers, 2006). As a consequence, corporate governance rules as they are set to serve all stakeholders found to score low in countries with a high level of Uncertainty Avoidance” (Chan and Cheung, 2012). Therefore, “People from high Uncertainty Avoidance cultures may feel uncomfortable adopting any new management practices when their ‘own’ ethical codes, which are beneficial to in-group members, have been applied for so long” (Chan and Cheung, 2012).

Moreover, some studies such as Rawwas's (2001), took the challenge of pairing Hofstede's dimensions to utilize societal groupings. For instance, Rawwas described small Power Distance and weak Uncertainty Avoidance people to be ‘functionalists’. high Power Distance and strong Uncertainty Avoidance described as ‘deferents’. weak Power Distance and strong Uncertainty Avoidance people were given the description of ‘survivors’. Strong Power Distance and weak Uncertainty Avoidance people are viewed as ‘enthusiasts’. Interestingly, Rawwas found these four types of societies held opposing perceptions regarding the appropriateness of behavior in the market place. For example, ‘deferents’ were found so obedient to their bosses' rules, and also found to have stringent ethical beliefs. Rossouw (2005), states “the way in which a company treats its stakeholders reflects its ethical standards. It is therefore to be expected that companies for whom ethics is a priority will be sensitive to its stakeholders. This moral sensitivity will be reflected in the identification of stakeholders as well as in the manner in which they are being engaged by the Company” (p. 99). Hence, national cultures value dimensions can explain existing corporation's policies and procedures put in place. The association of Hofstede cultural dimensions in the determination of dividend policies worldwide has been under research scrutiny. In a sample of 112,295 firms from 33 countries, it has been found that the cultural dimensions of Uncertainty Avoidance, Masculinity, and Long-term Orientation affect both the potential to pay dividends and the amount of dividends paid (Bae *et al.* 2012). In addition, this association has varied with the strength of corporate governance worldwide measured by the degree of investors' protections. The findings suggested that firms are more likely to pay lower dividends in high Uncertainty Avoidance, high masculinity and high long term orientations cultures (Bae *et al.* 2012). Hence, the relation between cultural dimensions and dividends level varies in accordance with the level of strength of investor protections. “Collectively, cultural dimensions are negatively related to dividend levels and investor protection is positively related to dividend payouts. The cultural factors and investor protection, however, interact

with each other, such that strong investor protection is positively associated with firms' dividend levels even in highly uncertainty-avoiding and /or highly masculine cultures. [Therefore,] national culture and investor protection independently affect firms' dividend payouts but also interact with each other, such that strong investor protection induces higher dividend payouts in high uncertainty avoiding and /or highly masculine cultures" (Bae *et al.* 2012). In addition, the level of dividends is found to be positively affected with the corporate governance measures of firm size, dividend tax incentives (Bae *et al.* 2012). In addition, the level of dividends is found to be negatively affected by financial leverage, growth rate and a country's stock market development (Bae *et al.* 2012).

The predicative nature of Hofstede cultural value dimensions has provided a strong support for the argument that norms rooted in such culture affect the corporate governance practice at least at the board level (Li and Harrison, 2008). 33, 999 multinational firms in 15 industrial countries were empirically investigated to find out to what extent national cultures influence the composition and leadership structure of the boards of directors (Li and Harrison, 2008). The findings were in favor of the predictive nature of the Hofstede dimensions. The results suggested that national cultures have a major effect on corporate governance. For instance, "firms based in uncertainty avoiding cultures tend to have more outside directors on their boards and tend to consolidate the CEO and chair positions. Firms based in societies that value higher levels of individual freedom tend to have a higher percentage of outside directors on their boards, and also consolidate the leadership positions. Firms based in societies that value personal dominance (masculinity) tend to have fewer outside directors, and also to consolidate the leadership positions. Firms based in societies that prefer high power distances are more likely to have a single leader as both board chair and CEO and fewer insiders on the board" (Li, Harrison, 2008). Such relationship between cultural value dimensions, Hofstede, and corporate governance measure of board compositions and structures have been substantiated by previous research as well (Ghoshal and Bartlett, 1990; Doz and Prahalad, 1991; Nelson, 1993).

### ***The Effects of Religions and Languages on CG, Shareholder's Perspective***

In an attempt to find out the effect of religion and language as the core cultural proxies when examining the variations of investors' protections across countries, certain elements of cultural proxies were found significant when controlling for legal origins (Stulz and Williamson, 2003). In a sample of 49 countries, the cultural proxies, language and religion, were found to play significant roles in the variations of shareholders' rights worldwide. Also, these cultural proxies were found to have more explanatory power of how a country enforces investors' rights within. Nevertheless, caution is recommended to be exercised when investigating Muslim countries as the impact of their cultures would be minimized in favor of their institutional hysteria as a case in Iran depicted (Stulz and Williamson, 2003). In addition, the cultures of countries which were colonies not far ago tend to matter less. Hence, the cultures that matter more for institutions in those past colonized countries are rather the cultures of the colonizing countries (Pistor *et al.* 2001). Moreover, the degree of openness to international trades of such culture mitigates the

influences of religion and language (Stulz and Williamson, 2003). A similar but rather more specific attempt to uncover whether or not cultures in general and religions in particular are capable of mitigating earnings management has been documented. A sample of 31 countries has revealed that earnings management was unrelated to religions "despite the social stigma engendered by major religions against manipulative activities" (Callen *et al.* 2010). Such result can be rationalized in many ways. "Unlike tax evasion for example, earnings management is not necessarily viewed by religious adherents as being solely manipulative. Earnings management may be more nuanced and may be ascribed, at least some of the time, to a positive economic activity, namely, management's attempt to signal firm productivity" (Callen *et al.* 2010). Such finding possibly conveys the fact that religion might matter but rather implicitly as it influences other cultural variables. Nevertheless, limitations of such findings have been attributed to possible aggregation of data, and small sample size to reveal concrete evidence. However, the most intriguing finding was that earnings management was negatively related to Hofstede (1980) cultural dimension of Individualism and positively related to the dimension of Uncertainty Avoidance (Callen *et al.* 2010). The impact of culture on earnings management in terms of religion is equivalent to the impact of culture on corruption. An analysis of the impact of culture on corruption using religion as a proxy, in a sample of 11 religious variables from 100 countries, for such culture has been undertaken by (Paldam, 2001). The findings revealed that reformed Christian sectarians such as Protestants and Anglicans decreased corruption whereas the pre-reform Christian sectarians of Catholics, Orthodox did not (Paldam, 2001). Islam can be added to the pre-reform group as indicated by Paldam (2001). This nature of cultural effect in terms of religions on economic development is philosophically attributed to Max Weber as he predicted such link in (1904). "Clear signs of this mechanism were found but it is difficult to estimate from static-cross data as it has developed via historical processes" (Paldam, 2001). However, Adam Smith's (1776) assumption of religious diversity's capabilities of reducing corruption is a suitable counterpart for further investigations of such effect.

### **Market Maturity and CG: Shareholder's Perspective**

The cultural influence on the level of corporate governance was empirically investigated by Chan and Cheung (2008). Their findings were suggestive of the dimensions of Power Distance and Uncertainty Avoidance to be the most valuable indicators of the degree of corporate governance regardless of the maturity of a country's stock market. Low Power Distance and low Uncertainty Avoidance in a culture are associated with strong corporate governance regimes worldwide. The logic behind such association is due to the fact that shareholders' in low Power Distance countries are culturally equipped with applying more pressure on corporations to improve accountability, openness, and ultimately governance (Sweeney, 2008). In addition, people in low Uncertainty Avoidance cultures are more encouraged to speak about poor governance practices and, in turn, corporations are, "more accustomed to handle such diversity, conflict, and feedback from shareholders" (Sweeney, 2008). Therefore, despite the historical significance of such market or how long it has been in operation or whether or not it has reached maturity, the cultural dimensions are more prevalently predictive of better

governance. "Age alone is not enough to make people smarter or to provide more governance protections" (Sweeney, 2008).

### Corporate Governance Definition and its Implication

There is a lot of logic in Sweeney's interpretations of the work of Chan and Cheung (2008) as such logic has been confirmed by other empirical studies. Hence, the adaptation of Sweeney's definition of corporate governance is worthwhile for the purpose of this study. Sweeney states, "corporate governance refers to forces that encourage management to be accountable and to act in the interests of stakeholders. These forces are varied and complex. They include the nature of the firm's organizational structure, type of legal system, accounting protections, and even the politics"(2008, pp. ??). Further evidence of the implications of Sweeney's definition is found in an empirical study of 41 countries regarding the issues of private benefits of control and earnings management (Zhang *et al.* 2013). Their findings suggested strong evidence of the culture, legal rules, and law enforcements in playing critical roles in shaping corporate behaviors. Their statistical results revealed the fact that both private benefits of control and earnings management were positively associated with the level of collectivism in a given society. In turn, both private benefits of control and earnings management were negatively associated with the level of investors' protection in any given country. Unlike in individualistic cultures, agency issues between stakeholders are severe in collective cultures. In addition, their results were robust as they included "controls for investor protection, country wealth, and economic heterogeneity across countries as well as international differences in Owner [ship concentration]" (Zhang *et al.* 2013, pp. ??).

### Conclusion

The study observations and offered few policy suggestions on National Cultures, Religions and Languages, Institutional Environments through agency theory & Institutional theory and ontological Conflict in Corporate Governance. How and where the set objectives were accomplished and it raised 2 hypothesis (issues), discussed them and offered solutions. Issues and hypothesis traced the theoretical base and mentioned problem in proper perspective of the Culture and Corporate Governance to substantiate the relationship between CG and culture and it's impact on economical developments has been addressed with the proper evidences.

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