The Study on Relationship Between Internal Control and Enterprise Culture—Based on Corporate Governance Mechanism

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Abstract

In recent years, the concept of internal control has become the highly concern of theory and practice fields, and plenty of scholars have made studies concerning that subject from various perspectives or adopting different methods. In this paper, it firstly introduces the idea of corporate governance mechanism on basis of humanistic perspective, i.e. the enterprise culture; then it probes into the coupling foundation of internal control and enterprise culture as well as the interaction relationship between the two factors; besides, by means of the analysis on practical case of Jiangsu Yueda Group Co., Ltd., it eventually draws the conclusion that sustainable development of enterprises could be realized by integration of internal control and enterprise culture.

Key words: Internal control; Enterprises culture; Relationship

INTRODUCTION

Since the *Basic Norms of Internal Control* (hereinafter referred to as "Basic Norms" for short) had been issued by joint effort of Ministry of Finance and other departments of our country from 2008, the concept of "internal control" aroused general concern of theory and practice fields. Many scholars have conducted further research from various perspectives such as accounting and internal auditing, or through different methods for assessment with respect to that concept. For example, Wang (2009) proposed the IC-CMM Model after introducing the CMM method in Management Engineering, and in so doing to establish the system for assessing internal control process in enterprises; Yang (2010) performed analysis on the effect of internal auditing on internal control; Yang (2011) assessed the effectiveness of internal control system through the construction of comprehensive index of internal control adopting the management method called PDCA Cycle; Fang and Zhang (2012) carried out an empirical study with A-Share Listed Companies on SZSE from 2007 to 2010 as sample, indicating the relationship between internal control quality and accounting conservation. Nonetheless, the result from implementing internal control in practice field is not as satisfactory as expected; what is worse, it is nothing new to see the great losses or bankruptcy of enterprises caused by failure of internal control. At this point, it should be imperative for us to reflect on the factors that might have caused such problems. The previous analysis on theories and empirical data revealed that, most enterprises always stressed on, during implementation of internal control, method for system control, economic activities and business processes but often ignored the major factor— The dominant position and subjective initiative of people, i.e. lacking studies of internal control from the humanistic perspective. Therefore, it is necessary for theory and practice fields to focus on the impact of enterprise culture on internal control.

It clarifies in the *Basic Norms* that, enterprise culture is a main component of internal environment, which could be regarded as the foundation for implementing

internal control; thus, there must be a special relationship between internal control and enterprise culture. However, what is the kind of relationship between the two factors exactly? With this focus, this paper will illustrate the concept of corporate governance mechanism and try to get a comprehensive & objective understanding about the relationship between the two factors at the very first place, expecting to provide with rational and effective recommendations for practice field; then it will improve the results of implementing internal control from the angle of enterprise culture, so as to promote the sustainable development of enterprises. The corporate governance mechanism mainly consists of the content such as restraint mechanism, incentive mechanism and mechanism of efficiency & fairness.

1. COUPLING FOUNDATION OF INTERNAL CONTROL AND ENTERPRISE CULTURE

There are some specified studies made by scholars concerning analysis of coupling of internal control and enterprise culture. For instance, Pan (2012) noted that the coupling foundation of the two factors shall lie in emphasizing the importance of "people"; the integration in achieving the strategic objectives of enterprises; both are featured by dynamics and demanding for the "top-down" implementation method. This paper is attempting to make analysis on the coupling foundation of internal control and enterprise culture from the aspects of restraint mechanism, incentive mechanism and mechanism of efficiency & fairness starting with the viewpoint of corporate governance mechanism.

1.1 Restraint Mechanism

The internal control in enterprises is often implemented, during the whole process, with internal control system as backup, and employees are usually required to execute a certain task as per provisions of the system under enforcement, hoping to realize the goals set by enterprises using such system with focus on rigid and external regulations; while as for enterprise culture, there isn't any support for enforceable system requirement and it guides, regulates and standardizes the behavior of employees through soft cultural characteristics as well as motivates them to provide services for enterprises self-consciously. As a result, the outstanding enterprise culture could be established, which stresses on the importance of soft and internal restraint. Consequently, now that internal control is considered as rigid restraint mechanism while enterprise culture as the soft restraint mechanism, both of the two could disclose restraint mechanism in the process of enterprise governance.

1.2 Incentive Mechanism

Robert Simons, the expert of management control in the U.S., pointed out in his book of *Levels of Control:*

How Managers Use Innovative Control Systems to Drive Strategic Renewal that, approximately 70% of the people in an entity might avoid responsibility without measures for supervision and motivation. In order to implement internal control in enterprises, it shall emphasize on involvement of all employees, which means each and every one of them shall bear responsibility and obligation towards internal control; the corresponding incentive treatment with payment and equity in terms of various levels of completing the internal control objective during such process would undoubtedly show its inventive effect. The restraint on employees from enterprise culture could be taken as a set of unwritten rules instead of systematic regulations in words, but it is always endowed with enforcement like a kind of invisible influence (on employees). First of all, with great cohesive force, the enterprise culture could motivate the consciousness, initiative and enthusiasm of employees, connecting their individual destiny with enterprise development; secondly, it often reveals from the outstanding enterprise culture that, business developmental goals and strategies of enterprises would motivate their employees to take joint effort to achieve business goals. Hence, incentive mechanism is indispensable during the process of implementing internal control together with enterprise culture.

1.3 Mechanism of Efficiency & Fairness

According to the *Basic Norms*, listed companies are required to disclose their self-assessment report on internal control effectiveness from administrators during the annual reports; in addition, CPA shall, as per requirement, express the audit opinion for internal control effectiveness in listed companies. The stakeholders could never form the reasonable judgment whenever a decision shall be made unless efficiency & fairness has been focused on during such process mentioned before. Meanwhile, as involvement of all employees is emphasized by internal control, its system shall be formulated fairly and equally to every single one of them. Likewise, this mechanism is fully reflected in enterprise culture. Fairness appears to be extremely significant with respect to the management concept of people oriented. The sense of fairness has seriously affected initiative and working efficiency of employees in either salary distribution or promotion. Thus, efficiency & fairness has been stressed on by both internal control and enterprise culture.

2. ACTION AND REACTION OF ENTERPRISE CULTURE UPON INTERNAL CONTROL

It can tell from the analysis of coupling between internal control and enterprise culture from the perspective of corporate governance mechanism set forth that the features in common of the two factors. Based on theories and

experience previously, systems and culture are somehow connected rather than single issues concerning systems or culture. If so, as sub-categories of system and culture respectively, there must be certain connection between internal control and enterprise culture. The next part will probe into the action and reaction of enterprise culture upon internal control from the above three mechanisms.

2.1 From the Perspective of Restraint Mechanism

It is well-known that internal control emphasizes on rigid restraint mechanism while enterprise culture highlights soft restraint mechanism. Firstly, the majority of enterprises nowadays, despite of the systems established which seem to be perfect, treat internal control as single systems or methods, failing to achieve the objectives as expected; thanks to cultural soft restraint, by which enterprise culture is about to play the important role of supplementing and correcting internal control, and in so doing to coordinate the process in internal control system which could never be realized by other mechanism. Besides, the single implementation of rigid restraint might repel employees, because they often consider such approach as nothing but cruel; however, enterprise culture could bring soft restraint mechanism in internal control on basis of rigid restraint, and consequently, the employees are not only able to observe requirement provided in regulations self-consciously, but they also might enhance their self-government (Jiang, & Wang, 2009) as well as integrate the individual objectives into the great goal set by their enterprises. With outstanding enterprise culture, it shall help in the formation of a unified outlook on values and code of practice of employees on one hand; on the other hand, it will decrease the cost of internal control and probability of failure.

Likewise, internal control could affect enterprise culture. First of all, enterprise culture is an invisible status of awareness, which could never be seen or touched. Therefore, it is required, in order to reveal the developmental process of enterprise culture, to tell from specific conditions of system performance and working processes during internal control. Secondly, enterprise culture shall be continually improved in the developmental process; while the fact is that, without a whole set of well-developed rules to follow, the inside order shall impossibly be established even though all employees have noble professional ethics. As a result, it is imperative to add rigidity into the flexible enterprise culture under the execution of internal control system with the rigid restraint measures taken during internal control process.

2.2 From the Perspective of Incentive Mechanism

Since it is formulated and managed by administrators and the board of directors with involvement of all employees, the internal control system would become invalid very easily due to artificial factors; thus, the implementation results of internal control are significantly connected to administrators, the board of directors and all employees. Under such circumstance, management methods in other forms are necessary to motivate all employees to achieve the objective of internal control, whereas enterprise culture can be adopted to perform that function. By means of outstanding enterprise culture, the internal control might be improved through perfecting "artificial factors" and in such case, all employees are motivated to make self-regulation and self-restraint, which means they could grasp this chance to alter themselves from passive status to positive context while to manage themselves instead of receiving governance from others, providing effectiveness security for the implementation of internal control.

Generally, it is inevitable to encounter various obstacles during the formation of enterprise culture, including restriction of people, shortage of regulations, lacking enough execution and so on. In this context, internal control could play the role as decreasing the degree of impact on the formation of enterprise culture from these obstacles, and also taking advantage of the unique mandatory measures and rigid standards to motivate all employees to make joint effort for the same objective during the internal control process of goal achievement. If things go this way, it might be of great help to promote the formation of understanding enterprise culture, which will be invaluable in the long-term development of enterprises.

2.3 From the Perspective of Efficiency & Fairness

There is a wide range of positions, functions and workers involved in internal control, and a series of issues might arise during its implementation in enterprises. For example, the minority shareholders are unable to fully express their opinions and recommendations; the internal audit department is unavailable to perform its functions as expected; lacking strong collective consciousness; imperfect promotion system; etc. Nonetheless, in order to provide reasonable security for effectiveness in performing internal control, it has to depend on a control environment developed healthily and orderly. Enterprise culture could be taken as an effective method for promoting the development of internal control through environment enhancement for that matter, i.e. to improve code of ethics and quality of employees, to affect corporate governance structure, etc., so as to establish the kind of internal control environment with high efficiency and fairness while to further better the implementation of internal control systems.

At the same time, the environment is key to the formation of outstanding enterprise culture but the thing is, what measures should be taken to establish the right environment? Speaking of internal control, of which the effect shall not be underestimated, is attempting to regulate business activities of enterprises by series of controlling programs, including authorization, execution, inspection and recording for all economic events. As a result, the

effective implementation of internal control could assist in formation of high-efficient, fair and equal environment of enterprise culture, which could also lay solid foundation for forming outstanding enterprise culture.

3. CASE OF "HARMONY ENTERPRISES DEVELOPMENT PROMOTED BY INTEGRATION OF INTERNAL CONTROL AND ENTERPRISE CULTURE"

Since the analysis on interaction between internal control and enterprise culture based on corporate governance mechanism has revealed the close relationship between the two factors, now it is necessary to explore the valid method to apply such relationship in promoting business development during the enterprise governance. In that case, the integration and combination between internal control and enterprise culture will be essential to the application. With the practical case of Jiangsu Yueda Group Co., Ltd., the next part will make an analysis of the integration between the two factors in enterprise governance and on how such integration might promote constant development of enterprises.

3.1 Brief Introduction to the Case

Jiangsu Yueda Group Co., Ltd., one of the 520 national key state-owned enterprises, has gradually grown up in the trend of the reform and opening-up policy in China. After making tremendous effort for over 30 years, nowadays there are two listed companies and over 30 subsidiaries, almost 40,000 employees at home and abroad with total assets of over 50 billion Yuan. The Group has established two pillars of automobile and textile, and set up seven industry clusters, including industrial manufacturing and energy & mining; it has built partnerships with the fortune 500 enterprises world-wide like Korean Hyundai & Kia and French Carrefour, internationally well-known enterprises and renowned companies in Taiwan of China; thereby leading Yueda Group to a successful road of a new type of industrialization driven by internationalization, and making a great contribution to regional economic development. In 2013, Yueda Group achieved operating revenue of 101.22 billion Yuan, with tax & profit reaching 16.04 billion Yuan, due to which it became one of the enterprises with total income equal to hundreds of billions. In 2014, it is expected to reach total operating revenue of over 110 billion Yuan and total tax & profit exceeding 16 billion Yuan, being one of the 100 national key enterprises and one of the 10 key enterprises of large scale as well as keeping the leading position in northern areas of Yangtze River in Jiangsu Province. One of the reasons why Yueda Group has succeeded shall lie in the integration between outstanding enterprise culture and effective internal control, and such success could never be accomplished accidentally.

3.2 Case Analysis

The enterprise culture of Jiangsu Yueda Group mainly consists of three aspects, namely substance culture, institutional culture and spiritual culture in Yuedda, all of which have constructed Yueda's culture concentric circles resonance system. It is also called "cultural governance" of Yueda Group.

It could reveal from Yueda's governance that its internal control has been endowed with comprehensive coverage from design to implementation, which is not only formulated in accordance with relevant laws and standardized documents for internal control in listed companies, but the Group has drafted the corresponding control handbook as well as made or revised the relevant regulations with respect to its own features and situations. From the angle of business result and internal audit report, the internal control implemented by Yueda Group is effective.

3.2.1 Integration of Substance Culture and Internal Control in Yueda Group

The substance culture of Yueda stands for the most external and intuitive cultural expression and it is also regarded as a prerequisite to the formation of systematic and spiritual culture, which could be divided into two areas—culture concerning product and management. Culture concerning product in Yueda mainly includes: product structure; developmental ability and orientation of enterprise products; production capacity of enterprise products; etc. There is a wide range in business scope of Yueda, involving a great number of industrial fields, such as manufacturing, mining development, service and finance, and the Group has acquired remarkable performance in all fields as such. Culture concerning governance in Yueda usually consists of the following: characteristics of culture in enterprise governance; OS; processing, storage and convey of information; job training system; public relations; etc. For example, Yueda Group has successfully established close partnerships with various international well-known enterprises; it has created and expanded good brand effect of Yueda, promoted the multinational development of the enterprise and accelerated its speed of internationalization. However, Yueda Group would always prefer to make risk assessment whenever investing to brand new fields or establishing cooperation with other enterprises, so as to restraint and control behaviors of the enterprise before making up the final decision on whether it shall make investment or if it is worth in doing so. The truth is, risk assessment could serve as an important part of internal control. Take the year 2014 as an example, under the circumstance of facing with the pressure on national macro-economic downturn and the competition of the slowdown in demand of automobile industry, Dongfeng Yueda Kia still created an amazing sales amount of total 646 thousand cars, steadily ranking the eighth place in passenger car industry of China. Chen Yunhua, the Chairman of Board

of Directors of Yueda Group noted that "Finance might be one of the directions in our future development, but we are comparatively cautious in such area". Besides, as far as he was concerned, "We have to take full consideration of both preparations of talents and market before embarking on financial field; otherwise, there will be no turning back". Accordingly, now that it has become one of the six fields in Yueda Group, the proportion of financial industry is not high. It was reported that, the total profit acquired from financial filed in Yueda Group in 2013 was only over 10 million Yuan. Thus, the impact of utilizing internal control upon the substance culture to regulate the investment direction in enterprise development shall never be underestimated.

3.2.2 Integration of Institutional Culture and Internal Control in Yueda Group

As the interface of enterprise culture, institutional culture in Yueda refers to standardized portions affecting behaviors of the organization and its members. It epitomizes the demand for enterprise as well as its behavior from substance and spirit concerning culture of Yueda, including regulatory rules and systems, interpersonal relation and organization of enterprises. One of the objectives of enterprise governance is to strive for the most income with the least investment; while in order to realize that objective, it shall require the soundest operational status of the enterprise, and in that case, the establishment of one or several set(s) of regulatory rules systematically and scientifically must be inevitable. The internal control system is one typical example of those rules, and since Yueda Group has carried out management by such system, it helped every single one of employees know better about their duties with rules to follow and perfect division of work on one side; on the other side, it urged the personnel at different levels to supervise and restraint each other. For instance, as required by Yueda Group, the systems like control over separation of interlinked duties and authorization control shall be used to regulate the process of activities; besides, it has also positively promoted the rule called "Bilateral Enrollment and Alternate Appointment" that the principals of the party committee could be elected as members of the Board of Directors and the Board of Supervisors as per legal procedures while the Chairman of the Board and Chairman of the Board of Supervisors are allowed to enroll the party committee in terms of relevant provisions; all of the above measures taken could provide reasonable security for involvement in decision-making and problem-solving concerning major issues of party organizations in enterprises. Besides, it carried out a variety of mode of distribution, such as system of contracted responsibility, annual salary system and joint stock system in Yueda Group at the earlier period, taking the goal achievement of internal control as reference standard, motivating each employee to perform the corresponding liability and obligations from responsibility and benefit. As a result, those measures might help mobilize the initiative of the employees as well as their collective consciousness and stronger working enthusiasm. Hence, the effect on the formation of well-developed regulatory systems from integration between institutional culture and internal control shall not be ignored.

3.2.3 Integration of Spiritual Culture and Internal Control in Yueda Group

As the core of enterprise culture, the spiritual culture in Yueda is like the distillation of substance and institutional culture in enterprises, which could be taken as fundamental concept, value standard, vocational ethics and spiritual outlook to be commonly observed by all the employees in Yueda. It consists of enterprise spirit, the managing of enterprise, business ethics, enterprise value, enterprise outlook, etc., serving as the sum total of enterprise ideology. Hu Youlin, the former Secretary of the Party Committee of Yueda Group, has stated for more than once that, the success of Yueda lies in its spirit. Yueda culture adheres to the core concept of "Sincere service oriented, permanent honesty utmost", and its employees would always hurl themselves into work and join the majority to serve other people with the same spiritual outlook. Looking back to the development history in the past 30 years, there emerged a multitude of representatives of advanced leaders, such as Hu Youlin, the former Secretary of the Party Committee of Yueda Group, SU Nanyong, the General Manager of Dongfeng Yueda Kia. Despite of various positions they are engaged in and different performance acquired, one thing in common is that, what they have done epitomizes the spirit of Yueda. The most prominent features of the spirit could be simply summarized as hardworking; being faithful; continuous self-renewal; perseverance; self-transcendence; innovation; fearless to hardship; selfless service; being ambitious; sticking to the last minute. All of the leaders have set good examples and performed duties honestly, providing guidance for more and more employees in Yueda, whom are able to follow their steps with the right attitude to work here. At the early period since the foundation of Yueda Group, there were various kinds of problems as neither internal control nor enterprise culture was well-developed; consequently, in order to manage the Group, more attention shall be paid to the mutual restraint between the two factors. Luckily, based on smooth development for ages, Yueda will transfer the management focus from internal control to culture regulation in the future with the gradual maturity of internal control and enterprise culture within the Group, which means it will make attempt to refrain and motivate employees to work by means of spiritual culture as regulatory method. There is no doubt that Yueda will create a higher working efficiency and besides, it might achieve a greater accomplishment after the realization of working effectively and efficiently in the near future.

CONCLUSION AND PROSPECT

On basis of the analysis on coupling foundation and interaction between internal control and enterprise culture from the perspectives of three mechanisms, namely restraint, incentive and efficiency & fairness for corporate governance as well as the practical case study of Jiangsu Yueda Group set forth, this paper has reached the conclusion that, it will promote the development of enterprises with integration of effective internal control and outstanding enterprise culture. Accordingly, either the rigid and external governance mode like internal control or the soft and internal regulatory method of enterprise culture shall be greatly emphasized during business development. In addition, when any enterprise attempts to enhance the effectiveness of internal control from the cultural aspect after the perfect combination of the two factors during the business management, it will not only promote enterprise culture, but could also assist in realizing the objectives of internal control; thereby improving the business operating efficiency and as a result, maintaining the vigorous, healthy and orderly development for enterprises.

The discussion of this paper is based on effective internal control and outstanding enterprise culture; however, in case of failure of internal control or terrible enterprise culture, there must be unsatisfactory influence from one to another. In that context, it will be impossible for the two factors to be integrated perfectly, letting alone the occurrence of mutual promotion between the two during enterprise governance. Therefore, it is necessary to focus on whether the goal orientation of internal control and enterprise culture is consistent or not; in case of inconsistency, it shall be revised immediately for any error. The limitation of this paper shall not be ignored as the statement on relationship between internal and enterprise culture has been made based on theoretical approaches; while in future studies, the author is going to make more comprehensive and through analysis on such relationship using empirical approaches.

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