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# A Conceptual Framework of Governance Diversity and ESG Adoption in SMEs: Evidence from Emerging Economies

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***Abstract:***
*This study develops a conceptual framework to explain environmental, social, and governance (ESG) adoption in small and medium-sized enterprises (SMEs) within emerging economies. Despite the growing importance of ESG practices in enhancing sustainability and competitiveness, existing literature has predominantly focused on large corporations, leaving SMEs underexplored. Addressing this gap, the study introduces governance diversity as a critical driver of ESG adoption and proposes a multidimensional Governance Diversity Index (GDI) that captures board heterogeneity in terms of gender, expertise, independence, and demographic characteristics. Drawing on stakeholder theory, the resource-based view (RBV), and institutional theory, the paper argues that governance diversity enhances stakeholder responsiveness and organizational decision-making, thereby facilitating ESG adoption. Furthermore, the study incorporates strategic agility as a mediating mechanism, suggesting that SMEs with diverse governance structures are better positioned to sense and respond to environmental changes, enabling the integration of sustainability practices into their operations. Institutional pressure is also introduced as a moderating factor, highlighting the role of regulatory frameworks, stakeholder expectations, and market forces in shaping ESG adoption. The proposed framework offers a comprehensive and context-sensitive understanding of how internal governance mechanisms and external environmental factors interact to influence sustainability practices in SMEs. This study contributes to the literature by extending ESG research to SMEs, introducing a novel multidimensional governance construct, and integrating multiple theoretical perspectives into a unified framework. The findings provide important implications for policymakers, SME practitioners, and regulators seeking to promote sustainable business practices in emerging economies. Future research is encouraged to empirically test the proposed framework across different contexts and industries.*

***Keywords: ESG adoption, SMEs, Governance diversity, Strategic agility, Institutional pressure, Emerging economies, Corporate Governance***

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## INTRODUCTION

The increasing global emphasis on environmental, social, and governance (ESG) practices has fundamentally reshaped how organizations define performance, accountability, and long-term value creation. ESG considerations are no longer confined to large multinational corporations but are increasingly recognized as critical for firms of all sizes, including small and medium-sized enterprises (SMEs). SMEs constitute more than 90% of global businesses and contribute significantly to employment and economic development, particularly in emerging economies (OECD, 2023; World Bank, 2022). Despite their economic importance, SMEs remain relatively underrepresented in ESG research, with existing studies predominantly focusing on large, publicly listed firms where governance structures and disclosure practices are more formalized (Kamarudin et al., 2022; Buallay, 2021). This imbalance highlights a critical gap in understanding how ESG adoption can be effectively promoted within SMEs, especially in contexts characterized by institutional and resource constraints.

In emerging economies, including ASEAN countries, the urgency of ESG integration is amplified by increasing exposure to climate-related risks, evolving stakeholder expectations, and growing participation in global supply chains that demand sustainability compliance. Regulatory bodies and market institutions have begun to promote ESG reporting frameworks; however, SMEs often face significant barriers in adopting such practices due to limited financial resources, lack of expertise, and weak governance mechanisms (Agyemang et al., 2022; OECD, 2023). Moreover, the institutional environment in emerging markets is often fragmented, with varying degrees of regulatory enforcement and stakeholder pressure, further complicating the adoption of standardized ESG practices (Nguyen et al., 2023). As a result, understanding the internal and external drivers of ESG adoption in SMEs has become an important area of inquiry for both researchers and policymakers.

Corporate governance is widely acknowledged as a central mechanism through which firms enhance accountability, transparency, and strategic decision-making. Within this domain, board diversity has emerged as a critical determinant of organizational outcomes, influencing not only financial performance but also sustainability practices (Rao & Tilt, 2016; Birindelli et al., 2018). Diverse boards—characterized by variations in gender, expertise, independence, and professional background—are better equipped to process complex information, reduce cognitive biases, and respond to diverse stakeholder demands (Post & Byron, 2015; Adams & Ferreira, 2009). Recent studies suggest that board diversity positively influences ESG disclosure and sustainability performance, particularly in emerging markets where governance structures are evolving (Khan et al., 2023; Rahman & Hashim, 2023). However, most of this research is concentrated on large firms, leaving a gap in understanding how governance diversity operates within SMEs, where governance systems are often informal and less institutionalized.

To address this limitation, this paper introduces the concept of a Governance Diversity Index (GDI), which captures the multidimensional nature of board diversity in SMEs. Unlike traditional measures that focus on a single attribute such as gender diversity, the GDI integrates multiple dimensions—including independence, expertise, and demographic diversity—to provide a more comprehensive assessment of governance structures. This approach aligns with recent calls in the literature for more holistic and context-sensitive measures of governance that reflect the complexity of organizational decision-making (Terjesen et al., 2016; Zaid et al., 2020). By conceptualizing governance diversity as a composite construct, this study aims to advance the theoretical understanding of how board characteristics influence ESG adoption in SMEs.

While governance diversity may directly influence ESG adoption, its impact is likely to be mediated by internal organizational capabilities. Drawing on the resource-based view (RBV), firms with diverse governance structures possess valuable, rare, and inimitable resources that can enhance their strategic capabilities (Barney, 1991). In the context of SMEs, one such capability is strategic agility—the ability to sense and respond effectively to environmental changes. Strategic agility enables firms to adapt to evolving sustainability demands, integrate ESG considerations into their operations, and maintain competitiveness in dynamic markets (Teece et al., 2016; Clauss et al., 2022). Recent research indicates that agile organizations are more likely to adopt innovative practices, including sustainability initiatives, due to their flexibility and responsiveness (Shams et al., 2021). Therefore, this study posits that strategic agility serves as a key mediating mechanism through which governance diversity influences ESG adoption in SMEs.

In addition to internal capabilities, external institutional factors play a crucial role in shaping organizational behavior. Institutional theory suggests that firms respond to coercive, normative, and mimetic pressures from their external environment, which influence their strategic choices and practices (DiMaggio & Powell, 1983). In emerging economies, institutional pressures such as regulatory requirements, stakeholder activism, and market expectations are increasingly driving firms to adopt ESG practices (Zheng et al., 2022). However, the strength and effectiveness of these pressures vary across contexts, affecting the extent to which firms engage in sustainability initiatives. Consequently, institutional pressure is expected to moderate the relationship between governance diversity and ESG adoption, either strengthening or weakening its influence depending on the regulatory and market environment.

Against this backdrop, this study develops a comprehensive conceptual framework that integrates governance diversity, strategic agility, institutional pressure, and ESG adoption within the context of SMEs in emerging economies. By synthesizing insights from stakeholder theory, the resource-based view, and institutional theory, the paper contributes to the literature in several ways. First, it extends ESG research to SMEs, addressing a significant gap in sustainability scholarship. Second, it introduces the Governance Diversity Index (GDI) as a novel construct that captures the multidimensional nature of board diversity. Third, it explains the mechanism through which governance diversity influences ESG adoption by incorporating strategic agility as a mediator. Finally, it highlights the role of institutional pressure in shaping governance outcomes, providing a more nuanced understanding of ESG adoption in emerging markets.

In the theoretical aspect, this study combines three theories that complement each other in explaining the adoption of ESG in SMEs. Organizations do sustainable business practices because they have to respond to the expectations of multiple groups of stakeholders – this is the basis of the Stakeholder Theory. Within the Resource-Based View (RBV), governance diversity is considered a valuable organizational resource that helps to build strategic agility and implement ESG. Institutional Theory also contributes to these views by providing an understanding of the effects of external regulatory, norm and competitive forces on organizational sustainability decisions. The combination of these theoretical frameworks offers a complete picture of internal capacities and external institutional features that collectively explain the relationship between ESG adoption and SMEs in emerging economies.

In small and medium enterprises, governance diversity takes on special significance as strategic decision-making is likely to be made by a handful of owners, directors or family members. In smaller companies, where the decision-making function is more concentrated, the nature of governance has a greater impact on the organizational strategy than in larger companies. The diversity of governance teams helps to increase the knowledge, professional expertise and stakeholder perspectives that are available when making strategic decisions, thereby improving SMEs' ability to identify sustainability opportunities, manage new and emerging risks, and act in a proactive way to meet evolving stakeholder expectations. This trait is especially significant in determining the adoption of ESG in SMEs in resource-poor settings.

The remainder of this paper is structured as follows. The next section critically reviews the literature on ESG adoption in SMEs and corporate governance diversity. This is followed by the development of the theoretical framework underpinning the proposed relationships. The subsequent section presents the conceptual model and research propositions. The paper concludes with a discussion of theoretical and practical implications, as well as directions for future research.

## LITERATURE REVIEW

### ESG Adoption in SMEs

Environmental, social, and governance (ESG) adoption has emerged as a central theme in contemporary business research, reflecting the growing expectation that firms contribute to sustainable development beyond financial performance. While large corporations have made significant progress in integrating ESG practices into their operations and disclosures, the adoption of ESG among small and medium-sized enterprises (SMEs) remains inconsistent and underdeveloped. This disparity is particularly evident in emerging economies, where SMEs face structural constraints such as limited financial resources, lack of technical expertise, and insufficient institutional support (OECD, 2023; Agyemang et al., 2022).

Existing literature suggests that SMEs often adopt ESG practices in an informal and fragmented manner, driven more by immediate operational concerns than by strategic sustainability objectives (Revell et al., 2010; Johnson & Schaltegger, 2016). Unlike large firms, SMEs are less likely to engage in formal ESG reporting due to perceived complexity, cost implications, and limited awareness of reporting frameworks (Brammer et al., 2012; García-Sánchez et al., 2023). This results in a significant gap between the growing global emphasis on ESG and the actual implementation of sustainability practices within SMEs.

Recent studies have begun to highlight the importance of contextual factors in shaping ESG adoption among SMEs. For instance, institutional environments characterized by strong regulatory frameworks and active stakeholder engagement tend to promote higher levels of ESG compliance (Nguyen et al., 2023; Zheng et al., 2022). Conversely, in many emerging economies, weak enforcement mechanisms and limited stakeholder pressure reduce the incentives for SMEs to adopt sustainability practices (Hossain et al., 2024). Furthermore, SMEs embedded in global supply chains may face external pressure from multinational partners to comply with ESG standards, thereby accelerating adoption (Soundararajan et al., 2018). Despite these insights, the literature remains fragmented, with limited attention given to the internal governance mechanisms that enable or constrain ESG adoption in SMEs.

**Corporate Governance and Board Diversity**

Corporate governance plays a fundamental role in shaping organizational behavior, influencing strategic decisions, accountability, and stakeholder engagement. Within this domain, board diversity has gained increasing attention as a determinant of firm performance and sustainability outcomes. Board diversity refers to the heterogeneity of board members in terms of demographic characteristics, professional expertise, independence, and cognitive perspectives (Terjesen et al., 2016).

Theoretical arguments supporting board diversity are grounded in the notion that diverse boards enhance decision-making quality by incorporating a wider range of perspectives and reducing the likelihood of groupthink (Adams & Ferreira, 2009). Empirical evidence suggests that board diversity is positively associated with improved financial performance, innovation, and corporate social responsibility (CSR) practices (Post & Byron, 2015; Birindelli et al., 2018). More recently, scholars have extended this line of inquiry to ESG performance, demonstrating that firms with more diverse boards tend to exhibit higher levels of ESG disclosure and sustainability engagement (Khan et al., 2023; Rao & Tilt, 2016).

Despite these advancements, the majority of governance research has focused on large, publicly listed firms in developed economies, where governance structures are formalized, and regulatory requirements are stringent. In contrast, SMEs often operate with less formal governance arrangements, and board structures may be limited or even absent (Neville, 2011). This raises important questions about the applicability of traditional governance theories in the SME context. Moreover, existing studies tend to examine individual dimensions of diversity, such as gender or independence, in isolation, thereby overlooking the multidimensional nature of board diversity (Zaid et al., 2020). This limitation suggests the need for a more comprehensive framework that captures the combined effects of multiple diversity attributes on organizational outcomes.

## Governance Diversity and ESG: Emerging Evidence

The relationship between corporate governance and ESG adoption has gained increasing scholarly attention, with a growing body of evidence suggesting that governance mechanisms play a crucial role in shaping sustainability outcomes. Governance structures influence not only the strategic priorities of firms but also their responsiveness to stakeholder demands and regulatory expectations (Frias-Aceituno et al., 2013).

Recent empirical studies indicate that board diversity is positively associated with ESG performance and disclosure. For example, gender-diverse boards have been found to enhance transparency and ethical decision-making, leading to improved ESG outcomes (Birindelli et al., 2018; Khan et al., 2023). Similarly, boards with diverse expertise and professional backgrounds are better equipped to address complex sustainability challenges, integrate ESG considerations into strategic planning, and respond to evolving stakeholder expectations (Haque & Ntim, 2020). In emerging markets, governance diversity is particularly important as firms navigate institutional uncertainties and adapt to changing regulatory environments (Rahman & Hashim, 2023).

While most previous studies show that governance diversity is correlated with positive ESG scores, the results are not consistent across institutional settings. A few studies have shown that board diversity can improve sustainability disclosure and governance involvement (Khan et al., 2023; Rahman & Hashim, 2023), but there are also studies that indicate that board diversity can be effective depending on the context of the company, including company size, quality of regulations and maturity of institutions. Moreover, most of the previous research implements governance diversity only with isolated measures, for instance gender diversity or board independence, failing to consider the positive interaction of several governance features. The inconsistencies argue for the governance diversity as a multi-dimensional concept and the need to study it in a wider organizational and institutional context, especially in SMEs in emerging economies.

## Strategic Agility and Organizational Capability

The resource-based view (RBV) posits that firms achieve competitive advantage through the effective utilization of valuable, rare, inimitable, and non-substitutable resources (Barney, 1991). In this context, governance diversity can be conceptualized as a strategic resource that enhances a firm’s ability to process information, innovate, and adapt to environmental changes. However, the translation of governance resources into organizational outcomes depends on the firm’s internal capabilities.

Strategic agility has emerged as a critical capability that enables firms to respond effectively to dynamic and uncertain environments. It encompasses the ability to sense opportunities and threats, make timely decisions, and reconfigure resources to achieve strategic objectives (Teece et al., 2016). In the context of ESG, strategic agility allows firms to integrate sustainability considerations into their operations, adapt to regulatory changes, and respond to stakeholder demands (Clauss et al., 2022).

Recent studies suggest that agile organizations are more likely to adopt innovative practices, including sustainability initiatives, due to their flexibility and responsiveness (Shams et al., 2021). For SMEs, which often operate in resource-constrained environments, strategic agility is particularly important as it enables them to leverage limited resources effectively and adapt to changing market conditions (Cegarra-Navarro et al., 2016). Despite its relevance, the role of strategic agility in linking governance diversity to ESG adoption has received limited attention in the literature, representing an important gap that this study seeks to address.

### Institutional Pressure in Emerging Economies

Institutional theory provides a useful lens for understanding how external pressures influence organizational behavior. Firms operate within institutional environments characterized by regulatory frameworks, cultural norms, and stakeholder expectations, which shape their strategic decisions and practices (DiMaggio & Powell, 1983). Institutional pressures can be categorized into coercive pressures (regulations and laws), normative pressures (social expectations), and mimetic pressures (imitation of successful peers).

In the context of ESG, institutional pressures play a significant role in driving adoption, particularly in emerging economies where regulatory frameworks are evolving. Firms may adopt ESG practices to comply with regulatory requirements, enhance legitimacy, or respond to stakeholder demands (Zheng et al., 2022). However, the effectiveness of these pressures varies across contexts, depending on factors such as regulatory enforcement, market maturity, and stakeholder activism (Nguyen et al., 2023).

For SMEs, institutional pressure can serve as both a driver and a constraint. On one hand, external pressure from regulators, customers, and supply chain partners can incentivize SMEs to adopt ESG practices. On the other hand, weak institutional environments and limited enforcement may reduce the urgency of compliance, leading to lower levels of ESG adoption (Hossain et al., 2024). This dual role suggests that institutional pressure may moderate the relationship between governance diversity and ESG adoption, influencing the extent to which internal governance mechanisms translate into sustainability outcomes.

### Operationalization of Key Constructs

The main constructs introduced in the proposed framework are operationalized to improve the conceptual clarity and to make it easy to validate the framework in the future through empirical studies. Governance diversity is a multi-dimensional concept touching on the diversity of the board members with respect to gender, professional expertise, board independence, and demographic diversity. The proposed Governance Diversity Index (GDI) is designed to measure the overall effect of several governance attributes on the governance of organizations and their orientation toward sustainability. Strategic agility is the ability to sense environmental changes, quickly shift resources and appropriately react to new opportunities and problems which are emerging (Teece et al., 2016; Clauss et al., 2022). The institutional pressure refers to the coercive, normative and mimetic pressures exerted by regulatory agencies, professional bodies and market actors that push organizations to engage in ESG practices (DiMaggio & Powell, 1983; Scott, 2014). According to Kamarudin et al. (2022) and OECD (2023), the adoption of ESG by SMEs is measured by the degree of their voluntary incorporation of ESG principles in their strategy, operations and decision-making processes. Table 1 shows the definition of key constructs.

### Research Gap and Contribution

Despite the growing body of literature on ESG and corporate governance, several gaps remain. First, the majority of studies focus on large firms, with limited attention given to SMEs, particularly in emerging economies. Second, existing research on board diversity tends to adopt a fragmented approach, examining individual dimensions of diversity rather than considering its multidimensional nature. Third, there is a lack of theoretical integration in explaining how governance diversity influences ESG adoption, with limited exploration of mediating mechanisms such as strategic agility. Finally, the moderating role of institutional pressure in shaping governance–ESG relationships remains underexplored.

To address these gaps, this study proposes a comprehensive conceptual framework that integrates governance diversity, strategic agility, institutional pressure, and ESG adoption in SMEs. By introducing the Governance Diversity Index (GDI) as a multidimensional construct, the study advances the understanding of governance in the SME context. Furthermore, by incorporating both mediating and moderating mechanisms, the framework provides a more nuanced and theoretically grounded explanation of ESG adoption in emerging economies.

Table 1. Definitions of Key Constructs

| Construct | Definition | Key References |
|---|---|---|
| Governance Diversity | Multidimensional diversity of the governing body comprising gender, expertise, independence, and demographic diversity. | Terjesen et al. (2016); Khan et al. (2023) |
| Strategic Agility | The capability to sense, respond, and adapt rapidly to environmental changes. | Teece et al. (2016); Clauss et al. (2022) |
| Institutional Pressure | Coercive, normative, and mimetic pressures encouraging ESG adoption. | DiMaggio & Powell (1983); Scott (2014) |
| ESG Adoption | Integration of environmental, social, and governance practices into organizational strategy and operations. | Kamarudin et al. (2022); OECD (2023) |

## THEORETICAL FRAMEWORK

The development of a robust conceptual framework explaining ESG adoption in SMEs requires a multidimensional theoretical perspective that captures both internal governance dynamics and external environmental influences. Given the complexity of sustainability practices and the unique characteristics of SMEs in emerging economies, no single theory is sufficient to explain the mechanisms underlying ESG adoption. Accordingly, this study integrates three complementary theoretical lenses—stakeholder theory, the resource-based view (RBV), and institutional theory—to provide a comprehensive explanation of how governance diversity influences ESG adoption through strategic agility under varying institutional conditions.

### Stakeholder Theory and ESG Adoption

Stakeholder theory provides a foundational perspective for understanding why firms engage in ESG practices. Originally developed by Freeman (1984), stakeholder theory posits that organizations are accountable not only to shareholders but also to a broader set of stakeholders, including employees, customers, suppliers, regulators, and the wider community. ESG adoption can thus be viewed as a strategic response to stakeholder expectations, aimed at enhancing legitimacy, trust, and long-term value creation.

In the context of SMEs, stakeholder relationships are often more direct and relational compared to large corporations. SMEs tend to operate within close-knit communities and rely heavily on local networks, making them particularly sensitive to stakeholder perceptions and social legitimacy (Jenkins, 2006). As a result, ESG practices in SMEs are often driven by normative and relational considerations rather than formal regulatory requirements. However, the ability of SMEs to effectively respond to stakeholder demands depends on the quality of their governance structures.

Governance diversity plays a critical role in enhancing stakeholder responsiveness by broadening the range of perspectives and experiences represented in decision-making processes. Diverse boards are more likely to consider the interests of multiple stakeholder groups, leading to more inclusive and socially responsible strategies (Post & Byron, 2015). For example, gender-diverse boards have been associated with greater attention to social and environmental issues, reflecting differences in values and ethical orientations (Birindelli et al., 2018). Similarly, boards with diverse professional expertise are better equipped to understand complex sustainability challenges and develop appropriate responses.

From a stakeholder theory perspective, governance diversity enhances ESG adoption by improving the firm's ability to identify, interpret, and respond to stakeholder expectations. This suggests that SMEs with more diverse governance structures are more likely to engage in ESG practices as a means of maintaining legitimacy and strengthening stakeholder relationships.

**Institutional Theory and External Pressures**

While internal governance and capabilities are critical, firms do not operate in isolation. Institutional theory highlights the influence of external environmental factors on organizational behavior, emphasizing the role of regulatory frameworks, cultural norms, and stakeholder expectations (DiMaggio & Powell, 1983). According to institutional theory, firms adopt certain practices not only for efficiency but also to gain legitimacy and conform to societal expectations.

Institutional pressures can be categorized into three types: coercive, normative, and mimetic pressures. Coercive pressures arise from formal regulations and legal requirements, such as mandatory ESG reporting standards. Normative pressures stem from societal expectations and professional norms, while mimetic pressures involve the imitation of successful peers or industry leaders (Scott, 2014).

In emerging economies, institutional environments are often characterized by variability in regulatory enforcement and stakeholder engagement. While some countries have introduced ESG reporting guidelines and sustainability frameworks, enforcement mechanisms may be weak, leading to inconsistent adoption across firms (Nguyen et al., 2023). At the same time, increasing integration into global supply chains exposes SMEs to international standards and expectations, creating additional pressure to adopt ESG practices (Soundararajan et al., 2018).

Institutional pressure is therefore expected to moderate the relationship between governance diversity and ESG adoption. In environments with strong institutional pressure, the positive effect of governance diversity on ESG adoption is likely to be amplified, as firms are incentivized to align their practices with regulatory and stakeholder expectations. Conversely, in weak institutional environments, the impact of governance diversity may be diminished, as the absence of external pressure reduces the urgency of ESG adoption.

This moderating role highlights the importance of context in shaping governance outcomes and underscores the need for a comparative perspective in studying ESG adoption in SMEs across different emerging economies.

**Integrating Theoretical Perspectives**

The integration of stakeholder theory, RBV, and institutional theory provides a comprehensive framework for understanding ESG adoption in SMEs. Each theory offers a distinct but complementary perspective: stakeholder theory explains why firms engage in ESG practices, RBV explains how internal resources and capabilities enable ESG adoption, and institutional theory explains how external pressures shape organizational behavior.

By combining these perspectives, this study develops a holistic framework in which governance diversity serves as a strategic resource that enhances stakeholder responsiveness and organizational capability, strategic agility acts as a mediating mechanism that translates governance diversity into ESG adoption, and institutional pressure moderates this relationship by influencing the extent to which firms respond to external expectations.

This integrative approach addresses the limitations of prior research, which often relies on a single theoretical lens, and provides a more nuanced understanding of the complex interplay between governance, capability, and environment in shaping ESG adoption. Furthermore, it is particularly relevant for SMEs in emerging economies, where both internal constraints and external pressures play a critical role in determining sustainability practices.

## CONCEPTUAL FRAMEWORK AND PREPOSITIONS

### Conceptual Framework Development

Building on the integration of stakeholder theory, the resource-based view (RBV), and institutional theory, this study proposes a comprehensive conceptual framework that explains ESG adoption in SMEs through the interplay of governance diversity, strategic agility, and institutional pressure. The framework positions governance diversity, operationalized through the proposed Governance Diversity Index (GDI), as a key antecedent of ESG adoption, while strategic agility functions as a mediating mechanism, and institutional pressure serves as a moderating factor.

At the core of the framework is the argument that governance diversity enhances the firm's ability to respond to sustainability challenges by improving decision-making quality, broadening stakeholder representation, and strengthening strategic capabilities. However, the translation of governance diversity into ESG adoption is not automatic; it depends on the firm's ability to leverage diverse knowledge and perspectives effectively. This is achieved through strategic agility, which enables firms to sense environmental changes, adapt to emerging sustainability demands, and integrate ESG practices into their operations. Furthermore, the strength of these relationships is contingent upon the institutional environment in which SMEs operate, as external pressures influence the extent to which firms prioritize and implement ESG practices. Figure 1 illustrates the conceptual framework of governance diversity and ESG adoption.

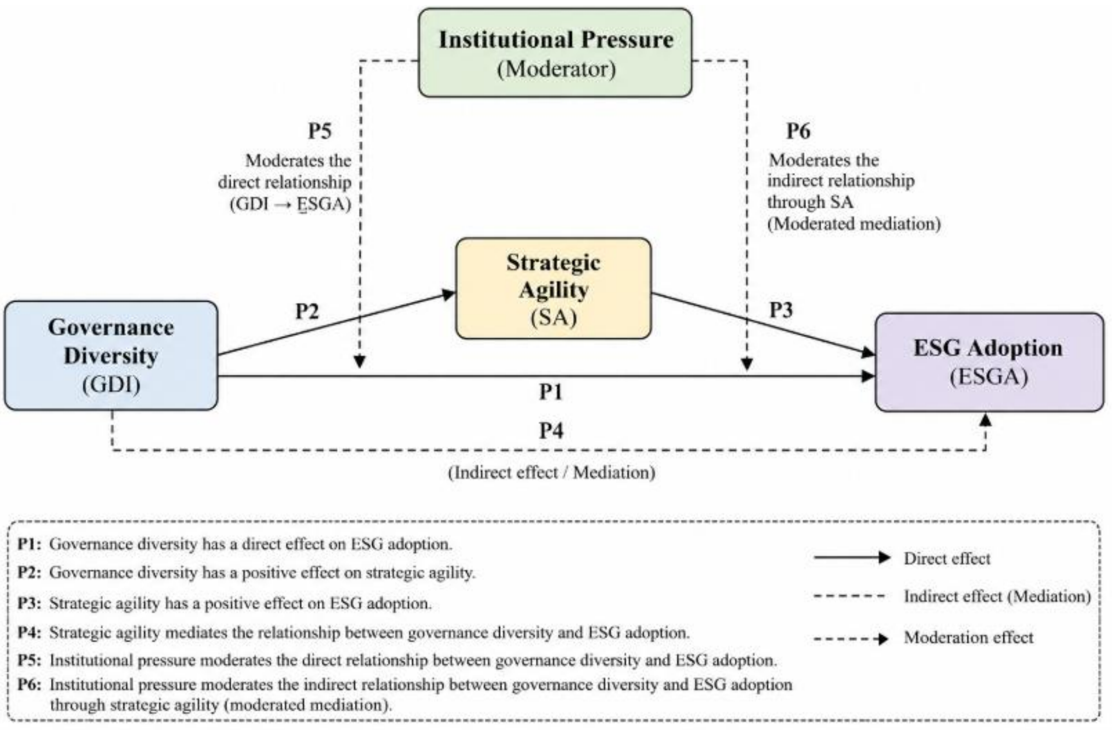


Figure 1: Conceptual Framework of Governance Diversity and ESG Adoption

**Governance, Diversity, and ESG Adoption**

Governance diversity is conceptualized as a multidimensional construct encompassing gender diversity, board independence, professional expertise, and demographic heterogeneity. From a stakeholder theory perspective, diverse governance structures enhance the firm's ability to recognize and respond to the needs of various stakeholder groups, thereby promoting socially responsible and sustainable practices (Freeman, 1984; Post & Byron, 2015). Diverse boards are more likely to consider environmental and social issues in strategic decision-making, as they bring varied perspectives and values that challenge conventional approaches.

Empirical evidence supports the positive association between board diversity and ESG performance, suggesting that firms with more diverse governance structures exhibit higher levels of sustainability disclosure and engagement (Birindelli et al., 2018; Khan et al., 2023). In the context of SMEs, governance diversity can play an even more critical role, as decision-making is often concentrated among a small group of individuals. The presence of diverse perspectives can therefore significantly influence strategic orientation and openness to ESG practices.

Based on these arguments, the following proposition is advanced:

*Proposition 1 (P1): Governance diversity is positively associated with ESG adoption in SMEs.*

**Governance, Diversity, and Strategic Agility**

From the resource-based view, governance diversity is a valuable organizational resource that enhances the firm's cognitive capacity and strategic flexibility. Diverse boards bring together a range of skills, experiences, and knowledge, which can improve the firm's ability to process information, anticipate environmental changes, and generate innovative solutions (Terjesen et al., 2016).

Strategic agility, defined as the firm's ability to sense, respond to, and capitalize on changes in the external environment, is particularly important for SMEs operating in dynamic and uncertain contexts (Teece et al., 2016). Governance diversity contributes to strategic agility by facilitating more comprehensive environmental scanning, enhancing decision-making speed, and promoting adaptive strategies (Clauss et al., 2022).

Therefore, governance diversity is expected to strengthen the firm's strategic agility, leading to the following proposition:

*Proposition 2 (P2): Governance diversity is positively associated with strategic agility in SMEs.*

### Strategic Agility and ESG Adoption

Strategic agility enables firms to adapt to evolving market conditions, regulatory requirements, and stakeholder expectations, making it a critical capability for ESG adoption. Agile firms are better equipped to integrate sustainability considerations into their operations, develop innovative solutions to environmental challenges, and respond proactively to social and governance issues (Shams et al., 2021).

In SMEs, where resource constraints often limit the ability to implement large-scale sustainability initiatives, strategic agility allows firms to leverage existing resources efficiently and adopt flexible approaches to ESG practices. For example, agile SMEs may implement incremental sustainability initiatives, adopt digital solutions for ESG reporting, or collaborate with external partners to enhance their capabilities.

Accordingly, the following proposition is proposed:

*Proposition 3 (P3): Strategic agility is positively associated with ESG adoption in SMEs.*

### The Mediating Role of Strategic Agility

While governance diversity provides the foundation for improved decision-making and stakeholder responsiveness, its impact on ESG adoption is likely to be indirect and contingent upon the firm's ability to translate diverse perspectives into actionable strategies. Strategic agility serves as this critical mechanism, linking governance diversity to ESG outcomes.

From an RBV perspective, governance diversity enhances the firm's resource base, but it is through organizational capabilities such as strategic agility that these resources are effectively utilized (Barney, 1991). Strategic agility enables firms to interpret and act upon the diverse insights generated by heterogeneous governance structures, facilitating the adoption of ESG practices.

Thus, the mediating role of strategic agility is formalized as follows:

*Proposition 4 (P4): Strategic agility mediates the relationship between governance diversity and ESG adoption in SMEs.*

### The Moderating Role of Institutional Pressure

Institutional pressure plays a significant role in shaping organizational behavior, particularly in relation to sustainability practices. In emerging economies, SMEs are subject to varying levels of coercive, normative, and mimetic pressures that influence their adoption of ESG practices (DiMaggio & Powell, 1983; Zheng et al., 2022).

In environments characterized by strong institutional pressure—such as stringent regulations, active stakeholder engagement, and participation in global supply chains—firms are more likely to prioritize ESG adoption. In such contexts, the positive effect of governance diversity on ESG adoption is expected to be amplified, as diverse boards are better equipped to interpret and respond to external demands.

Conversely, in weak institutional environments where regulatory enforcement is limited and stakeholder pressure is minimal, the influence of governance diversity may be reduced, as firms face fewer incentives to adopt ESG practices.

Accordingly, the following proposition is developed:

*Proposition 5 (P5): Institutional pressure moderates the relationship between governance diversity and ESG adoption, such that the relationship is stronger under high institutional pressure.*

### Moderated Mediation Effect

Building on the mediating role of strategic agility and the moderating role of institutional pressure, this study further proposes a moderated mediation effect. Specifically, the indirect effect of governance diversity on ESG adoption through strategic agility is expected to vary depending on the level of institutional pressure.

In high-pressure environments, SMEs are more likely to leverage their governance diversity and strategic agility to adopt ESG practices, as external demands create a sense of urgency and provide incentives for compliance. In contrast, in low-pressure environments, the indirect effect may be weaker, as firms face fewer external constraints and may prioritize short-term operational concerns over sustainability.

This leads to the final proposition:

*Proposition 6 (P6): Institutional pressure moderates the indirect relationship between governance diversity and ESG adoption through strategic agility, such that the mediating effect is stronger under high institutional pressure.*

### Summary of the Conceptual Framework

In summary, the proposed conceptual framework positions governance diversity as a key driver of ESG adoption in SMEs, operating through the mediating mechanism of strategic agility and contingent upon the moderating influence of institutional pressure. By integrating multiple theoretical perspectives, the framework provides a comprehensive explanation of how internal governance structures and external environmental factors interact to shape sustainability practices in SMEs.

This framework not only advances theoretical understanding but also offers a foundation for future empirical research, enabling scholars to test the proposed relationships and refine the model across different contexts and industries.

## DISCUSSION AND IMPLICATIONS

### Discussion of the Conceptual Framework

This study develops a theoretically integrated framework to explain ESG adoption in SMEs by linking governance diversity, strategic agility, and institutional pressure. The framework advances existing literature by shifting the focus from large corporations to SMEs, which have been relatively underexplored despite their critical role in economic development. By positioning governance diversity as a multidimensional construct and introducing strategic agility as a mediating mechanism, the study provides a more nuanced understanding of how internal governance structures influence sustainability practices in resource-constrained environments.

The proposed relationships highlight that governance diversity is not merely a structural attribute but a strategic enabler that enhances decision-making quality and stakeholder responsiveness. Consistent with stakeholder theory, diverse governance structures allow SMEs to better interpret and address the expectations of multiple stakeholder groups, thereby promoting ESG adoption. At the same time, the inclusion of strategic agility reflects the importance of organizational capability in translating governance attributes into actionable outcomes. This aligns with the resource-based view, which emphasizes that resources alone are insufficient unless they are effectively deployed through firm capabilities (Barney, 1991; Teece et al., 2016).

Furthermore, the moderating role of institutional pressure underscores the importance of external context in shaping governance–ESG relationships. The framework acknowledges that SMEs operate within diverse institutional environments, particularly in emerging economies where regulatory frameworks and stakeholder pressures vary significantly. By incorporating institutional theory, the study demonstrates that the effectiveness of governance diversity in driving ESG adoption is contingent upon the level of external pressure, thereby providing a more context-sensitive explanation of sustainability practices.

### Theoretical Contributions

This study makes several important contributions to the literature on ESG, corporate governance, and SMEs.

First, it extends ESG research beyond large corporations by focusing on SMEs, which have been largely overlooked in sustainability scholarship. While prior studies have predominantly examined ESG adoption in listed firms with formal governance structures, this paper highlights the unique challenges and opportunities faced by SMEs in adopting sustainability practices, particularly in emerging economies (Agyemang et al., 2022; OECD, 2023). By doing so, it responds to recent calls for more inclusive and context-specific ESG research.

Second, the study advances the corporate governance literature by introducing the Governance Diversity Index (GDI) as a multidimensional construct. Unlike traditional approaches that examine individual aspects of board diversity in isolation, the GDI captures the combined effects of gender, expertise, independence, and demographic diversity. This holistic approach provides a more comprehensive understanding of governance structures and their influence on organizational outcomes, addressing a key limitation in prior research (Terjesen et al., 2016; Zaid et al., 2020).

Third, the study contributes to theory by integrating stakeholder theory, the resource-based view, and institutional theory into a unified framework. While previous studies have often relied on a single theoretical perspective, this integrative approach offers a more comprehensive explanation of ESG adoption by capturing both internal and external drivers. In particular, the inclusion of strategic agility as a mediating mechanism enriches the RBV by highlighting the role of dynamic capabilities in translating governance resources into sustainability outcomes (Clauss et al., 2022).

Fourth, the study contributes to the emerging literature on strategic agility by linking it to ESG adoption. Although strategic agility has been widely studied in the context of innovation and competitive advantage, its role in sustainability practices remains underexplored. By positioning strategic agility as a key mediator, this study provides new insights into how firms can leverage their capabilities to achieve sustainability objectives, particularly in dynamic and uncertain environments.

Finally, the incorporation of institutional pressure as a moderating variable adds a contextual dimension to the governance–ESG relationship. This contribution is particularly relevant for emerging economies, where institutional environments are characterized by variability in regulatory enforcement and stakeholder engagement (Nguyen et al., 2023). By highlighting the contingent nature of governance effectiveness, the study provides a more nuanced understanding of ESG adoption across different contexts.

**Practical Implications**

The findings of this conceptual framework have important implications for policymakers, SME practitioners, and regulatory bodies.

For policymakers, the study highlights the need to strengthen institutional frameworks that promote ESG adoption among SMEs. This includes developing clear guidelines, providing financial and technical support, and enhancing regulatory enforcement. Given the moderating role of institutional pressure, policymakers in emerging economies should focus on creating an enabling environment that incentivizes SMEs to adopt sustainability practices, such as through tax incentives, capacity-building programs, and access to sustainable financing.

For SME owners and managers, the study underscores the strategic importance of governance diversity in driving ESG adoption. SMEs should consider diversifying their governance structures by incorporating individuals with varied expertise, backgrounds, and perspectives. Even in informal governance settings, introducing diversity in decision-making processes can enhance strategic thinking, improve stakeholder engagement, and facilitate the adoption of sustainability practices.

Furthermore, the role of strategic agility suggests that SMEs should invest in developing adaptive capabilities that enable them to respond effectively to changing environmental and market conditions. This may involve adopting flexible business models, leveraging digital technologies, and fostering a culture of innovation and learning. By enhancing strategic agility, SMEs can better integrate ESG considerations into their operations and remain competitive in increasingly sustainability-driven markets.

For regulatory bodies and industry associations, the study highlights the importance of promoting ESG awareness and providing practical tools for SMEs to implement sustainability practices. This includes developing simplified ESG reporting frameworks tailored to SMEs, offering training programs, and facilitating knowledge-sharing platforms. Such initiatives can help reduce the barriers to ESG adoption and encourage broader participation in sustainability efforts.

**Policy and Regional Implications (ASEAN Context)**

In the context of ASEAN and other emerging regions, this study provides valuable insights into how regional collaboration can enhance ESG adoption among SMEs. Given the diversity of institutional environments across ASEAN countries, there is a need for harmonized ESG frameworks that facilitate cross-border comparability and knowledge exchange. Regional organizations can play a key role in promoting best practices, standardizing reporting guidelines, and supporting capacity-building initiatives.

Moreover, the integration of SMEs into global value chains presents both challenges and opportunities for ESG adoption. While SMEs may face increased pressure to comply with international sustainability standards, they also have the opportunity to enhance their competitiveness and access new markets by adopting ESG practices. Policymakers and industry stakeholders should therefore focus on supporting SMEs in meeting these requirements through targeted interventions and collaborative initiatives.

**Directions for Future Research**

While this study provides a comprehensive conceptual framework, it also opens several avenues for future research. Empirical studies are needed to test the proposed relationships and validate the Governance Diversity Index (GDI) across different contexts and industries. Future research could also explore additional mediating and moderating variables, such as digital transformation, organizational culture, or leadership styles, to further refine the framework.

Additionally, comparative studies across different emerging economies could provide deeper insights into the role of institutional environments in shaping ESG adoption. Longitudinal studies may also be valuable in examining how governance diversity and strategic agility evolve and influence sustainability outcomes.

This study develops a comprehensive conceptual framework to explain ESG adoption in small and medium-sized enterprises (SMEs) by integrating governance diversity, strategic agility, and institutional pressure. Responding to the growing importance of sustainability in business practices, the paper addresses a significant gap in the literature by shifting the focus from large corporations to SMEs, particularly within the context of emerging economies where institutional environments and resource constraints shape organizational behavior.

By introducing the Governance Diversity Index (GDI) as a multidimensional construct, this study advances the understanding of corporate governance beyond traditional single-dimension measures. The framework highlights that governance diversity is not merely a structural attribute but a strategic resource that enhances decision-making quality, stakeholder responsiveness, and organizational adaptability. Through the lens of the resource-based view, governance diversity contributes to the development of strategic agility, which serves as a critical capability enabling SMEs to respond effectively to dynamic environmental conditions and integrate ESG practices into their operations.

Furthermore, this study emphasizes the importance of institutional pressure in shaping ESG adoption. Drawing on institutional theory, it demonstrates that the effectiveness of governance diversity and strategic agility is contingent upon the external environment, including regulatory frameworks, stakeholder expectations, and market forces. This contextual perspective is particularly relevant for SMEs in emerging economies, where variations in institutional strength significantly influence sustainability practices.

The proposed framework contributes to the literature in several ways. It provides a theoretically integrated model that combines stakeholder theory, the resource-based view, and institutional theory to explain ESG adoption in SMEs. It also introduces a novel construct—the Governance Diversity Index—that offers a more holistic approach to measuring governance structures. Additionally, by incorporating both mediating and moderating mechanisms, the study offers a nuanced understanding of the processes and conditions through which governance influences sustainability outcomes.

From a practical standpoint, the study offers valuable insights for policymakers, SME practitioners, and regulatory bodies. It underscores the need for policies that promote governance diversity and strengthen institutional frameworks to support ESG adoption. For SMEs, it highlights the importance of developing diverse governance structures and enhancing strategic agility to remain competitive in an increasingly sustainability-driven business environment.

Despite its contributions, this study is conceptual in nature and therefore requires empirical validation. Future research should test the proposed framework across different contexts and industries, refine the measurement of governance diversity, and explore additional factors that may influence ESG adoption. Such efforts will further enhance the understanding of sustainability practices in SMEs and support the development of more effective policies and strategies.

In conclusion, this study provides a foundation for advancing research on ESG adoption in SMEs by offering a comprehensive and integrative framework. As sustainability continues to shape the global business landscape, understanding the role of governance and organizational capabilities in driving ESG adoption will be essential for achieving long-term economic, social, and environmental goals.

**Authors Contribution**: Dr. Jaya Kumar Shanmugam conceived the study, developed the conceptual framework, conducted the literature review, synthesized the theoretical arguments, prepared the original manuscript draft, and managed the overall project. Prof. Dr. Corina Joseph contributed to the conceptual development of the study, refined the theoretical framework, critically reviewed the manuscript, and provided academic supervision throughout the study. Mr. Noor Asrafez Jailuddin contributed to the literature review, validated the conceptual arguments, and critically reviewed the manuscript. Dr. Marjan Mohd Noor contributed to validating the conceptual framework, improving the visualization of the proposed model, critically reviewing the manuscript, and providing academic supervision. All authors discussed the results, contributed to the revision of the manuscript, and approved the final version for submission.

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