Relationship Between Corporate Governanceand Financial Performance of Turkish Companies

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Abstract

We explore the relationship between firm value and corporate governance (CG) and also the relationship between profitability performance and corporate governance (CG) of Turkish companies. We employ corporate governance scores of 31 companies published by Corporate Governance Asssociation of Turkey as well as stock market data and financial statement data of the companies investigated. Regarding corporate governance and firm valuation, CG is not found to have a statistically significant relationship with Tobin's Q. Regarding Corporate governance and profitability, CG is not found to have a statistically significant relationship with ROE or ROA. The findings of the study do not support the hypothesis that better corporate governance is associated with higher firm values and better performance.

Keywords: Corporate Governance, Financial Performance, Turkish Companies

JEL code: G3

The purpose of this study is to investigate the relationship between firm value and corporate governance and also to explore the relationship between profitability performance and corporate governance in Turkey. To our knowledge, this paper is one of the first studies employing the Corporate Governance Scores of Turkish companies issued by the Corporate Governance Association of Turkey for this purpose.

1. Introduction

The concept of corporate governance has captivated the attention of Turkish social scientists and business units especially in the recent decade as Turkish capital markets grow and develop and companies adopt contemporary corporate governance practices. 31 of the companies listed on Istanbul Stock Exchange (ISE) have been evaluated by Corporate Governance Rating Agencies and assigned Corporate Governance Scores for at least one year for the period 2006-2010. The scores of these companies are announced by the Corporate Governance Association of Turkey.

In the broader sense, Corporate Governance (CG) is defined as the relationship between the corporation and all of its stakeholders. A number of procedures are utilized for managing this relationship including laws and regulations as well as voluntary private sector practices. The increasing popularity and spread of CG practices mainly stems from expected benefits of adopting the mentioned procedures at the micro and macro level.

Various benefits can be associated with sound Corporate Governance practices as mentioned in the Center for International Private Enterprise Reform Toolkit (Coprorate Governance for Emerging markets) for the society as well as companies and investors.

The benefits for the companies and investors include enhancing company performance, lowering the cost of capital, strengthening company reputation, mitigating risk and increasing the shareholder value. The benefits for the society include encouraging investment and sustainable growth, fighting corruption, promoting competition and efficiency, developing capital markets. (http://www.cipe.org/sites/default/files/publication-docs/CGToolkit0808.pdf

The development of the Corporate Governance concept in Turkey can be related to the reforms undertaken as a part of the harmonization process initiated by the membership negotiations with EU since 2005 as a candidate country. In this respect, especially the ongoing attempts for the convergence to international accounting and auditing standards enhance the understanding and acceptance of the inevitability of CG.

The Capital Market Board of Turkey (CMBT) issues principles and guidelines to augment the development of CG in Turkey. The principles emphasized by CMBT are fairness, transparency, accountability and responsibility.

The guidelines issued by CMBT are grouped in 4 sections: (Arsoy & Crowther, 2008)

1. Shareholders: Shareholders' rights and equal treatment
   - Right to obtain and evaluate information
   - Right to participate in the general shareholders' meeting
   - Right to vote
   - Right to obtain dividend
   - Minority rights
2. Public Disclosure and Transparency: Establishment of information policies in companies with respect to shareholders
3. Stakeholders: Regulation of the relationship between the company and stakeholders
4. Board of Directors: Functions, duties, obligations, operations and structure of the board of directors (remuneration, committees etc.)

Typically, most Turkish companies have some specific characteristics which are expected to have considerable influences in the process of adoption of CG procedures. The vast majority of the Turkish companies are family owned companies and have a paternalistic company culture. Traditionally, ownership and control are not separated and the owners are usually unwilling to delegate authority and responsibility between managers and subordinates as well as between father and son/daughter. The decisions of the owners tend to be dominated by instrumentality and short-termism. (Oba, Özsoy, & Atakan, 2010)

2. Literature Review

Various studies in developed and developing countries provide controversial findings with respect to the relationship between corporate governance and financial performance. Several studies support the relationship between corporate governance and financial performance (especially for emerging markets), while others do not. We summarize the main findings of some leading studies in this field as follows.

Country	Authors	Year

- USA   Gompers, Ishii, Metrick (GIT)   2003
  Firms with strong shareholder rights have higher firm value, profits , sales growth and lower capital expenditures (Gompers, Ishii, & Metrick, 2003)
- USA   Core,Guay,Rusticus   2006
  Results do not support that weak governance causes poor stock returns (Core, Guay, & Rusticus, 2006)
- Canada   Klein,Shapiro,Young   2005
  Shareholder rights, disclosure mechanisms valued by investors, no evidence for board composition and independence (Klein, Shapiro, & Young, 2005)
- Germany   Drobetz,Schillhofer, Zimmermann   2003
  Strong relationship found between CG and firm value (Drobetz, Schillhofer, & Zimmermann, 2004)
- England   Bauer, Günster, Otten (BGO)   2003
  Results do not provide evidence of a relationship between CG and performance (Bauer, Günster, & Otten, 2004)
- Emerging Markets   Klapper, Love   2004
  Better corporate governance is highly correlated with better operating performance and market valuation (Klapper & Love, 2004)
- Russia   Black   2001
  Strong correlation found between value ratio and governance rating (Black B. , 2001)
- Korea   Black, Jang, Kim   2006
  CG found to be important factor in explaining market value of companies (Black, Jang, & Kim, 2006)
- China   Bai, Lui, Lu, Son, Zhang   2003
  High concentration of non-controlling shareholding have positive effects on firm valuation (Bai, Liu, Lu, Song, & Zhang, 2004)
- Turkey   Gönenç, Aybar   2006
  Companies offreing stronger protection to minority shareholders experience smaller value losses during a financial crises (Gönenç & Aybar, 2006)
- Turkey   Büyükşalvarcı, Abdioğlu   2010
  No statistical difference is found on stock returns and financial ratios between the companies which are included in the CG index and the ones which are not. (Büyükşalvarcı & Abdioğlu, 2010)

3. *Data*

The dataset employed in this study consists of corporate governance scores of 31 companies published by Corporate Governance Asssociation of Turkey (in at least one of 2006, 2007, 2008, 2009/9 or 2010) and encompasses 75 observations. In order to compute the following variables we also utilize the financial statements of the companies in the dataset, which are obtained from the Public Disclosure Platform. (http://www.kap.gov.tr/yay/ek/index.aspx) Descriptive statistics of the dataset is presented in the Appendix.
We use the following variables:

- Closing stock prices of Istanbul Stock Exchange
  (http://www.imkb.gov.tr/Data/StocksData.aspx)
- Tobin's q(Q) :   [Market Value of Equity (Closing price*number of shares)]+Book Value of Liabilities)]/Book Value of Assets
- ROE: Net Profit/Equity
- ROA: Net Profit/Assets
- Book Value of Assets (BV):   Total Assets
- Book to Market(BM)   :   Total Assets/Market Value of Equity
- Sector Dummies (SD):   Financial/Non-financial

4. Methodology

Following the methology utilised by BGO, we build regression models to identify the relationship between corporate governance and firm valuation and the relationship between corporate governance and profitability. (We pool the data to utilise 75 observations) The following table displays the variables of the pooled regression models:

Model	Dependent Var.	Independent Var.	Independent Var.(Control)
1	Q	log of CG	log of BV, log of AGE, ROE, SD
2	ROE	log of CG	log of BM, SD
3	ROA	log of CG	log of BM, SD

5. Findings

Regarding corporate governance and firm valuation, CG is not found to have a statistically significant relationship with Tobin's q (Model 1). The model as a whole and all other independent variables are found to be statistically significant with respect to Corporate governance and profitability, CG is not found to have a statistically significant relationship with ROE or ROA (Model 2 and Model 3) . The models as a whole and only BooktoMarket in these models are found to be statistically significant The findings of the regression models are summarised in Table 1, Table 2 and Table 3 respectively.(* indicating variable to be statistically significant at 5% level of significance)

6. Conclusion

The findings of the study do not seem to support the hypothesis that better corporate governance is associated with higher firm values and better performance. A possible explanation for the poor relationship between corporate governance and profitability is that accounting figures are biased measures of company performance. Companies with better CG scores may be more inclined to report the earnings more conservatively than the others as a discretionary accounting procedure. As the accounting procedures of Turkish companies converge to international accounting and auditing standards, we will probably be able to observe more healthy comparability of financial performance and make a better evaluation in the near future. We think that in the long run, as the awareness and perception of the investors regarding the corporate governance rating scores improve, the relationship between corporate governance and firm valuation will become more evident in Turkey.

7. Limitations of the Study and Suggestions for Further Research

The data of this study comprises only observations of 31 companies for different periods (2006-2010). Faced with an unbalanced panel data (some companies have scores for only 1 year whereas some have for 2,3 or 4 years), we employed pooled regression models to utilise 75 observations. As the number of companies rated has been increasing since 2009, a balanced panel data set can be provided and panel data regression models could be employed in the coming years to recognize time series and cross-sectional properties of the dataset.

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Tables

Table 1. Model 1 (Tobin's Q)

Var.	Coefficient	Std. Error	t-Statistic	Prob.	
C	0.024605	1.717429	0.014327	0.9886	
LCG	1.271456	0.857952	1.481967	0.1429	
LBV	-0.063654	0.021936	-2.901813*	0.0050	
LAGE	-0.215505	0.070058	-3.076097*	0.0030	
ROE	0.983456	0.240930	4.081914*	0.0001	
SD	-0.247468	0.087405	-2.831297*	0.0061	
R-squared	0.366445		Mean dependent var		1.257888
Adjusted R-squared	0.320535		S.D. dependent var		0.392249
S.E. of regression	0.323329		Akaike info criterion		0.656328
Sum squared resid	7.213392		Schwarz criterion		0.841727
Log likelihood	-18.61231		Hannan-Quinn criter.		0.730356
F-statistic	7.981836		Durbin-Watson stat		1.641056
Prob(F-statistic)	0.000006				

Table 2. Model 2 (ROE)

Var.	Coefficient	Std. Error	t-Statistic	Prob.	
C	-0.635135	0.836536	-0.759244	0.4502	
LCG	0.361976	0.398665	0.907970	0.3670	
LBM	-0.070547	0.022114	-3.190090*	0.0021	
SD	0.066345	0.044639	1.486257	0.1416	
R-squared	0.135665		Mean dependent var		0.092123
Adjusted R-squared	0.099144		S.D. dependent var		0.169164
S.E. of regression	0.160559		Akaike info criterion		-0.768446
Sum squared resid	1.830334		Schwarz criterion		-0.644847
Log likelihood	32.81673		Hannan-Quinn criter.		-0.719094
F-statistic	3.714701		Durbin-Watson stat		1.508688
Prob(F-statistic)	0.015292				

Table 3. Model 3 (ROA)

Var.	Coefficient	Std. Error	t-Statistic	Prob.	
C	-0.004780	0.328049	-0.014572	0.9884	
LCG	0.028895	0.156337	0.184825	0.8539	
LBM	-0.032903	0.008672	-3.794032*	0.0003	
SD	0.000317	0.017505	0.018099	0.9856	
R-squared	0.180755		Mean dependent var		0.032647
Adjusted R-squared	0.146139		S.D. dependent var		0.068139
S.E. of regression	0.062964		Akaike info criterion		-2.640659
Sum squared resid	0.281474		Schwarz criterion		-2.517059
Log likelihood	103.0247		Hannan-Quinn criter.		-2.591307
F-statistic	5.221725		Durbin-Watson stat		1.203228
Prob(F-statistic)	0.002580				

Appendix

Descriptive Statistics

	AGE	BM	BV (TL)	NPM	ROA	ROE	CG
Mean	14.181	3.095	6,799,203	0.025	0.033	0.092	8.184
Median	13.389	1.626	3,570,642	0.055	0.030	0.122	8.200
Maximum	25.164	25.963	84,776,146	1.716	0.203	0.449	9.000
Minimum	2.825	0.475	15,043	-2.438	-0.176	-0.607	7.100
Std.Dev.	6.302	3.614	13,914,274	0.478	0.068	0.169	0.379
Skewness	-0.018	3.749	4.269	-2.033	-0.220	-1.306	-0.410
Kurtosis	2.008	22.718	21.435	14.900	3.886	6.987	3.543
Observations	75	75	75	75	75	75	75