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RESEARCH ARTICLE

THE EFFECT OF CORPORATE GOVERNANCE APPROACH IN FIRMS ON FINANCIAL PERFORMANCE LEVEL: AN APPLICATION ON BORSA ISTANBUL CORPORATE GOVERNANCE INDEX[1]

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ABSTRACT

The understanding of corporate governance is an effective management system in which the rights of all stakeholders of the firms are protected and managed with principles. Corporate governance has become a frequently discussed issue recently due to the failure in the management of firms and the financial crises experienced. Corporate governance can have an impact on the financial risks and portfolio of the firm, thus providing explanations to investors in making investment decisions. Therefore, it is considered important by both investors and companies. The aim of this study is to investigate the effect of corporate governance rating scores on fim performance which are qouted on Borsa İstanbul Corporate Governance Index. Within the scope of the study, 23 firms that were included in the BIST Corporate Governance Index in the 2011-2019 period and whose data were continuously accessed were analyzed. In this study we used multiple regression analysis and ROA (Return on Assets) was analyzed as the dependent variable, corporate governance rating scores were used as an independent variable. Firm size, leverage ratio and firm age are included in the analysis as control variables. According to the study; the variable of corporate governance score has no significant effect on ROA. But one of the control variables which is leverage has a negative and significant impact on ROA of the firms. According to this result it can be said that incerase in the level of financial leverage will lead to an decrease in firm performance

Key words: Corporate governance, financial performance, BIST, Corporate Governance Index

1. INTRODUCTION

In today's world, where global competition is accelerating, new concepts and understanding are introduced in the field of business management. In this process, the concepts of corporate governance and financial performance are among the topics that attract attention by both academics and practitioners. The prominence of the corporate governance approach is due to the key role it has assumed in there structuring, development and supervision of firms and financial markets. In this context, it is emphasized that a successful corporate governance practice reduces the capital cost of firms and increases their financing opportunities.

The Organization for Economic Cooperation and Development (OECD) defines corporate governance as "the management of a firm consists of the relationships between the board of directors, shareholders and other stakeholders" (OECD, 2004). Corporate governance essentially means an effective management system that is characterized by ethical values such as responsibility, accountability, fairness and transparency (Uyar, 2004; 154). Corporate governance is the process of leading and controlling firms. Corporate governance is a system that not only improves the relationship between the various parties (shareholders, directors and investors of the firm), but also allows proper provision of resources among competitors. At the same time, it provides ways to examine whether the firm goals and objectives as well as the achievement of performance (Al Ahrad et al., 2020: 2). The content of corporate governance consists of balancing the interests of those related to the firm, treating all shareholders equally and protecting the rights of other parties related to the firm other than the shareholders in achieving the efficiency and profitability targets of the firms (Khanchel, 2007: 741). However, firms' success in corporate governance practices enables them to gain competitive advantage in both national and international markets. For this reason, firms need to make regulations in their corporate governance understanding in order to gain competitive advantage in global markets. For a firm that has adopted corporate governance principles, it is emphasized that this change will provide a more successful financial management and a higher market value feedback (Ege et al., 2013: 101).Standard and Poors, an international rating agency, has developed a corporate governance evaluation

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criterion in order to reveal the corporate governance value of countries or firms. In this direction, ownership structure, financial stakeholder relations, financial transparency, board structure and processes are stated as evaluation criteria (Byrnesvd, 2003: 80).

Performance is important in terms of the firm's basic economic objectives such as ensuring sustainability, as well as adapting to changing environmental conditions and maintaining its existence (Detthamrong et al., 2017: 691). Shareholders and managers of firms need access to regular and reliable information regarding the financial and legal status of the firm. This will only be possible with a fair management, transparency, responsibility and accountability. Corporate governance can have an impact on the firm's financial risks and portfolio, thus providing explanations to investors in making investment decisions. Therefore, it is considered important by both investors and firms (Van den Bergheand Levrau, 2003: 45). Corporate governance is important in terms of the financial performance of the firm as it is a management approach that aims to maximize the value of the firm and add value to the firm.

Many studies have argued that corporate governance plays an important role in controlling the operations of the firm. Previous studies have found mixed findings on the relationship between firm performance and corporate governance practices (Zabri et al., 2016: 288). In this study, the effect of the corporate governance rating scores of the firms listed in the BIST (Borsa Istanbul) Corporate Governance Index (XKURY) on the firm performance will be examined.

2. LITERATURE REVIEW

Factors such as the development of international economic relations that emerged with the effect of globalization, the increase of international capital fluidity and thus the increase in the importance of the decisions made by the board of directors of the firm, have been effective in the emergence of the concept of corporate governance (Koçel, 2003: 54). There are two categories of corporate governance mechanisms. The first of these is the internal mechanism factors such as board size, board independence and board of directors, and the external mechanism consisting of competitive market conditions, managerial workforce and talent market, and corporate control market (Zabri et al., 2016: 288).

The focus of corporate management is to create an organizational culture that will enable the firm to work effectively and efficiently and to establish a structure that will facilitate meeting the needs of stakeholders (Pamukçu,2011:113). The logic of the relationship between corporate governance rating scores and the performance of firms causes an increase in efficiency in a firm with better corporate management due to monitoring management activities. In this way, managers begin to follow projects that maximize value and avoid expropriation of firms' resources such as consumption demands (Akbar et al., 2016: 4).

Numerous studies have been conducted on the effect of corporate governance on financial performance and different results have been achieved at the end of these studies. It can be said that the studies conducted so far have been conducted in different countries and evaluated in different cultures. When the relationship between firm performance and corporate governance was examined, different results were found, in some studies there was a negative relationship between performance and corporate governance (Bathala & Rao, 1995; Hutchinson, 2002; Esendemirli & Acar, 2016), while a positive relationship was found in some studies (Rosenstein & Wyatt, 1990; Lee et al, 1992; Brown & Caylor, 2004; Akbar et al., 2016; Esendemirli & Acar; 2016). In some studies, no relationship was found between performance and corporate governance (Park & Shin, 2003; Singh & Davidson, 2003; Young, 2003; Detthamrong et al, 2017).

2.1. Corporate Governance in Turkey

The corporate governance rating in Turkey is determined by the rating institutions incorporated by Capital Market Board. In this context, BIST corporate governance index (XKURY) calculation studies have started. BIST Corporate Governance Index in Turkey, the share of Borsa Istanbul markets traded and corporate governance rating scores of minimum 7 over 10 as a whole and minimum of 6.5 for each main section. It was created to measure the price and return performance of firms. The grade of compliance with the Corporate Governance Principles is given as a result of the evaluation made by the rating institutions in the rating institutions list determined by the CMB, regarding the compliance of the firm with all corporate governance principles (http://www.tkyd.org/). Corporate governance in Turkey in August 2007 as the Corporate Governance Index (XKURY) as the initial value of the index began to be calculated and expressed in 48.082,17. Although there is no history of a very old of corporate governance index in Turkey, the index is less than the date on which it calculates then as the global crisis that order, because for the first time in 2011 by the CMB regulated by a corporate governance principles communicated is crucial that date. For this reason, the data used in this study belong to the 2011-2019 period.

The main component of this study consist of the corporate governance which are indicated by corporate governace rating scores (independent variable), firm size, firm age and leverage (control variables) where as the firm performance was measured by using firm's Return on Assets (ROA) (dependent variable). The following are hypotheses developed to be tested in this study.

H_1:There is a relationship between corporate governance rating scores and firm's ROA.

H_2:There is a relationship between firm size and firm's ROA.

H_3:There is a relationship between firm age and firm's ROA.

H_4: There is a relationship between leverage and firm's ROA.

3. RESEARCH DESIGN AND METHODOLOGY

The aim of this study is to investigate the effect of corporate governance rating scores on firm performance which are qouted on Borsa İstanbul Corporate Governance Index (XKURY). Within the scope of the research, there are 52 firms that were included in the BIST Corporate Governance Index at any date and included in the index as of the end of 2019. (Banks and the other financial institutions have not been included the analyse, because their reporting system is different). In the study, 23 firms that were included in the BIST Corporate Governance Index and whose data were continuously accessed in the 2011-2019 period were analyzed. Financial data used in the analyse are derived from annual financial reports published on Borsa İstanbul and Public Disclosure Platform web sites and corporate governance rating scores are devired from Turkish Corporate Governance Association. Anaylsis is made by SPSS 23.

3.1. Research Method and Models

In this study we use multiple regression analysis to determine the effect of corporate governance on firm performance. Dependent variable is ROA (Return on Assets) which is computed as the ratio of net profit after taxes to total assets. We select ROA over other similar accounting performance indicator (ROE and ROIC). Many perivious studies using ROA (Cheng, 2008; Guest 2009; Zabri et al., 2016; Ciftci et al., 2019) as their performance measures. ROA measurment denoted the actual performance of firm and it contained firms profitability and efficency by stock holders (Zabri et al., 2016: 289). Independent variable is CG rating scores. We include a sets of firm-level control variables to control for firm spesicif characteristic. Firm size which is measured the logarithm of the total assets, leverage which is measured the ratio of total debt to total assets. Several scholars have used this variable as a measure of financial leverage. We also include firm age is added the natural logarithm of the number of years since the firm was established.

Table 1. The variables used in the study

Variable Code	Variable name	Variable description
Firm Performance (Dependent variable):		
ROA	Return on Assets	Net Profit After Taxes/ Total Assets
(Independent variable): CGRS	Corporate Governance Rating Scores	Rating scores of compliance to all corporate governance principles of the firm
Control Variables:		
Size	Firm size	The logarithm of total assets
LEV	Leverage	Total Debt/Total Assets
Age	Firm age	The natural logarithm of the number of years since establishment

We employ the following model;

$$ROA_{it}= \alpha+ \beta_1 CGRS_{it}+ \beta_2 LEV_{it}+\beta_3 Size_{it}+\beta_4 Age_{it}+\varepsilon_{it} \qquad (1)$$

Where ROA_{it} represents firm performance indicator, defined as the percentage of net income to total assets for firm i at time t. ROA represents a firms's operational performance for a spesific period. CGRS represents firms' corporate governance rating scores measured as all corporate governance principles of the firm at the year. LEV represents firms leverage, defined as the percentage of total debt to total assets, Size is calculated as the logarithm of total assets and Age represents firm's age, defined as the natural logarithm of the number of years since the firm was listed.

Table 2 shows the descriptive statistics of the variables used in this study for the final sample of 207 firm-year observations over the period 2011–2019. The mean (median) value of ROA is 0.06. The mean value of CGRS is 90,87 suggesting that firms in the study have good rating scores in XKURY. The mean value of leverage is 0.54, suggesting that firms in Turkey prefer debt to equity. The mean value of Size is 21,86, the mean value of Age is 37,86, suggesting that firms in the period of 2011-2019 are not young firms.

Table 2. Descriptive Statistics

Variables	Maximum	Minimum	Mean	Std. Dev.
ROA	0,9953	-0,1006	0,0633	0,0899
CGRS	96,67	77,05	90,8783	4,0094
LEV	0,8970	0,0800	0,5497	0,2002
Size	24,7398	17,7222	21,8660	1,5657
Age	4,1743	2,4849	3,5656	0,3860

Table 3 shows correlation coefficients of key variables for the final sample of 207 observations. When looking at correlation coefficients between CGRS and firmperformance variable (ROA), we find that there is no statistically significant relationship between them. The coefficients on the ROA and Leverage remain negative and statistically significant. This finding suggests that when firms use more debt, their profitability rate decrease. There is a positive relationship between size and CGRS. Also we find a positive and statistically significant relationship between LEV and Size. This means, large firms use more debt. The coefficients on the CGRS and Age remain positive and significant. This means, older firms tend to have a better organizational process, structure and activities (Detthamrong et al., 2017: 698).

Table 3. Correlation Matrix

Variables	CGRS	ROA	Size	LEV	Age
CGRS	1				
ROA	-0,018	1			
Size	0,253**	-0,063	1		
LEV	0,055	-0,292**	,297**	1	
Age	0,140*	-0,037	,102	,002	1

Note: * and** representstatisticalsignificance at the %5 and %1 levels

3.3. Empirical Results

Regression model is a useful tool that tells us whether the independent variable has a significant impact on the dependent variable or not. To test the impact of corporate governance rating scores on firm performance we estimate Equations (1). Table 4 shows findings from the estimation of the regression using ROA .

Table 4. The Result of RegressionAnaylsis

Model 1 (RAO)

Variable	Coefficient	Std. Error	t-Statistic	Sig.
CGRS	-0,004	0,002	-0,059	0,953
Size	0,031	0,004	0,428	0,669
LEV	-0,300	0,032	-4,266	0,000
Age	-0,039	0,016	-0,566	0,572
R	0,295			
R^2= 0,087; Adjusted R^2 =0,069				

Table 4 presents the results of the regression analysis for model ROA. The variable of corporate governance score has no significant effect on ROA. Thus, H_1 is rejected. This result is supported by Kara et al. 2015; Yeğen, 2016. The result is consistent with the statistically insignificant correlation relationship determined between the grade of compliance with corporate governance principles and the rate of return on assets. We find no significant effect on ROA and the control variables named firm size and firm age, thus H_2 and H_3 are rejected. But one of the control variables found to be statistically significant in the firm performance. Leverage has a negative and significant impact on ROA of the firms thus H_4 is accepted.This findings is consisted with Chen et al., 2005; Campbell and Minguez-Vera, 2008; Ciftci et al., 2019. According to this result it can be said that incerase in the level of financial leverage will lead to an decrease in firm performance and increase the risk of bankruptcy. These results can show to suggest that corporate governance attributes do not support to better firm performance.

4. CONCLUSION AND RECOMMENDATIONS

In this study, the impact of the corporate governance on firm performance has been investigated. The data set involves 23 firms covering a period of nine years from 2011 to 2019. The firms listed in BİST Corporate Governance Index (XKURY) and data has been analyzed with analysis.

Results show that, there is no a statistically meaningful relationship between corporate governance rating scores and ROA. This result can be explained by there might be no direct relationship between financial performance indicators and corporate governance activities of firms. Another reason is that the grades in the corporate governance index in Turkey are determined by different rating agencies. This means it can be shown as the absence of a common and single criterion (Ege et al., 2013: 115). Establishing a standard criterion by the relevant organizations in determining the corporate governance rating may help to obtain more meaningful results. The other variables named firm size and firm age appear to be insignificant conditioners of firm perormance. On the other hand, it is found that leverage directly influenced firm performance. According to this results, firms have a preference to finance their investment internally rather than using debt due to the higher risk of default and bankruptcy.

This study was limited Corporate Governance Index (XKURY) public listed firms from 2011-2019. Among the samples, there are 23 firms can be used as do not have full set of information to analyze. In order to this the samples not to suitably represents the whole population. There is only one indicato rused for corporate governance measuremet and firms' ROA. ROA is an accounting performance measuremet. Different results will be obtained by using different indicators. Forexample; Tobin's Q is the market performance indicator using firm performance measurement. Also this study can be improved by analyzing a longer time period or new data set involving different sectors.

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