

## VALUE RELEVANCE OF CORPORATE GOVERNANCE TO STOCK INVESTORS: EMPIRICAL EVIDENCE FROM AN EMERGING MARKET

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### Abstract

*The aim of this study is to investigate the benefits provided by corporate governance to stock investors. For this purpose, companies which are included in the corporate governance and the dividend return indices have been examined. The data include BIST Corporate Governance Return, All Return and Dividend Return indices. Empirical analysis has been performed through OLS regression along with Beta calculations. The results of the study have shown that corporate governance has a positive impact on risk management and internal control constituents of companies. Corporate Governance Return index and All Return index decrease in parallel to each other when indices fall down (beta down). However, the decrease in the former index is less than the decrease in the latter one. Therefore, we argue that encouraging conformity to principles of corporate governance will generate benefit to shareholders and companies at micro level while also providing a more transparent investment environment and advancing the capital market.*

**Keywords:** Corporate Governance, Risk Management, BIST Corporate Governance Return Index, BIST Dividend Return Index

## KURUMSAL YÖNETİMİN HİSSE YATIRIMCISINA YARATTIĞI DEĞER: GELİŞMEKTE OLAN PİYASADA BİR AMPİRİK ÇALIŞMA

### Öz

*Bu çalışmanın amacı, kurumsal yönetimin hisse senedi yatırımcısına faydalarını araştırmaktır. Bu sebeple, Kurumsal Yönetim ve Temettü Getiri Endeksine dâhil olan şirketler incelenmiştir. BIST Kurumsal Yönetim Getiri Endeksi, Tüm Getiri Endeksi ve Temettü Endeksi verileri kullanılmıştır. Ampirik analizde regresyon analizi kullanılarak Beta hesaplaması yapılmıştır. Çalışma, kurumsal yönetimin risk yönetimi ve iç kontrol sistemleri üzerinde pozitif etkisi olduğu sonucunu ortaya koymuştur. Kurumsal Yönetim Getiri Endeksi ve Tüm Getiri Endeksi piyasa düştüğünde birbirine paralel düştüğü görülmüştür. Ancak, Kurumsal Yönetim Getiri Endeksindeki düşme daha az gerçekleşmiştir. Sonuç olarak, kurumsal yönetim ilkelerine uyum sağlama mikro seviyede hissedarlara ve şirketlere fayda sağlarken, daha şeffaf yatırım ortamı yaratarak makro seviyede sermaye piyasalarını geliştirmektedir.*

**Anahtar Kelimeler:** Kurumsal Yönetim, Risk Yönetimi, BIST Kurumsal Yönetim Getiri Endeksi, BIST Temettü Getiri Endeksi

### Introduction

Corporate governance focuses on the relation of stakeholders who are determining the performance and direction of the company. The stakeholders may be defined as shareholders, managers, members of board of directors, personnel, customers, suppliers,

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creditors, government etc. The main purpose is to establish such a governance system which would prevent the stakeholders –who are enabling the continuity of the company– from having any conflict of interest. By this means, globalization could happen to be assured by high-performing companies which are long-lived and have attained sustainable growth. Thanks to corporate governance, transition from an approach looking after the interest of shareholder to an approach looking after the interest of stakeholder is becoming easier.

The behaviors of household, government, and companies, which take all part in the literature as economic units are determining the economy of a country at macro level. At micro level, structuring of a company –which is an economic unit– within the frame of corporate governance will provide long-term growth performance for both the company and the country. In this context, corporate governance is the most significant element of developing micro economic efficiency at company level. Moreover, corporate governance is extremely effective in the development of capital market and in fulfillment of its function.

Corporate governance systems are theoretically being gathered under two main headings. These are *concentrated ownership* and *dispersed ownership* systems. These two systems are providing different benefits and opportunities to the stock investor. The system dominating in Turkey is concentrated ownership. In this context, the main purpose of this study is to empirically show the benefits of corporate governance systems adopted in Turkey for the stock investors. For this reason, corporate governance systems have been primarily discussed in theoretical aspect while their positive/negative aspects have been specified in the study. Through literature review, whether there are any prior studies made on this issue has been explored. It has been observed there that there are significant studies regarding the benefits of corporate governance for the stock investors. However, literature is silent in that there is not a prior study that employs dividend Return Index, corporate governance Return Index and the (aggregate or composite) Return Index formed by all the companies traded in a stock exchange market (i.e. Borsa Istanbul or BIST). This is an early examination doing so, therefore making an original contribution to the literature.

Investors who tend to request less yield when the risk happens to be low also tend to request less yield from the companies with corporate governance. Within this frame, the yield that the investors would expect to obtain out of a stock investment depend on the level of company's market risk factor which is beta coefficient. Given this, in this paper, the interaction among dividend Return Index, corporate governance index, and the index formed by all the companies traded in Borsa Istanbul has been examined while the benefits that companies which have adopted corporate governance may provide for the investors have been shown. It has been also shown that meticulous implementation of the principles of corporate governance will decrease companies' market risk factor. The next section explores the body of the relevant literature while presenting a theoretical approach.

## **1. THEORETICAL APPROACH AND RELEVANT LITERATURE**

### **1.1. Theoretical Approach**

Corporate governance systems are being subjected to distinction as per the control, and the identity of the shareholder having the control. The concentration of majority of shares and control in one individual is being defined as concentrated ownership system. If numerous shareholders have small shares, it is being defined as dispersed ownership

system instead. The corporate governance system dominating in the US and the UK is the dispersed ownership one. The benefits provided by this system are to make the shares more liquid, to enable facilitation of the development of stock exchange, to decrease the cost of capital, and to give the chance of diversifying the risk by providing more opportunities to the investors. Dispersed ownership also has negative aspects. In this context, given the model of owner (shareholder) of company and legal agent (principle-agent rhetoric), shareholders and the ones holding the corporate management control being different individuals may decrease the corporate performance. This is because it causes managers to become stronger while causing shareholders to lose strength instead. Within this frame, adoption of effective corporate governance principles contributes to the corporate performance by restricting the initiative of the management. In this system, all the reforms intend to improve the weakness of supervision, increase the accountability of management, and have the benefits of the management and shareholder meet somewhere in the middle.

The system dominating in the Continental Europe and Turkey is rather concentrated ownership versus that of the US and the UK. The most significant positive aspect of this system is that shareholders possess the control. This is what is to allow the company's management to make decisions in the direction of the desires and the preferences of the shareholders. The concentrated ownership, dominating in Continental Europe and Turkey, also has negative aspects. The literature there is generally supporting the thesis that there are conflicts of interest in between dominating major shareholders and other shareholders. Accordingly; strong majority shareholders, weak managers and minority shareholders happen to arise. The structure of share ownership as well as the rights pursuant to the protection of investor are some possible determinants of this conflict.

The main problem in terms of corporate governance is to determine how to design the company law and rules of management in order to increase the benefits that major shareholders would obtain as the effective supervisor (ombudsman) of management (by ensuring a public benefit). It is also about encouraging small and minority shareholders to invest in a company's shares by preventing the one –controlling the entity- from obtaining any excessive private benefits at all. The next subsection surveys the relevant literature.

## 1.2. Prior Literature

As mentioned in the preceding subsection, the prior literature generally contends that there are conflicts of interest between dominating major shareholders and other shareholders. The share ownership structure as well as the rights pursuant to the protection of investors are some possible determinants of the arising conflict (e.g. Porta, Lopez, Shleifer and Vishny, 1997).

The concentration of majority of shares and control in one individual alone or in a few individuals only may be given as *concentrated ownership system*, or else as *insider system*. The presence of major shareholders improves the supervision of management and increases the corporate performance. Nevertheless, the controlling major shareholders may abuse the company for their own private interests. This private interest may harm the minority shareholder as well as other stakeholders, which would be to prevent the small investor from investing capital while causing the formation of

stock exchange in a way to lack of depth and damaging risk diversification (Kugler, 2001).

Yurtoğlu (2000) analyzed the Turkish corporate governance system. He had depicted the corporate governance in Turkey as an “insider system” which is to cover the wealthiest families of the country. Share ownership has highly been concentrated, and it is being carried out through pyramid structures, cross-share ownership and differentiated voting rights. Hostile take-overs are insignificant as measures creating discipline. There is no sufficiently deep stock exchange for the market to control the companies. Internal control systems such as the supervision of major shareholders are the leading means of control. Insufficient protection of small shareholders makes the conflict between small and major shareholders a significant problem in Turkey. Low dividends, low profitability and low market-book value rates of companies at lower levels of the pyramid provide evidence on management’s act of generating benefit and securing itself. Its three main characteristics are as follows:

- 1- Number of public companies is low. Market capitalization / GNP is around 12%.
- 2- Companies have concentrated partnership structure. The families control 75% of the company either directly or indirectly.
- 3- There is no active / deep capital market.

The benefits of concentrated ownership are direct supervision and profitability.

The concentration of share certificates in one body alone mitigates the legal representative problems existing between shareholders (principal) and managers (agent). As the concentration of share ownership (and voting power) increases, the willingness of shareholders to monitor the management increases to that extent. Concentrated vote blocks are the front means of controlling the managers in the majority of countries of Continental Europe such as Austria, France, Germany, Italy, Belgium, Netherlands and Spain. In these countries, the biggest major shareholder is holding about 30 to 55% of the voting power (this rate is 44.7% in Turkey). And in the UK and especially in the US, the concentration of share ownership / voting power is much lower, where equity capital shares of the biggest major shareholders on average may even fall short of 20%. A more common dispersed structure of share ownership in the US compared to majority of other countries might be accounted for by politics deterring large share ownership (Yurtoğlu, 2001).

The possibility of conflict of interest arising due to concentration of high share ownership in the countries of Continental Europe is the highest between majority (or even super majority) shareholders and minority shareholders. Managerialism hypothesis alleges that managers of the companies that may be under the control of a manager to engage in behaviors maximizing the profit is less probable than do the managers of the companies that are under the control of owners of the companies instead.

Despite examinations relevant to the linkage between share ownership / ownership structure and corporate performance had been performed before 1960 (e.g. Berle and Means, 1932), it has intensely been subject to academic research since 1960s and 1970s. Although results are generally ambiguous, majority of the studies indicates the role control of company owners may play in increasing corporate profit (e.g. Short, 1994). Among the earlier investigations that show that companies being controlled by

owners tend to show better performance than the companies being controlled by managers are Monsen, Chio and Cooley (1968); Radice (1971) or Boudreaux (1973).

One of the major negative aspects of concentrated ownership is that major shareholder may take advantage of small shareholders. In the previous section, we have seen that the supervision of management by major shareholders may improve corporate performance. However, the owners of large blocks may also give a rise to negative effects due to their increasing influences over the company.

The benefits of having major shareholders are rather relevant to matching of cash flow and control interests, and to direct supervision. Major shareholders have the power of withdrawing their money. The cost covered by the investors is to get rent (surplus) and management's act of securing itself as well as diversification of risk and decrease in the level of liquidity. Morck, Shleifer and Vishny (1988) define management's act of securing itself as "a manager controlling a significant part of a company's equity capital may have voting power or influence sufficient to guarantee his employment within the company with a good salary".

It is hard to figure out the degree to which the major shareholder or the ones holding the control may benefit from small shareholders, or how many small shareholders. If it is the case that the controlling partner might be taking advantage of the small partner, then the market is required to embed the "control" into the price of share. In such a case, prices of shares which distribute equal profit but have different voting rights should be different. One of the means of measuring potential leverage is to compare the yields or returns of common shares with preferred shares. Should the shares having superior voting power be traded with a higher premium, any private benefits to emanate from control may be coming at the expense of the minority shareholders. Zingales (1994) contended large voting premium in Italy which may imply establishment of high private benefits from control.

In the examinations made as for the territories of the US and the UK, it was shown that in the companies with low share ownership concentration corporate performance tends to increase as the concentration increases, but also that performance tends to get lower as the concentration level continues to level up (e.g. Mc Connel and Servaes, 1990).

Shleifer and Vishny (1997) specified that corporate governance mechanisms cover many rules, structures and procedures through which investors get able to secure themselves for the sake of obtaining a reasonable yield. Because it will not be possible for the managers to use the resources as incorrect due to corporate governance.

Porta, Lopez, Shleifer and Vishny (2000) as well as Hart (1995) argued that the interests of the investors will be protected and the problems among shareholders will diminish along with the correct implementation of principles of corporate governance. Provided that it is conformed to the standards of corporate governance, we can assume that the risk of the investors will go down. In the event of mandatory conformity to the principles of corporate governance, the cited problems will be lessened more so will the risk of the investors (Hart, 1995).

Studies show that when there happens share concentration, major shareholder obtains some gains at the expense of the small shareholders. The major shareholder takes advantage of the small shareholders in the form of not distributing any profit (dividend) through using its control power. The conflict of interest over here is in between the major shareholder(s) and small shareholders. If an individual's / company's

shares happen to be more than 50%, it is given as a company dominated by “major shareholder”. If an individual’s / company’s shares are rather less than 50% in a company, it would be given as a company dominated by “small shareholder” instead. Profit distribution rates were calculated by using the Lintner model. The intended profit distribution rate is lower in the companies with one major shareholder ( $>50$ ) ( $t = 0.10$ ) as opposed to the ones not having one major shareholder ( $t = 0.16$ ). Again, in the companies not having one major shareholder, the partial adjustment factor rate is found to be 0.48, and it is higher than the companies with one major shareholder (where the rate comes down to 0.31). In other words, as the partnership structure becomes concentrated, profit distribution rate and partial adjustment factor rate tend to level down both. In the companies that do not have one shareholder larger than 50%, minority shareholders would push for higher and rapid profit distribution (Öcal, 2005).

Chong and Silanes (2007) shown that there is a positive correlation between the principles of corporate governance and corporate values in the case of mandatory implementation of the principles of corporate governance.

The main point is how the corporate law and rules of management should be designed for enhancing the benefits to be obtained by the major shareholders -as the effective supervisor of management (by ensuring public benefit)- in a way to encourage the small and minority shareholders to invest in company shares by preventing the major shareholders from entering in and the controlling ones from obtaining any excessive private benefits. For instance, despite the fact that the shares not yielding any voting right is a low-cost means of both remaining in control and collecting external equity capital, it is a method to inducing the shareholder to be taken advantage of (abused). For this reason, the best possible policy is to allow the issuance (as limited) of shares not yielding any voting right while also providing effective legal means and authorities to minority shareholders for them to indemnify their rights in a fair manner in case one’s taking advantage of a small shareholders arises. As a legal right for indemnity, minority shareholders may be allowed to file collective lawsuits as in the US. Besides, distribution of dividend may be mandatory.

Corporate governance principles of OECD suggest the understanding and managing of risks in the company. The board of directors there is responsible for setting up the infrastructure of the corporate management and its supervision (OECD, 2010)

Shank, Hill and Stang (2013) examined whether good governance leads to positive firm results, through considering firm size. Their findings showed that the relationship between good corporate governance practices and financial achievement of a company happens to be the strongest for smaller firms compared to mid- and large-sized firms.

Koerniadi, Krishnamurti and Tourani-Rad (2014) analyzed the impact of corporate governance executions on the riskiness of firms’ stock returns by building an index of governance best practices. They empirically showed that firms that have good governance practices encounter lower levels of risks. Corporate governance parameters or constituents such as board composition, shareholder rights, and disclosure practices are found to be associated with lower levels of risk. Well-governed firms experience lower variations (volatility) in stock returns compared to poorly governed firms.

Maranho and Leal (2018) examined the relationship between the role played by corporate governance mechanisms and shareholder wealth for the setting of Latin

American firms. The test results showed that corporate governance implementation has positive relationship with better corporate achievement. The evidence also suggests that results are moderated by the characteristics of boards of directors, ownership, control structure and various simultaneous governance mechanisms, through broad indices and special corporate governance trading segments.

Arrora and Bodhanwala (2018) explored the linkage between corporate governance index that was constructed using governance framework variables and firm performance in India. The study found significant positive relationship between corporate governance index and firm performance indicators. Investors were shown to also appreciate about firms maintaining high governance standards, thus reducing possible funding costs.

Wamba, Braune and Hikkerova (2018) examined the effect of corporate governance mechanism on the volatility of firms' profitability in Europe. The empirical results indicated that the synthetic index of governance that the authors have constructed is only significant at the 10% threshold (90% confidence). Management's commitment to shareholders and the effectiveness of the board of directors in carrying out its supervisory tasks are also shown to reduce, but again to a limited extent, the risk borne by the company.

Saha, Moutushi and Salauddin (2018) investigated the connection between corporate governance and firm performance, through considering the role board of directors and audit committee play. The results of the investigation signify that board independence ratio and audit committee are statistically significant and have positive impact on ROA (return on assets) and TQ (Tobin's Q). However, it was not found to be statistically significant in the case of firm performance indicator being ROE (return on equity) in this examination. In addition, board size was not found to be statistically significant either and found to have negative correlation with firm performance instead.

They have attributed the reason for this to group dynamics, communication gaps and indecisiveness of larger groups. The next section presents data and methodology.

## **2. DATA AND METHODOLOGY**

In this empirical paper, the yield indices of Borsa Istanbul (BIST) have been used. Yield indices are the ones that consider the dividend paid in the calculation of the index, and in ensuring the continuity in which a correction is made given the assumption that the dividend paid is being deposited at the rate of the weights of shares included in the index. In these types of indices, earnings obtained owing to dividend as well as the average change in the prices of shares are also relayed to the index. The indices employed to run our empirical model are BIST All Return Index, BIST Corporate Governance Return Index, and BIST Dividend Return Index.

The following formula is used in the calculation of indices:

$$E_t = \frac{\sum_{i=1}^n F_{it} * N_{it} * H_{it} * K_{it}}{\quad}$$

$B_t$

- $E_t$  = Value of the index at time t
- $n$  = Number of constituent stocks
- $F_{it}$  = Price of the stock "i" at time t
- $N_{it}$  = Total number of shares of stock "i" at time t
- $H_{it}$  = Free float ratio used in index calculation of the stock "i" at time t
- $K_{it}$  = Weighting factor of the stock "i" at time t
- $D_t$  = Foreign exchange rate on day t
- $B_t$  = Divisor of the index at time t

where latest price data are used and BIST Indices are obtained as free float market capitalization weighted ([www.borsaistanbul.com](http://www.borsaistanbul.com)).

BIST All Yield is the index indicating the yields of all the shares being traded at the stock exchange, except for Investment Trusts. BIST Corporate Governance Yield is the index indicating the yields of shares included in the corporate governance index with the minimum required corporate governance-rating grade. BIST Dividend Yield is the index showing the yields of shares given in the dividend index including those of the real estate investment trusts and venture capital investment trusts traded on the Collective and Structured Products Market ([www.borsaistanbul.com](http://www.borsaistanbul.com)).

All the data used in this examination has been obtained from Borsa Istanbul's official website ([www.borsaistanbul.com](http://www.borsaistanbul.com)). The data pertaining to BIST All Return Index and BIST Corporate Governance Return Index on the last trading day of the month for the sampling period of April 30, 2008 through June 30, 2017, and the data as per BIST Dividend Return Index on the last trading day of the month in the period from November 30, 2011 through June 30, 2017 had been used in the sampling.

First, we want to test how/if the BIST Corporate Governance Return Index that is comprised of companies having corporate governance rating scores may fluctuate compared to BIST All Return Index which is formed by all the shares registered/traded at Borsa Istanbul. In addition, we are also to test how/if the BIST Corporate Governance Return Index may fluctuate when the BIST All Return Index may go up or down.

Second, we want to test how/if the BIST Dividend Return Index that covers the companies regularly distributing dividends may fluctuate compared to BIST All Return Index. In addition, we are also to test how/if the BIST Dividend Return Index may fluctuate when the BIST All Return Index may level up or down.

Third, we want to test how/if the BIST Dividend Return Index that entails the companies regularly distributing dividends may fluctuate compared to BIST Corporate Governance Return Index. In order to attain our purposes, Beta calculation will be made by using regression analysis. Beta will be used in order to document how the other index may become affected when the benchmark index changes. Beta is obtained by dividing the covariance of two indices to the variance of benchmark index. The coefficient of X variable of regression curve is equal to beta. Therefore, our model is

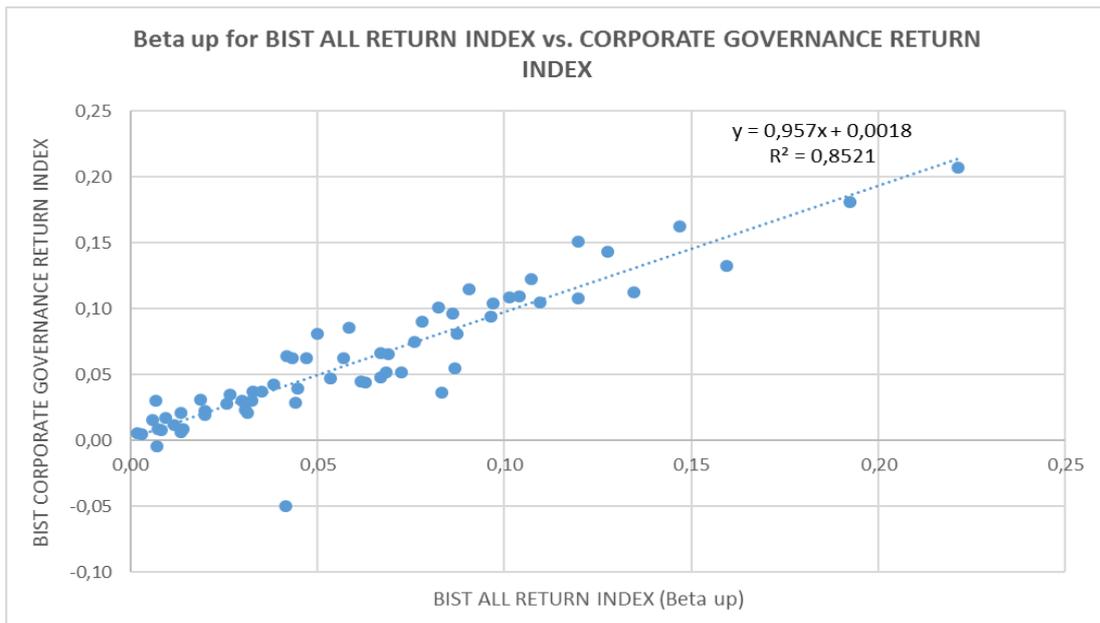
specified as the following:  $Y_n = \beta_0 + \sum_{i=1}^l \beta_i X_{ni} + \varepsilon_n$  where the terms have obvious meaning.

The next section presents the empirical results.

### 3. EMPIRICAL RESULTS

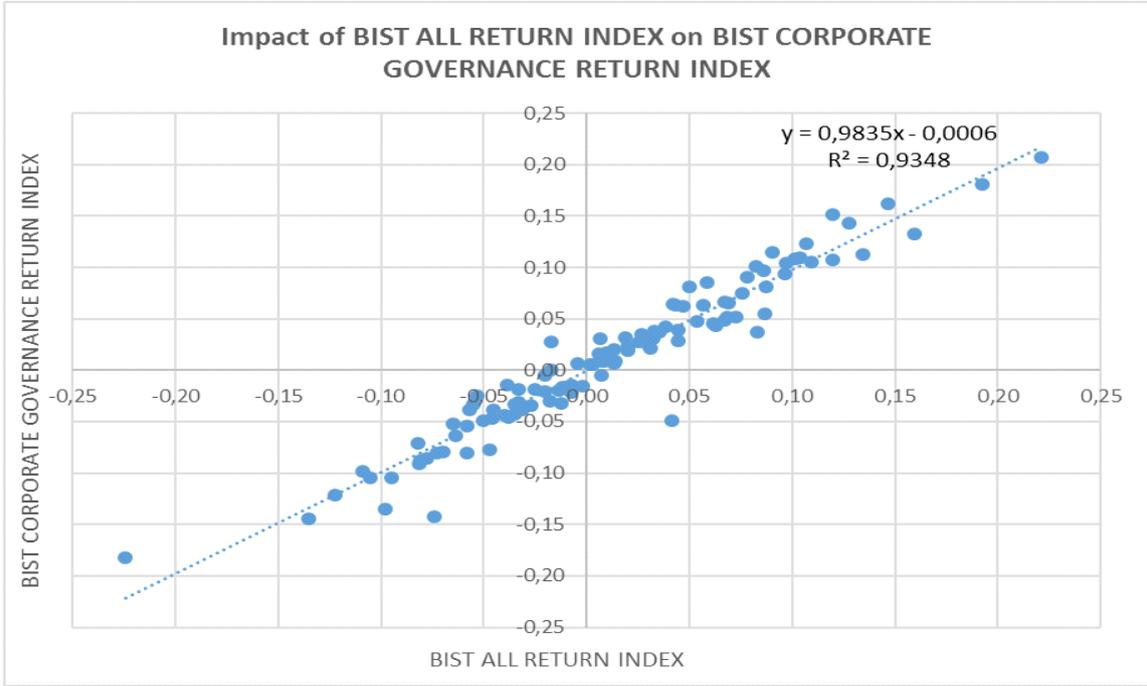
As observed in Figure 1 below, BIST Corporate Governance Return Index that consists of companies having corporate governance ratings fluctuates less compared to BIST All Return Index formed by all the shares registered at Borsa Istanbul. This implies that while BIST Corporate Governance Return Index shows lower performance compared to BIST All Return Index when the market is bull while showing better performance when the market is bear. In particular, it is seen that when the BIST All Return Index descends by 1%, the BIST Corporate Governance Return Index also descends by 0.9835%. Under negative market conditions, companies included in BIST Corporate Governance Return Index provide relative protection for the investors of shares. It is seen that the  $R^2$  value, obtained as a result of the regression analysis, is 0.9348. This suggests that independent variables account for the changes in the level of the dependent variable as much as 93.48%.

Figure 1.



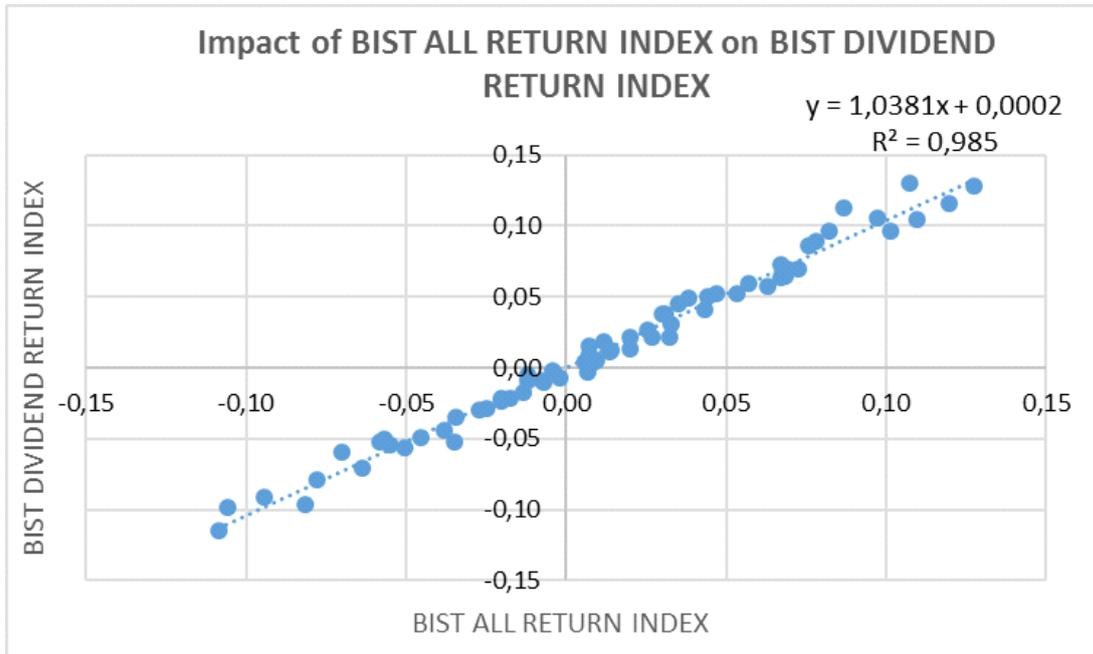
As seen in Figure 2 below, when the BIST All Return Index goes up by 1%, BIST Corporate Governance Return Index generates 4.3% lower yield than that yield. It is documented that the  $R^2$  value, obtained as a result of the regression analysis, is 0.8521. This suggests that independent variables explain the changes in the level of the dependent variable as much as 85.21%.

**Figure 2.**



As shown in Figure 3, when the BIST All Return Index goes down by 1%, BIST Corporate Governance Return Index generates 4.27% higher yield (less loss) than that yield. It is documented that the  $R^2$  value, obtained as a result of the regression analysis, is 0.8152. This suggests that independent variables account for the changes in the level of the dependent variable as much as 81.52%.

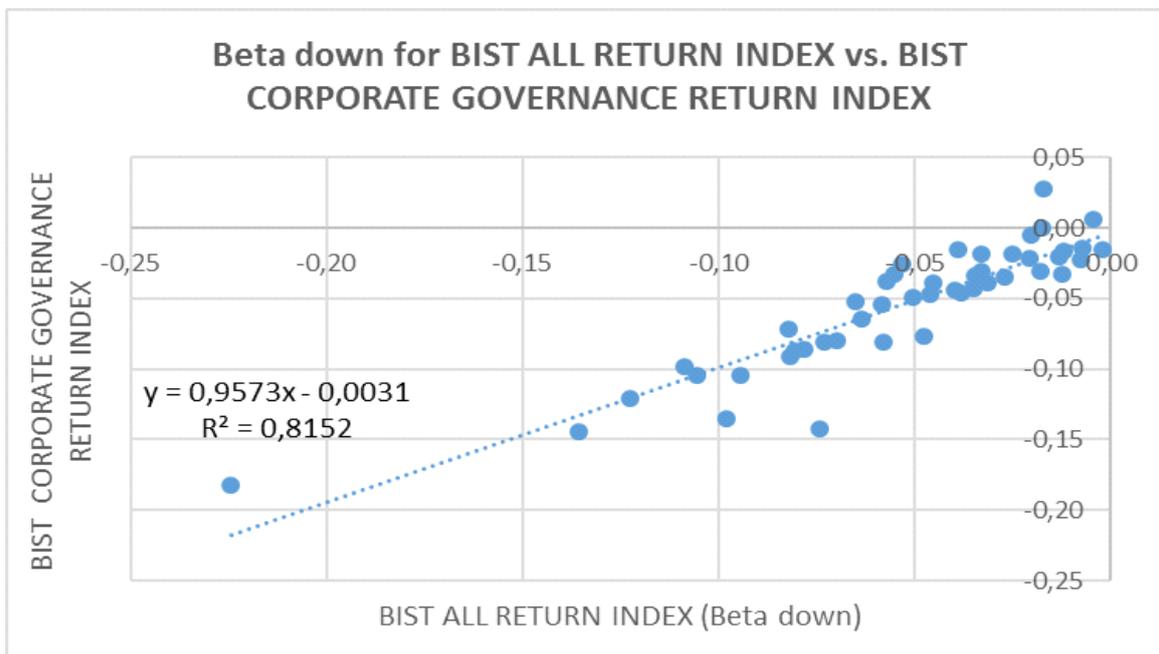
Figure 3.



We argue that attribution of more importance to risk management and internal control by the companies included in the Corporate Governance Return Index may cause them to show better performance compared to BIST All Return Index when the stock exchange underperforms. In addition, it may provide a relief in the level of company's risk by minimizing the problems of conflicts of interest among the shareholders.

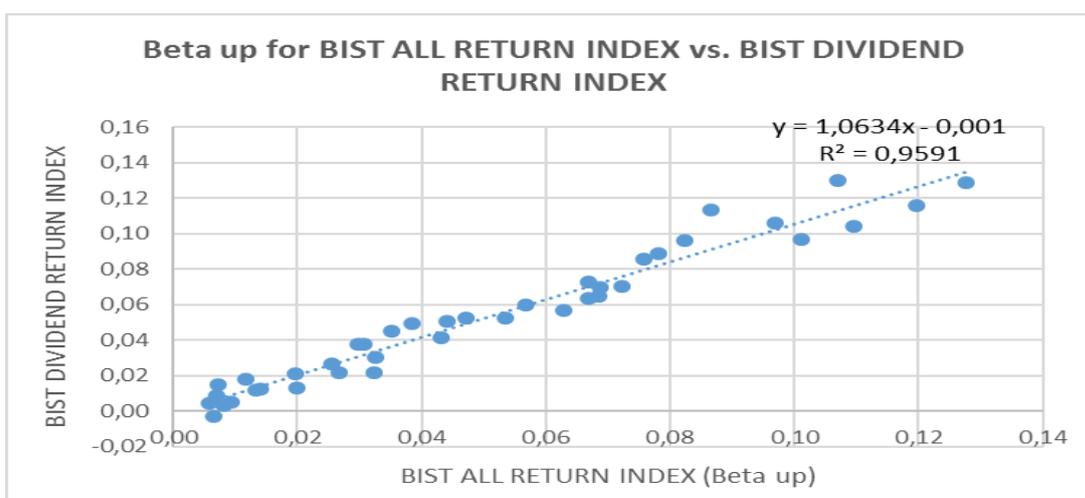
As given in Figure 4, it is shown that in case BIST All Return Index levels up by 1%, BIST Dividend Return Index that entails the companies regularly distributing dividends also levels up 3.8% more than that yield. It is there documented that the  $R^2$  value, obtained as a result of the regression analysis, is 0.985. This suggests that independent variables explain the changes in the level of the dependent variable as much as 98.5%.

**Figure 4.**



As shown in Figure 5, when the BIST All Return Index increases by 1%, BIST Dividend Return Index generates 6.34% more increase than that yield. In other words, in upward movements of stock exchange, the companies that are included in the BIST Dividend Return Index offer 6.34% more income. It is there documented that the R<sup>2</sup> value, obtained as a result of the regression analysis, is 0.9591. This suggests that independent variables explain the changes in the level of the dependent variable as much as 95.91%

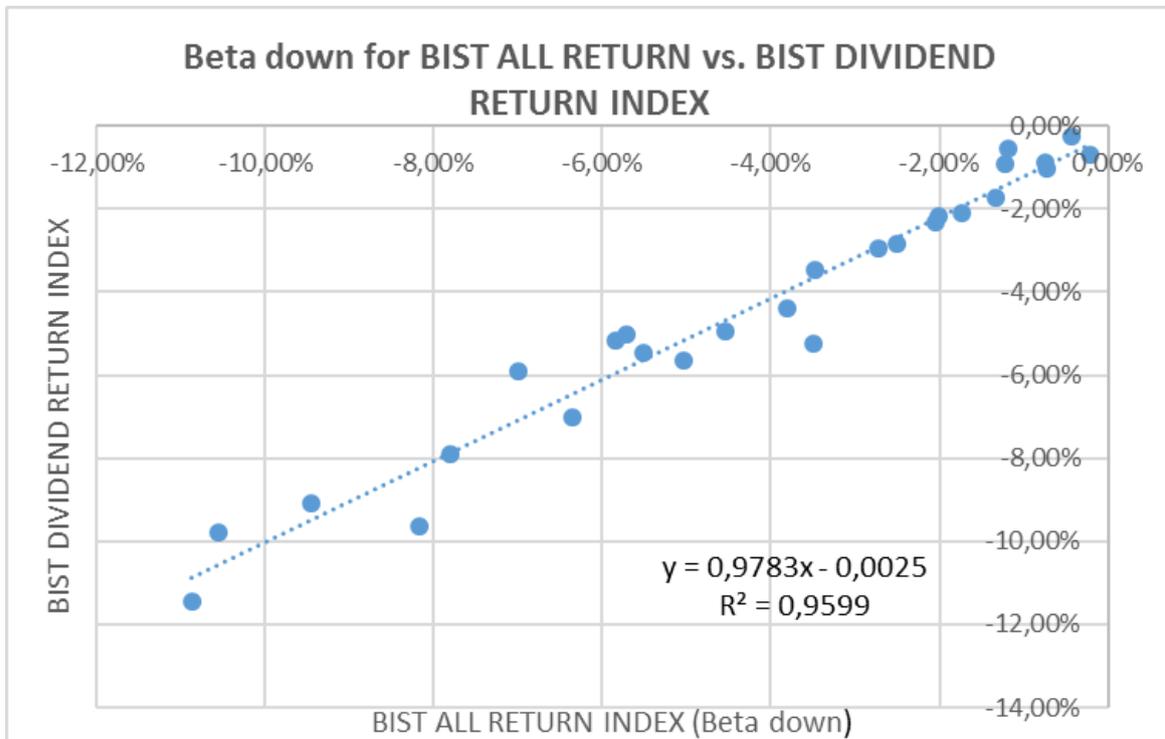
**Figure 5.**



As given in Figure 6, when the BIST All Return Index descends by 1%, BIST Dividend Return Index reads a-0.97%-decrease. This indicates that dividend Return Index

provides 3% protection when the stock market tends to be bull. It is there documented that the  $R^2$  value, obtained as a result of the regression analysis, is 0.9599. This suggests that independent variables account for the changes in the level of the dependent variable as much as 95.99%.

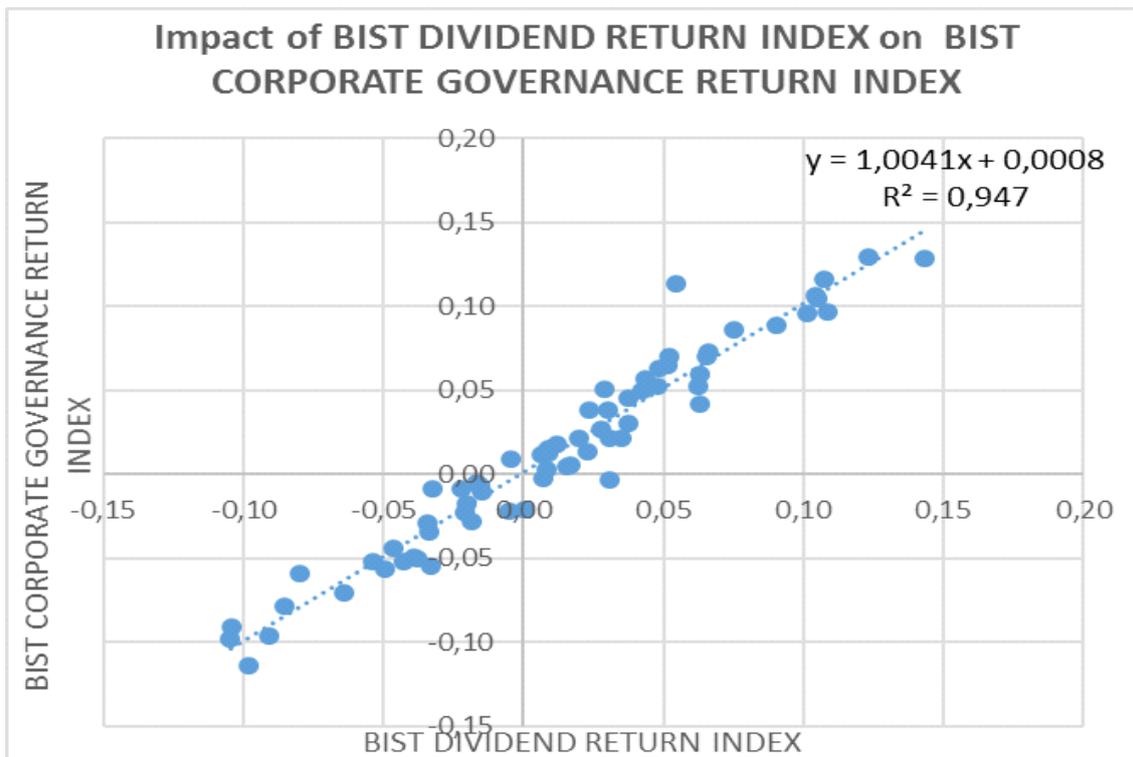
Figure 6.



The companies included in the dividend index show better performance in the upward movements of stock exchange compared to BIST All Return Index. In addition, in downwards movements of stock exchange, it again shows a better performance by levelling down less compared to BIST All Return Index. It therefore provides a bi-directional protection in the increases and decreases of share prices.

As observed in Figure 7, it is shown that when BIST Corporate Governance Return Index rises by 1%, BIST Dividend Return Index that is to cover the companies regularly distributing dividends also rises by 1.004%. It is there documented that the  $R^2$  value, obtained as a result of the regression analysis, is 0.947. This suggests that independent variables account for the changes in the level of the dependent variable as much as 94.7%. In other words, we can say that the two indices move in parallel to each other. In this case, despite the fact that the balance sheet size of the companies in corporate governance index is smaller than the balance sheet size of the companies in dividend index, and in spite of the fact that the companies in dividend index regularly distribute dividends, it can be contended that the preference by the investors of the companies in the corporate governance index as much as those in dividend index may be tied to their corporate structures. The next section concludes this paper.

Figure 7.



### Conclusion

The aim of this study was to explore the benefits provided by corporate governance to stock investors. For this purpose, companies which are included in the corporate governance and the dividend return indices have been examined. The data included BIST Corporate Governance Return, All Return and Dividend Return indices. Empirical analysis has been performed using OLS regression along with Beta calculations.

The results of the study have shown that corporate governance has in fact a positive impact on risk management and internal control constituents of companies. Corporate Governance Return index and All Return index decrease in parallel to each other when indices fall down (beta down). However, the decrease in the former index is less than the decrease in the latter one. Therefore, we argue that encouraging conformity to principles of corporate governance will generate benefit to shareholders and companies at micro level while also providing a more transparent investment environment and advancing the capital market.

In particular, we found that when the companies included in corporate governance index are compared with all the other companies of BIST, they provide a protection for the investors by decreasing in less amounts in the downward movements of stock exchange. It is seen that attribution of more importance to risk management and internal control by the companies included in corporate governance Return Index may cause them to show better performance compared to BIST All Return Index when the stock exchange underperforms or tends to be bear. In addition, it may create a decrease in the level of

the company's risk exposure by minimizing the problems of conflicts of interest among the shareholders.

The companies included in the dividend index show a better performance in the upward movements of stock exchange compared to the index formed by all the other companies of BIST. Moreover, in the downward movements of stock exchange, it again shows a better performance by descending in less amounts when compared to the index formed by all the other companies of BIST. It provides a bi-directional protection for the investors either way when the share prices change.

Corporate governance index moves in parallel with the BIST Dividend Return Index which has to cover the companies regularly distributing dividends. If this turns out to be the case, it was shown that companies included in corporate governance index are being preferred as much as the companies in the dividend index despite the advantages that the companies in dividend index may have. It could be argued that the reason for this may be corporate structures of the companies entailed in the corporate governance index.

While the demand for the company's shares in the stock exchanges, and deepening of the capital market may be ensuring production, employment, price stability and sustainable economic growth in a macro sense, they also provide benefits in terms of the resolution of companies' financial problems and the distribution of investment risks in a micro sense. Moreover, it makes the risks and uncertainties in stock investments foreseeable or predictable for the individual investors. Investors request less yield when the investment risk is low by definition. The implementation of principles of corporate governance lessens the risk of the company by minimizing the problems it may encounter by means of: increasing the transparency, encouraging effective cooperation in between the company and its stakeholders, acting equally to all the shareholders without any discrimination between major or small shareholders, and defining the responsibilities of the board of directors.

Likewise, high accounting standards may provide the transparency required by the small shareholders for them to feel comfortable while investing in securities market. The amendment of laws in the recent period in some European countries is now heading towards strengthening and protecting minority shareholders. In this context, it should be that number of companies that are included in corporate governance index and dividend index be increased for the purpose of deepening of the capital market and for the capital to spread over to the base. For this reason, companies might be legally mandated to distribute dividends.

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