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Araştırma Makalesi / Research Article

THE EFFECT OF CORPORATE GOVERNANCE ON STOCK RETURNS BY PVAR: AN INVESTIGATION IN BIST[1]

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Abstract

In this study, the effect of corporate governance practice on stock returns is examined. The research was analyzed within the framework of public disclosure and transparency, shareholder, stakeholders and board of directors, which has both corporate subheadings and corporate governance total score. The study was analyzed by using Panel Vector Autoregressive (PVAR) model for 2009-2016 periods. According to the results, corporate governance practice in Turkey is not effective in buying stocks of investors. The corporate governance of the companies is reflected negatively in the long term returns. Investor profile in Turkey is not interested in how the company is generally managed, investors are more care about short-term returns. It is thought that the corporate governance of firms should be introduced more in order to become a long-term preference for the investor.

Keywords: *Corporate Governance, Stock Returns, BIST100*

KURUMSAL YÖNETİMİN HİSSE SENEDİ GETİRİSİNE ETKİSİNİN PVAR ANALİZİ İLE ÖLÇÜLMESİ: BIST'TE BİR ARAŞTIRMA

Öz

Bu çalışmada, kurumsal yönetim uygulamalarının firmaların hisse senedi getirileri üzerine etkisi Panel Vektör Otoregresif Model (PVAR) ile analiz edilmiştir. Bu bağlamda 2009-2016 yılları arasında kurumsal yönetim endeksinde yer alan ve en az beş yıllık kurumsal yönetim notu olan 19 adet finansal olmayan firmanın kurumsal yönetim notları ile hisse senedi getirileri arasındaki ilişki incelenmiştir. Araştırma, hem kurumsal yönetim toplam notu hem de kurumsal yönetim notunu oluşturan kamuyu aydınlatma ve şeffaflık, pay sahipleri, menfaat sahipleri ve yönetim kurulu alt başlıkları çerçevesinde ayrı ayrı analiz edilmiştir. Elde edilen sonuçlara göre, Türkiye'de firmaların kurumsal yönetim ile yönetilmesi, yatırımcıların hisse senedi alımlarında etkili bir faktör olduğu söylenememektedir. Şirketlerin kurumsal yönetime sahip olması uzun vadede hisse senedi getirilerine negatif yönde yansımıştır. Kurumsal yönetime sahip firmaların yatırımcıların uzun vadeli tercihi olması için kurumsal yönetiminin yatırımcılara daha fazla tanıtılması gerektiği düşünülmektedir.

Anahtar Kelimeler: *Kurumsal Yönetim, Hisse Senedi Getirileri, BIST 100*

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1.Introduction

With the abandonment of traditional finance approaches and modern financial methods gained weight, maximizing shareholder welfare has started to become the primary aim of firms. The aim of maximizing shareholder welfare is also possible by eliminating conflicts between interest groups with different objectives such as customers, suppliers and employees. The concept of corporate governance regulates the relations between these interest groups. Corporate governance can also be defined as a mechanism that tries to make a profit by not violating the rights of any stakeholders (Corporate Governance Association of Turkey [TKYD], 2003:11). A widely accepted view is that good corporate governance is one of the main conditions of company success, and that financial markets will function effectively (Sönmez and Yıldırım, 2015:21). The first studies of corporate governance in Turkey began with corporate governance application code issued by TUSIAD. The Capital Markets Board later published the communiqué on corporate governance principles in 2005. All these activities, which are in the form of a recommendation, have been put on the legal basis with the new Turkish Commercial Code and some concrete steps have been taken.

Corporate governance in Turkey based on shareholders, public disclosure and transparency, stakeholders and board of directors principles. The principle of the shareholders is related to the debriefing and analysis, attendance and voting in the general meeting, dividend and regulation of minority rights. The principle of public disclosure and transparency aims to provide all stakeholders with accurate, complete, analyzable, low-cost and easily accessible information about the company (SPK, 2005) Stakeholders' principle purposes regulate the relations of third parties with the company which are in direct relation with the company. The principle of the board of directors includes the function of the structure of the board of directors, the principles of its activities, the shape of its meetings, and the committees formed within it.

Corporate governance ratings of the companies in Turkey are determined by professional rating agencies designated by the Capital Markets Board of Turkey (CMB). Companies are graded out of 10 (or 100) points. The fact that the Company's rating score is in the range of 9-10 (90-100) shows that it complies with corporate governance principles. The fact that the Company's rating score is in the range of 7-8 (70-80) band, shows that it complies with corporate governance principles except for some rules and policies. If the Company's corporate governance rating is 6 (60), it complies with the principles moderately and needs improvement. On the other hand, in the 4-5 (40-50) band, it implies that the principles are applied to a minimum extent and that there is a need for significant improvements.

It has been accepted by almost every view that effective corporate governance benefits companies, investors and countries. A good corporate governance provides sustainable performance in companies (Youseef, 2017:4). It is emphasized that corporate governance is one of the important factors in increasing the value of the company especially in the studies on developing markets. The development of the company's reputation, increasing the brand value and attracting the productive labor force are some of the benefits of corporate governance to companies. In recent years, countries that want to develop capital markets should be a part of the international financial system. The restructuring of countries' capital markets as part of the global system increases the opportunities for international financing (SPK, 2003:2).

The purpose of this study is to measure the effect of corporate governance on stock returns of firms quoted on BIST. In this context, 19 non-financial firms quoted in Borsa İstanbul and having at least 5 corporate governance ratings were included in the analysis. The number of firms listed on Borsa Istanbul and having corporate governance ratings at the same time is low. For this reason, the observation period of the research is spans between 2009-2016 in order to avoid any data loss.

The effect of corporate governance on stock returns is widely discussed in Turkey. But absence of a study examining the medium and long term efffects by the same method increases the impotance of this study. In addition, examining the sub-headings of corporate governance in this study reveals which concept is important for the investor.

2. Literature Review

Since the introduction of corporate governance principles in countries, studies investigating the impact on stock have become widespread. In these studies, in addition to the results that good corporate governance increases the stock returns and firm value of firms, there are also some who argue that there is no relationship between these two.

Maher and Anderson (1999) investigated the effects of corporate governance on company performance and overall economic performance in some OECD countries, and concluded that corporate governance developed the financial market and the country's economy was also affected by these developments.

Bauers et al. (2003) found a positive relationship between corporate governance and stock returns and firm value in Europe after the country differences were corrected.

Gompers, Ishii and Metrick (2003) concluded that a strategy in which the stocks of the companies in the lower segment of the corporate governance index are sold and that the stocks of the high-segment companies are purchased, yielding an abnormal return of 8.5% per year.

Drobertz et al. (2004) concluded that investing in companies with a high corporate governance rating in Germany yields an above-normal return of 12% per annum.

Aksu and Kösedağ (2006) conclude that corporate governance decreases agency costs and provides resource efficiency, and that the performance of firms with high transparency levels is at a good level.

Bauer et al. (2007) found that in Japan, companies managed well in terms of corporate governance perform 15% better per year than poorly managed firms.

Karamustafa et al. (2009) examined the financial and operational performance of firms that are traded in the corporate governance index before and after entering the index. Significant differences have been observed in the performance indicators of asset turnover, return on assets and return on equity.

Çarıkçı et al. (2009), concluded that corporate governance indeks have return volatility grater than BIST 100 index in turkey. This shows that corporate governance index is riskier than BIST 100 index.

Javed and Iqbal (2007) investigated the relationship between corporate governance quality and stock performance on 50 firms traded on the Karachi stock exchange. According to the results, public disclosure and transparency are very important on stock performances, while board composition and ownership are less important.

Huang et al. (2010) found that the stock prices of firms with good corporate governance were more stable than the others in times of political crisis.

Owala (2010) analyzes the correlation between corporate governance and stock returns and concludes that there is no difference in yield between portfolios with weak or strong corporate governance and corporate governance notes are insufficient to explain stock returns.

Bistrova and Lace (2011) examined the impact of corporate governance quality on the performance of 116 companies listed in 10 selected European countries. According to the research findings, the companies with the highest corporate governance quality (highest 25%) performed a better performance of 0.98% on a monthly basis than the companies with the lowest corporate governance quality (the lowest 25%).

Saldanlı (2012) compared corporate governance index performance with BIST100, BIST50 and BIST30 index returns. As a result of this study, corporate governance index performance falled behind other indices.

Kouwenberg et al. (2012) found that companies that are not well-managed in terms of corporate governance in China, HonKong, India, Indonesia, Korea, Malaysia, Philippines, Singapore, Thailand and Taiwan achieve better average return on average up to 9% per year from well-managed firms.

Azeem et al. (2013) tested the relationship between stock performance and corporate governance on 50 companies listed on the Pakistan stock exchange, and concluded that quality corporate governance significantly influenced firm performance.

Ege et al. (2013), found that in Turkey, ranking according to financial performance different from the ranking made by the corporate management ratings. In addition, it was stated that the corporate governance rating of the companies did not reflect their financial performance.

Yenice and Dölen (2013) compared the stock prices 30 days before the corporate governance notes announcement of the companies and 30 days after the announcement. It is concluded that there is a significant relationship between corporate governance notes and stock price in Turkey.

Malik (2012) concluded that the higher corporate governance rating provided higher stock prices in the study,

Aksu and Aytekin (2015) found that no significant differences were found between the stock returns before disclosure of the corporate governance notes and the stock returns after disclosure.

Unlu, Yalçın and Yağlı (2017) evaluated the performance of firms with and without corporate governance index from 22 firms included in BIST 30 index. According to the findings, it is stated that it is not important whether firms are included in corporate governance index in terms of creating shareholder value.

Kömeçoğlu and Vuran (2018) found that corporate governance practices of companies operating in various sectors and included in BIST corporate governance index have no effect on profitability.

3. Data and Methodology

In this study, the effect of corporate governance ratings on stock returns was examined by using Panel VAR (PVAR) method. Nineteen non-financial companies listed in BIST between 2009-2016 and having corporate governance ratings were used in the research.

There are some limitations of this study. First, there are few companies that have corporate governance points and are listed on the Istanbul Stock Exchange. In addition, these companies have a limited period of observation. Secondly, between 2009 and 2016, the research period, 19 firms with at least 5 corporate governance ratings were included in the analysis.

PVAR model combines the traditional Vector Autoregressive Model (VAR) approach, which treats all variables in the system as endogenously, with the panel data approach that allows for unobserved individual heterogeneity (Love and Zicchino, 2006:6). PVAR is created with standard VAR logic by adding a cross-sectional dimension. This model allows short-term dynamic relationships.

The PVAR system consists of a combination of panel data models and the traditional VAR approach. In this respect, it carries the advantages of both the panel system and the VAR system. The first study on the panel VAR model was made by Holtz-Eakin, Newey and Rosen (1988) (Güriş, 2015:291).

The panel VAR model has the same structure as the VAR models because it is assumed that all variables are endogenous and interdependent. The cross-sectional dimension was added to the display.

The statistical model established for the research is as follows:

$$Y_{it} = Y_{it-1} A_1 + Y_{it-2} A_2 + \ldots + Y_{it-p+1} A_{p-1} + Y_{it-p} A_p + X_{it} B + u_i + \varepsilon_{it}$$

$$i \in \{1, 2, \ldots, N\} t$$

$$t \in \{1, 2, \ldots, T_i\}$$

where Y_{it} is dependent variable (endogenous variable), X_{it} is independent variable (exogenous variable); u_i and ε_{it} are unit effects and error term (1xk), respectively. Matrices (*1xk*) A_1, A_2, A_{p-1}, A_p and (*1xl*) B are predicted parametres. The model error term is assumed to have $E[e_{it}] = 0$, $E[\grave{e}_{it} e_{is}] = 0$ and all $t>s$ properties (Abrigo, 2015:2).

In the study, Y_{it} dependent variable was determined as stock returns and X_{it} independent variables as corporate governance ratings, market to book value, leverage ratio and firm size.

In the section where the effect of sub-headings of the study on stock returns is investigated, Y_{it} dependent variable is determined as stock returns, X_{it} independent variables are shareholders, stakeholders, public disclosure and transparency and board of directors.

Other information about the variables used in the study is as follows. The only dependent variable used in the study is the annual stock returns of firms. It gives the percentage change of the closing values between two desired dates.

The first independent variable of the study is the corporate governance rating given by a rating company authorized by the SPK.

Data related to corporate governance ratings are used in Turkey was obtained from the internet address of the Corporate Governance Association. As the control variable of the research, leverage ratios, market value/book value ratio and firm size have been used. One of the control variables used in the study is the firm size. Based on the size of the company, there are studies that have different results in terms of stock returns. In addition to the studies that argue that the stocks of the small firms have higher returns, the studies that tell the opposite are also included in the literature.

The other control variable in the study is market to book ratio. The fact that this ratio is greater than one is interpreted as the cost of equity capital is lower than the equity profitability. There are some findings suggesting that the companies with high market to book ratio have higher stock returns than the companies with low market to book ratio. The third control variable in the study is leverage ratios. In the literature, there are studies showing that the stocks of high leveraged firms have higher returns.

3.1. Findings

The data are considered as static because of the small number of observations and the lag lengths of unbalanced panel variables are determined.

Table 1: Lag Selection Criteria

Lag	MBIC	MAIC	MQIC
1	-261.7829	-57.89551	-140.619
2	-182.2682	-46.34328	-101.492
3	-93.75768	-25.79521	-53.3698

A lag is selected as the lag length at which the MBIC, MAIC and MQIC values are the smallest.

Table 2: Lag Selection Criteria for Corporate Governance Subheading

Lag	CD	J	J pvalue	MBIC	MAIC	MQIC
1	0.2077511	91.21299	0.0981059	-262.6744	-58.78701	-141.5106
2	0.7317379	59.89459	0.1594989	-176.0304	-40.10541	-95.25448
3	0.9055668	33.49388	0.1191764	-84.4686	-16.50612	-44.08066

In the next step, the effect of corporate governance on stock returns of firms is estimated by the Panel VAR model.

Table 3: Estimation PVAR for Stock Returns

	Coefficient	Std.Err.	z	p> |z|
Stock Return	0.390522	0.1074772	3.63	0.000
CGS	-634.6282	109.0707	-5.82	0.000
Size	7.387812	6.413388	1.15	0.249
Leverage	-4847.37	1232.103	-3.93	0.000
Market to Book Ratio	14.09149	1.350272	10.44	0.000

When the Table 3 is analyzed, it is seen that the corporate governance scores (CGS) and stock returns have a statistically significant and negative effect on the returns. When the control variables are examined, the effect of market value/book value ratio on stock returns is significant and positive, while the firm leverage level has a negative effect. On the other hand, no significant finding was obtained from the panel VAR model regarding the relationship between stock returns and firm size.

Table 4: Estimation PVAR for Subheading of Corporate Governance

	Coefficient	Std. Err.	z	p> |z|
Stock Returns	0.3778314	0.0205644	18.37	0.000
Public Disclosure and Transparency	281.0746	11.363	24.74	0.000
Shareholders	-199.8673	15.15322	-13.19	0.000
Stakeholders	63.41924	11.47203	5.53	0.000
Board of Directors	-182.6995	15.99691	-11.42	0.000

The Table 4 showing the effect of corporate governance on individual return shows that the effect of all principles on returns is statistically significant. When the table is examined, there is a positive relationship between public disclosure and transparency and stakeholders. In addition, a negative relationship was observed between the shareholders and board of directors principles and returns.

Table 5: PVAR Causality Wald Test

Dependent Variable: Stock Returns			
Excluded	**Chi2**	**df**	**Prob.**
Corporate Governance Note	33.855	1	0.000
Size	1.3270	1	0.249
Leverage	108.911	1	0.000
Market to book ratio	15.4780	1	0.000
All	113.027	4	0.000

According to the panel causality test, corporate governance notes, firm leverage and firm's market value / book value ratio are the Granger cause of stock returns at 5% significance level. The causality relationship between firm size and stock returns was not observed.

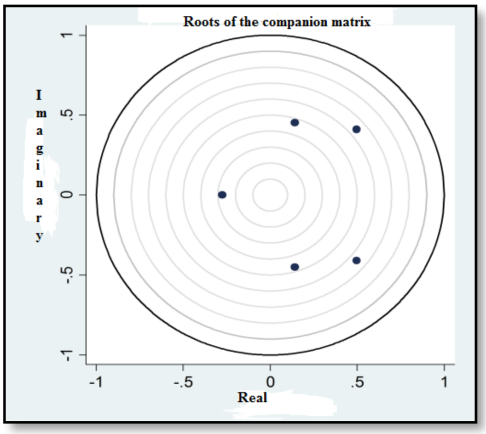
Table 6: PVAR Causality Wald Test between Corporate Governance Subheading

Dependent Variable: Stock Returns			
Excluded	**Chi2**	**df**	**Prob.**
Public Disclosure and Transparency	4.2150	1	0.040
Shareholders	54.956	1	0.000
Stakeholders	7.9460	1	0.005
Board of Directors	32.573	1	0.000
All	105.956	4	0.000

When the sub-headings of the corporate governance rating are examined, all principles at the level of 5% significance are the Granger cause of stock returns.

The stability of the Panel VAR model was tested before the estimation and variance decomposition of the impulse response analyzes.

Figure 1: Stability Test Results



It is seen that the estimation is static since all values are in the unit circle.

Table 7: Variance Decomposition

Dependent Variable	Independent Variables				
	Stock Return	Corporate Governance Score	Size	Leverage	Market to Book
Stock Returns					
0	0	0	0	0	0
1	1	0	0	0	0
2	0.9585320	0.0191831	0.0001500	0.0055446	0.0165904
3	0.9310043	0.0380736	0.0073246	0.0054995	0.0180979
4	0.9183903	0.0414778	0.0160482	0.0054327	0.0186509
5	0.9152206	0.0413649	0.0181399	0.0054656	0.0198091
6	0.9142187	0.0421410	0.0180993	0.0055524	0.0199887
7	0.9134979	0.0426305	0.0183690	0.0055549	0.0199476
8	0.9131688	0.0427269	0.0186054	0.0055533	0.0199456
9	0.9130871	0.0427262	0.0186709	0.0055605	0.0199552
10	0.9130729	0.0427311	0.0186737	0.0055633	0.0199590

As can be seen in the Table 7, the major explanation of the changes in the forecast error of stock returns belongs to itself only in the short term. In the following periods, the corporate governance grade could only be explained in only 4% of the stock returns.

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Table 8: Variance Decomposition for Corporate Governance Subheadings

Dependent Variable	Independent Variables				
	Public Disclosure and Transparency	Shareholder	Stakeholders	Board of Directors	Stock Return
Stock Returns					
0	0	0	0	0	0
1	0.0005093	0.0033820	0.0147827	0.0067055	0.9746206
2	0.0006074	0.0041587	0.0165065	0.0098395	0.9688879
3	0.0011429	0.0046876	0.0161393	0.0096870	0.9683432
4	0.0013918	0.0047519	0.0161641	0.0102505	0.9674417
5	0.0015528	0.0048032	0.0161719	0.0102565	0.9672156
6	0.0015814	0.0048094	0.0161817	0.0103733	0.9670604
7	0.0016005	0.0048096	0.0161974	0.0104104	0.9669822
8	0.0016012	0.0048109	0.0162033	0.0104510	0.9669348
9	0.0016034	0.0048114	0.1621060	0.0104758	0.9668992
10	0.0016034	0.0048104	0.1621430	0.0104984	0.9668761

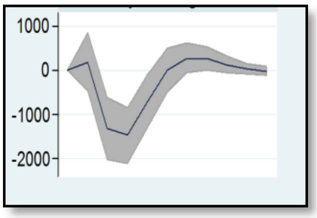

Figure 2: Impact of Corporate Governance Ratings on Returns

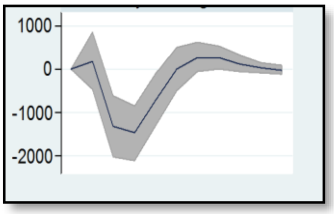

Figure 3: Effect of Firm Size on Returns

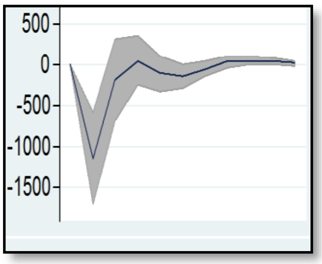

Figure 4: Effect of Leverage on Stock Returns

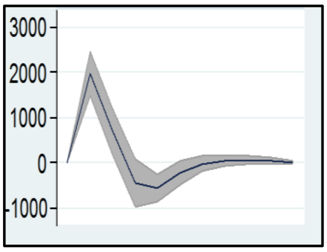

Figure 5: Effect of Market to Book Ratio on Stock Returns

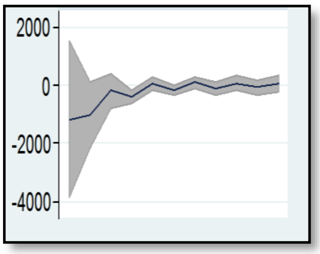

Figure 6: Effect of Board of Directors on Returns

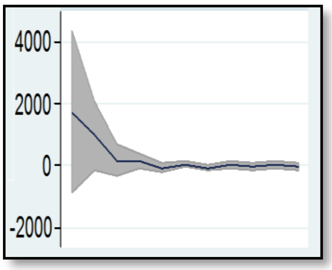

Figure 7: Effect of the Stakeholders on Returns

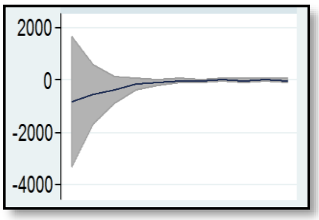

Figure 8: Effect of Shareholders on Returns

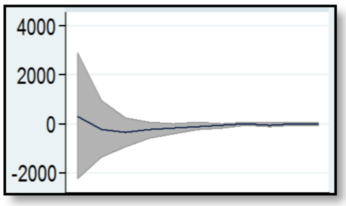

Figure 9: Effect of Public Disclosure and Transparency Principle on Returns

When the stock returns of the four sub-principles of the corporate governance grade and the impact response analyzes are analyzed, the returns have responded negatively to a standard deviated shock occurred in all other principles, except for the principle of shareholders. Stock returns, board of directors, shareholders and public disclosure do not give very significant reactions to transparency principles.

4.Conclusion

In this study, which examines how corporate governance ratings affect stock prices, there is a statistically significant and negative relationship between stock returns and corporate governance ratings. In addition, there was no statistically significant relationship between stock returns and firm size, but a negative correlation with leverage ratio and positive relationship with market value/book value ratio. According to the results, it is observed that stock returns are positive with transparency and stakeholders and negatively correlated with the principle of the board of directors and shareholders. According to Granger causality tests, corporate governance notes are the Granger cause of stock returns. The market value/book value ratio and firm leverage, which is the control variable, are Granger cause of stock returns.

According to the findings of the Granger causality test applied to subheadings, it was seen that the four principles were the Granger cause of the stock returns. When the obtained figures are examined, it is seen that the effect of a standard deviation shock on corporate returns is negative. The only variable that has a positive effect on stocks of a standard deviation shock is the ratio of market value/book value. When the figures are examined, it is seen that the effect of a standard deviation shock on corporate returns is negative. The only variable that has a positive effect on stocks of a standard deviation shock is the ratio of market value/book value. According to impulse response analysis applied to subheadings, it cannot be said that stock returns have significant reactions to a standard deviated shock given to the principles. xcept for the principle of shareholders, a standard deviated shock occurred in all other principles and the returns responded negatively.

According to the results of variance decomposition, the short and long term statement of stock returns is itself. When the results were evaluated with other empirical studies in Turkey, it can be said that consistent results could be obtained. Many of the studies that suggest a positive relationship between stock returns and corporate governance in Turkey were analyzed by event study. Accordingly, in Turkey, the signal of corporate governance rating will be expounded is taken a few days before the date of announcement and investors are buying that expectations**.** It can be said that this short-term effect and the impact of the corporate governance rating has disappeared. In the analysis conducted with the lagged values in this study, it is estimated that after the signal effect of the corporate governance notes have been made, the sales of the shares are made and in the medium term this is reflected in the stock price as decrease.

The results show that, investors in Turkey doesn't care about corporate governance rates. The high corporate governance ratings of the companies are not reflected in the stock prices in the same way. On the other hand, the positive relationship between the stock returns and the market to book ratio shows that the investor is interested in the book values of the firms and not the corporate governance ratings. Investor profile in Turkey is not interested in how the company is generally managed, investors are more care about short-term returns. Witholding period of domestic and foreign investors who invest in the capital markets in Turkey is decreasing day by day. When the data from 2012 to the present date are analyzed, the stock holding period of foreign investors (for BIST-All index) is 389 days in 2012, while this period in domestic investors decreases to 46 days. In 2016, the period of holding Turkish stocks (for the BIST-All index) in foreign investors decreased to 212 days and to 42 days in domestic investors. In this case, corporate governance practices are not a long-term preference for investors. It is thought that the corporate governance of firms should be introduced more in order to become a long-term preference for the investor.

It is thought that the recent emergence of the global crisis in the analyzed period also affected the results. It is predicted that corporate governance will gain momentum in the following periods.

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