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DO CORPORATE GOVERNANCE RATINGS REFLECT FIRM FINANCIAL PERFORMANCE?

In this study, we investigate whether the commercial corporate governance ratings generated by Turkish rating institutions provide useful information about firm financial performance. We analyze corporate governance ratings both summary and sub-ratings in reflecting firm financial performance. In the study, both accounting based (ROA) and market based performance measures (MVA, Tobin's Q) are used to properly capture firm financial performance. The results indicate that the summary corporate governance ratings seem to be inadequate to reflect firm financial performance, while mixed results are determined between sub-ratings and firm financial performance.

Keywords: Corporate Governance; Corporate Governance Ratings; Accounting-Based Firm Performance; Market-Based Firm Performance.

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Ібрагім Яглі, Улас Унлу

ЧИ ВІДПОВІДАЮТЬ РЕЙТИНГИ КОРПОРАТИВНОГО УПРАВЛІННЯ СТІЙКИМ ФІНАНСОВИМ ПОКАЗНИКАМ?

У статті досліджено чи рейтинги комерційного корпоративного управління, визначені турецькими рейтинговими установами, надають корисну інформацію про фінансові показники. Проаналізовано рейтинги корпоративного управління як підсумкові, так і суб-рейтинги, що відображають фінансові показники. Показники ефективності (ROA) і ринкові показники (MVA, Tobin's Q) використано для правильної фіксації фінансових показників. Результати показали, що підсумкові рейтинги корпоративного управління є недостатніми, щоб відображати фінансові показники, їх треба доповнювати суб-рейтингами.

Ключові слова: корпоративне управління; рейтинги корпоративного управління; фіскальна ефективність на базі бухгалтерського обліку; фіскальна ефективність на базі ринку.

Табл. 8. Літ. 35.

Ибрагим Ягли, Улас Унлу

СООТВЕТСТВУЮТ ЛИ РЕЙТИНГИ КОРПОРАТИВНОГО УПРАВЛЕНИЯ УСТОЙЧИВЫМ ФИНАНСОВЫМ ПОКАЗАТЕЛЯМ?

В статье исследованы рейтинги коммерческого корпоративного управления, которые определены турецкими рейтинговыми учреждениями, или они предоставляют полезную информацию о финансовых показателях. Проанализированы рейтинги корпоративного управления как итоговые, так и суб-рейтинги, что отображают финансовые показатели. Показатели эффективности (ROA) и рыночные показатели (MVA, Tobin's Q) использованы для правильной фиксации финансовых показателей. Результаты показали, что итоговые рейтинги корпоративного управления недостаточны, чтобы отображать финансовые показатели, их нужно дополнить суб-рейтингами.

Ключевые слова: корпоративное управление, рейтинги корпоративного управления, фискальная эффективность на базе бухгалтерского учета, фискальная эффективность на базе рынка.

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Introduction. In today's complex business and financial market, it is not adequate to investigate only financial records of a firm to make a successful investment decision, investors should also take every piece of information related to the firm into consideration. Therefore, investors start paying regard to issues such as environmental awareness, social responsibility, ethical concern, anti corruption, and bribery in order to evaluate the riskiness and long term success of the firm (Rogers, 2015).

Corporate Governance (hereafter referred as 'CG') becomes one of the non-financial issues in the last decade considered by investors as a consequence of recent corporate accounting scandals (Kula and Baykut, 2015) and therefore investors start giving close attention to issues such as transparency, public disclosure, diversity on boards, shareholder's rights, stakeholder's rights, ownership structure and so on. Since CG has a significant place in the eye of investors, firms that need access to equity capital have to attach attention to their CG attributes. Firms attempt to make their management process transparent as possible, make a disclosure at the appropriate level, and make their board of directors more independent in order to feel investors confident in the way of the firm is run.

Regulatory authorities also start issuing CG principles to assist firms operated in their countries. For instance, OECD publishes Corporate Governance principles in order to guide firms in both member and non member countries. Likewise, Sarbanes-Oxley Act is approved and adopted by the U.S. Securities and Exchange Commission. In parallel with the current practices worldwide, Capital Market Board of Turkey (CMB) issues Corporate Governance Principles of Turkey (hereafter referred as 'Principles') in July 2003 to make Turkish financial market more transparent, reliable and stable (CMB, 2005). Even though the Principles is not the first practice, it is the official and more comprehensive one¹.

In the light of recent developments, commercial rating institutions also proceed to publish CG ratings which demonstrate the overall soundness of CG practices at the firm. For instance, Corporate Library (TCL), Institutional Shareholder Services (ISS), Governance Metrics International (GMI), and Standard & Poor's (S&P) are the commercial rating institutions quantify the quality of CG practices at the U.S. firms. Similarly, SAHA Rating, Kobirate, and JCR Eurasia Rating are the rating institutions authorized by CMB to rate Turkish firms based on their compliance with the Principles² (CMB, 2016).

Although firms whose shares traded in Borsa Istanbul are obligated to publish the Principles Compliance Report since 2005 with the Capital Markets Board decision No. 48/1588 (CMB, 2004), rating CG compliance with the Principles is optional. The summary CG rating of the firm's compliance with the Principles is calculated as weighted average of four main sections' grade. Sections used in the formation of summary CG rating and its weights are as follows: shareholders (25%), public disclosure and transparency (25%), stakeholders (15%), board of directors (35%). Ratings can take a value between 1 and 10, while 1 indicates the lowest, and 10 indicates the highest.

¹ Before Corporate Governance Principles of Turkey, Turkish Industry & Business Association, TUSIAD, issued Corporate Governance Code of Best Practice: Composition and Functioning of the Board of Directors (TUSIAD, 2002).

² There were 4 rating agencies (ISS, SAHA, Kobirate, and JCR) operating in Turkey until 2014.

Since access to finance is an important constraint for most of the Turkish firms (Word Bank, 2010), CG becomes an essential issue for Turkey to improve both quantity and quality of international capital flows (CMB, 2003), therefore CG ratings has started to be used by firms as a powerful weapon to attract international investors. Although CG ratings is a useful tool that can be used by investors when they evaluate the CG practices in the firm, the very high ratings¹ cause doubt on their validity (Snyder 2009; Altan, 2013). Inspired by this situation, the current study aims to investigate the relation between the CG ratings generated by Turkish rating institutions and firm financial performance.

Turkey has a special case regarding CG rating. In more detail, rating institutions around the world use their own methodology, however, although rating institutions in Turkey use their own methodology, their methodology is based on the Principles. Therefore, rating methodology in Turkey is somehow different from rating methodology in other countries. In addition, there are several special cases of Turkey. As an emerging economy, foreign investment is extremely important when considering firms have obstacles to find funding. In addition, legal rules and institutions are weak in the recent past. These all makes CG ratings highly significant for Turkish firms to attract investors.

The rest of paper proceeds as follows. The next section provides information about rating institutions and their methodology. And then section 3 reviews the literature on CG and firm financial performance. In section 4, data and methodology used in the study are described. Section 5 reveals the empirical results and these results is discussed in section 6. Finally, the last section presents conclusions and final remarks.

Rating institutions. As of today, there are three authorized institutions SAHA Rating, Kobirate, and JCR Eurasia Rating respectively operates in Turkey. The background of these institutions and their methodology is going to be summarized briefly in this section. Details about these institutions and their rating methodology are also available on the institutions' websites: www.saharating.com, www.kobirate.com.tr, and www.jcrer.com.tr.

SAHA Rating has commenced its activities in 2005. SAHA was the first rating institution authorized by CMB. In the 2015 year, 68% of firms whose share traded in Borsa Istanbul Stock Exchange Corporate Governance Index (XKURY) were rated by SAHA. SAHA has identified 330 subcriteria under compliance with Principles. These criteria are evaluated using data provided by the related firm and publicly available information. While some of the criteria are evaluated simply by Yes/No method, some require further assessments.

Kobirate is another local rating institution founded in 2008 and authorized by CMB to conduct CG rating activities in 2009. Kobirate has various numbers of criteria for different firms. For instance; 408 criteria for Borsa Istanbul Stock Exchange (BIST) first group firms, 401 criteria for BIST second group firms, 399 criteria for BIST third group firms, 398 criteria for investment trust; for evaluating banks compliance with the Principles, 470 criteria for the first group of banks, 468 criteria for

¹ 42 firms out of 50 whose shares traded in Borsa Istanbul have ratings above 9 by the year of 2015 (TKYD, 2016).

second and third group of banks; and for evaluating football clubs compliance with the Principles 378 criteria are considered.

JCR Eurasia Rating was authorized to rate firms according to their compliance with the Principles on April 29, 2010. In the evaluation process, JCR takes not only managerial issues but also issues about the country and the sector in which firm operates into consideration. In addition, firm-specific issues such as whether it is a family firm, its free float rate, institutional investors interest in the firm are also considered in the assessment process. JCR employs 246 standards in total in order to evaluate firms compliance with Principles. The distribution of these standards among main sections and number of issues discussed is as follows: 30 issues and 70 standards covering 8 sub-sections under shareholders section, 26 issues and 56 standards comprising 6 sub-sections under public disclosure and transparency section, 15 issues and 23 standards for 6 sub-sections under the stakeholders section and lastly 55 issues and 100 standards related with 6 sub-sections under board of directors section.

Literature review. It is widely accepted that good CG practices have a positive influence on the firm ranging from increasing performance to minimizing the cost of capital. In most of the studies, a positive relation is found among CG and firm performance (e.g. Bebchuk et al., 2009; Ararat et al., 2016). However, the fact remains that there are several studies in which no significant relation or negative association is found between CG and performance of the firm (Varshney et al., 2012; Coskun and Sayilir, 2012).

At the beginning, the association between CG and firm performance is investigated by focusing different dimensions of CG including ownership structure (Demsetz and Villolonga, 2001), board size and composition (Carter et al. 2003; Kajola 2008), shareholders rights (La porta et al., 2000; Gompers et al., 2003; Klapper and Love, 2004), capital structure (Jiraporn and Gleason, 2007) and so on. Following this, indexes as a composite measure of CG is used to assess the overall soundness of CG practices at the firm. For instance, Leal and Silva (2005) construct a CG index (CGI) including 24 questions to analyze the impact of the quality of CG practices on firm value (Tobin's Q) and performance (ROA) for Brazil. The panel data results demonstrate that while there is a positive and statistically significant relation between CG and ROA, the significant relationship is not found between CG and Tobin's Q. Similarly, L. Brown and M. Caylor (2009) create Gov-Score which consist of 51 provisions covering both internal and external governance in order to investigate CG and Tobin's Q as a measure of firm valuation. Results reveal that CG is significantly and positively associated with Tobin's Q.

In addition, commercial institutions have started to issue CG ratings. However, some researcher starts questioning the ability of CG ratings provided by commercial rating institutions in reflecting firm financial performance. R. Epps and S. Cereola (2008) search for an answer the question whether institutional shareholder services' (ISS) CG ratings reflect a firm operating performance. They examine the relation between CG ratings and operating performance during the 2002-2004 years. The empirical results revealed that firms ISS CG ratings do not reflect their operating performance measured by return on assets (ROA) and return on equity (ROE). Likewise, M. Ertugrul and S. Hedge (2009) analyze the relation between CG ratings provided

by three premier US rating institutions (The Corporate Library – TCL, Institutional Shareholder Services – ISS, Governance Metrics International – GMI) and future firm performance. The results ascertain that summary CG ratings are generally poor predictors of primary and secondary measures of future firm performance while there is a positive association between some sub-ratings and future firm performance. R. Daines et al. (2010) also investigate the CG ratings (ISS, GMI, and TCL) in the perspective of their prediction of accounting restatements, classification lawsuits, future operating performance, firm value, and excess stock return. They find that CG ratings are poor predictors in predicting firm performance or other outcomes of interest to shareholders.

Empirical implementation. A few existing studies investigated the ability of CG ratings provided by commercial rating institutions in reflecting firm financial performance concentrate on developed markets. In this particular study, we seek an answer the same question for Turkey as an emerging market.

4.1. Model Design. In this study, we analyze the ability of both summary and sub-ratings in reflecting firm financial performance assessed by various performance measurement (ROA, MVA and Tobin’s Q). The models used in the study is demonstrated as follows:

Table 1. Models used in the study, author’s

<p>Model₁ $ROA_{it} = \alpha_{it} + \beta_1 CG + \beta_2 LN(ASSETS) + \beta_3 LEVERAGE + \epsilon_{it}$</p>
<p>Model₂ $ROA_{it} = \alpha_{it} + \beta_1 SHRHLDRS + \beta_2 DISCLOSURE + \beta_3 STKHLDRS + \beta_4 BOD + \beta_5 LN(ASSETS) + \beta_6 LEVERAGE + \epsilon_{it}$</p>
<p>Model₃ $LN(MVA)_{it} = \alpha_{it} + \beta_1 SHRHLDRS + \beta_2 DISCLOSURE + \beta_3 STKHLDRS + \beta_4 BOD + \beta_5 LN(ASSETS) + \beta_6 ROA + \epsilon_{it}$</p>
<p>Model₄: $TOBIN'S Q_{it} = \alpha_{it} + \beta_1 SHRHLDRS + \beta_2 DISCLOSURE + \beta_3 STKHLDRS + \beta_4 BOD + \beta_5 LN(ASSETS) + \epsilon_{it}$</p>

Only statistically significant models are reported in the study.

Where, *i* indexes the firm, *t* the year, ROA is return on assets, LN(MVA) is log of market value added, Tobin’s Q is the ratio calculated as book value of total debt plus firms year-end market value to year-end book value of total assets, CG is the summary corporate governance rating, SHRHLDRS is shareholders sub-rating, DISCLOSURE is public disclosure and transparency sub-rating, STKHLDRS is stakeholders sub-rating, BOD is board of directors sub-rating, LN(ASSETS) is log of total assets, and LEVERAGE is the ratio defined by total debts divided by shareholders equity.

4.2. Data and Methodology. The sample of this study consists of firms whose shares are traded in XKURY. Since the calculation of XKURY has started with 6 firms in 2007 and increasing year by year and has reached to 50 firms in 2015, we

examine the relation using unbalanced panel data¹. To reveal whether the CG ratings reflect firm financial performance, we employ both accounting based performance measures (ROA) and market-based performance measures (Tobin's Q and MVA).

Dependent Variables. In the study, three performance measures ROA, MVA and Tobin's Q respectively are used as a dependent variable. Performance measures used in the study and their formula is as follows.

Return on Assets (ROA) is a performance measure which demonstrates how effectively a firm use its assets. ROA is calculated as net income divided by total assets.

$$\text{ROA} = \text{Net income} / \text{Total Assets}$$

Market Value Added (MVA) is a value-based performance measure which equal to the difference between the total market value of firm and capital invested. In other words, MVA is a measure which shows the whether a firm adds a value to capital invested by shareholders or loses the value of capital (Bayrakdaroglu and Unlu, 2009). In that way, MVA analyzes how efficiently a firm uses its resources, thereby assess the success of the management of the firm (Stern et al., 2001). While negative MVA indicates that invested capital is not effectively used; positive MVA demonstrated that a value is added to the invested capital by the firm. G. Stewart and I. Stern (1991) claims that MVA is a performance measure can be used both in firm performance analysis and predicting future firm performance. The MVA formula developed by G. Stewart and I. Stern (1991) is as follows:

$$\text{MVA} = \text{Market Value of the Firm} - \text{Invested Capital}$$

Market value of the firm is calculated by multiplying the number of outstanding shares and the respective year end share price. In the calculation of invested capital, primarily book value of invested capital is obtained by subtracting interest free liabilities from total assets, and then the final amount of invested capital is computed by adding LIFO reserves, suspicious increase in trade receivables and correction related to balance sheet items and capitalized expense to book value of total book value of invested capital (Bacidore et al., 1997).

In the study, Tobin's Q also used as a market-based performance measure. Tobin's Q equal the financial rights on the firms market value divided by the replacement costs of the firm's assets. There are multiple methods of calculating the Tobin's Q including E. Lindenberg and S. Ross (1981), K. Chung and S. Pruitt (1994), D. Lee and I. Tompkins (1999) and L. Klapper and I. Love (2004). In this study, Tobin's Q is calculated by dividing the total value of book value of debt and firms year-end market value to year-end book value of total assets (Welch, 2003).

$$\text{Tobin's Q} = \text{Total Market Value of Firm} / \text{Book Value of Total Assets}$$

Control variables. Since capital structure and size are going to affect the firm financial performance, financial leverage and the natural log of total assets are used as a control variables in the study (Leal and Silva, 2005; Vintila and Gherghina, 2012). In addition, ROA is used as a control variable consistent with other studies in the literature in the model where MVA is used as a measure of performance (Campbell and Minguez-Vera, 2008).

¹ Sample size is 334 firm-years from 2007 to 2015.

Table 2. Descriptive Statistics for Dependent and Control Variables, author's

Variables	Roa	Mva	Tobin's q	Assets	Leverage
Mean	0.059	7.17E+08	1.410	4.38E+09	0.498
Median	0.057	-1258555	1.187	2.42E+09	0.532
Standard deviation	0.088	3.50E+09	0.763	5.21E+09	0.240
Min.	-0.216	-8.45E+09	0.330	20124948	0.003
Max.	0.957	1.84E+10	5.751	2.58E+10	0.971

Independent Variables. In the study, both summary and sub CG ratings are used as an independent variable. The descriptive statistics of variables is as follows.

Table 3. Descriptive Statistics of Corporate Governance Ratings, author's

VARIABLES	CG	SHRHLDRS	DISCLOSURE	STKHLDRS	BOD
Mean	8.74	8.62	9.11	9.06	8.18
Median	8.83	8.70	9.20	9.24	8.52
Standard deviation	0.49	0.58	0.45	0.71	0.97
Min.	7.12	6.00	7.51	6.63	6.08
Max.	9.54	9.77	9.94	9.95	9.78

The table presents that mean value of the summary rating is 8.74 for the 2007-2015 years. It is possible to say that this value (8.74) is quite high when considering the CG ratings get 10 as a maximum. While mean value of public disclosure and transparency's sub-ratings gets the highest value with 9.11, mean value of board of director's sub-ratings gets the lowest value with 8.18.

The data procured from several sources. While year-end balance sheet data obtained from the Public Disclosure Platform (KAP) and stock price information is obtained from BIST official website, summary and sub-ratings of the firm compliance with the Principles is procured from Corporate Governance Association of Turkey (TKYD) website.

Application and results. In this section, we present results on the ability of the summary and sub-ratings in predicting firm performance measured by ROA, MVA and Tobin's Q. In panel data analysis, there are two prediction models: random effects and fixed effects. Model selection is made by Hausman Test (Wooldridge, 2002). The hypothesis of Hausman Test are as follows¹:

H₀: Random Effect Model [E(uit / Xit) = 0]

H₁: Fixed Effect Model [E(uit / Xit) ≠ 0]

As in all-time series, it is also necessary to test whether variables are stationary. Levin-Lin-Chu (LLC) (2002) test applied to determine whether they are stationary. The hypothesis of LLC is as follows²:

H₀: Each time series contains a unit root

H₁: Each time series is stationary

¹ If the probability value is less than 0.05, H₀ is accepted, otherwise H₁ is accepted. For each 4 model, Hausman test is applied separately and the analysis is conducted in accordance with test results.

² If the probability value is less than 0.05, H₀ is accepted, otherwise H₁ is accepted.

Table 4. LLC Test Result, author's

VARIABLES	t-Statistic	Prob.
CG	-18.2543	0.0000***
SHRHLDRS	-11.4395	0.0000***
DISCLOSURE	-74.6930	0.0000***
STKHLDRS	-18.2166	0.0000***
BOD	-71.8514	0.0000***
ROA	-17.9866	0.0000***
LN(MVA)	-74.4384	0.0000***
TOBIN'S Q	-17.4916	0.0000***
LEVERAGE	-10.1560	0.0000***
LN(ASSETS)	-9.21643	0.0000***

LLC test results revealed that there is not unit root problem in the series. As seen from the table, probability values for all of the series are smaller than 0.05, thereby H_1 is accepted while rejecting the H_0 .

In the model 1, the relation between summary rating and firm performance measured by ROA is investigated. The analysis is made by using fixed effect model as a result of Hausman test. Table 7 present that there is not statistically significant relation between summary CG ratings and ROA.

Table 5. Model 1 Test Result, author's

Dependent variable: ROA				
Variables	Coefficient	Std. Error	t-Statistic	Prob.
CG	-0.021281	0.016999	-1.251947	0.2123
LN(ASSETS)	0.063369	0.021208	2.988053	0.0032***
LEVERAGE	-0.195831	0.086937	-2.252565	0.0255**
C	-1.014344	0.360059	-2.817160	0.0054***
R-squared	0.428438			
Adjusted R-squared	0.294529			
Prob (F-statistic)	0.000000			
Hausman Test Results				
Test Summary	Chi-Sq. Statistics	Chi-Sq. d.f.	Prob.	
Cross-section random	15.559283	3	0.0014***	

***significant at %1 level; **significant at %5 level; *significant at %10 level.

In the model 2, the relation between sub-ratings and firm performance measured by ROA is analyzed. Similar to model 1, the analysis is conducted by using fixed effect model. The results reveal that there is a negative and statistically significant relation between BOD sub-rating and ROA. In addition to this, there is not statistically significant relation is determined between ROA and other sub-ratings.

In the model 3, the relation between sub-ratings and firm performance measured by MVA is investigated. The prediction of the model is conducted by using fixed effect model. According to the results, there is not statistically significant relation between BOD and DISCLOSURE sub-ratings and MVA. In addition, there is positive and statistically significant relation is determined between SHRHLDRS sub-rating and MVA, while negative and statistically significant relation is found between STKHLDRS sub-rating and MVA.

Table 6. Model 2 Test Result, author's

Dependent variable: ROA				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
BOD	-0.015706	0.009076	-1.730483	0.0853*
DISCLOSURE	-0.031369	0.026290	-1.193178	0.2345
SHRHLDRS	0.032143	0.023406	1.373310	0.1715
STKHLDRS	0.004070	0.017598	0.231273	0.8174
LN(ASSETS)	0.072273	0.022194	3.256460	0.0014***
LEVERAGE	-0.241177	0.091193	-2.644684	0.0089***
C	-1.266308	0.391039	-3.238320	0.0014***
R-squared	0.440732			
Adjusted R-squared	0.296827			
Prob (F-statistic)	0.000000			
Hausman Test Sonuçları				
Test Summary	Chi-Sq. Statistics	Chi-Sq. d.f.	Prob.	
Cross-section random	22.135286	6	0.0011***	

***significant at %1 level; **significant at %5 level; *significant at %10 level

When these two outcomes are considered together, it can be said that shareholders do not support the policy on stakeholder's interest while they appreciate the positive policies are followed by the firm about themselves and this situation is reflected in the market value of the firm.

Table 7. Model 3 Test Result, author's

Dependent variable: LN(MVA)				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
BOD	-0.379715	1.358345	-0.279542	0.7802
DISCLOSURE	-2.677834	3.887692	-0.688798	0.4919
SHRHLDRS	6.628252	3.553621	1.865211	0.0639*
STKHLDRS	-4.487638	2.653226	-1.691390	0.0926*
LN(ASSETS)	-0.539012	2.226126	-0.242130	0.8090
ROA	15.34493	11.40006	1.346040	0.1801
C	24.96158	41.69178	0.598717	0.5502
R-squared	0.707704			
Adjusted R-squared	0.632493			
Prob (F-statistic)	0.000000			
Hausman Test Sonuçları				
Test Summary	Chi-Sq. Statistics	Chi-Sq. d.f.	Prob.	
Cross-section random	20.329304	6	0.0024***	

***significant at %1 level; **significant at %5 level; *significant at %10 level.

In the last model, the relation between sub-ratings and firms performance measured by Tobin's Q is investigated. Similar to others, the analysis in model 4 is conducted by using fixed effect model. The table presents that there is a negative and statistically significant between DISCLOSURE sub-rating and Tobin's Q.

Table 8. Model 4 Test Result, author's

Dependent variable: Tobin's Q				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
BOD	0.044615	0.044093	1.011834	0.3128
DISCLOSURE	-0.242142	0.116263	-2.082701	0.0385**
SHRHLDRS	0.027022	0.102593	0.263394	0.7925
STKSHLRS	0.079905	0.084696	0.943427	0.3465
LN(ASSETS)	0.160538	0.070758	2.268826	0.0243**
C	-1.261394	1.351728	-0.933171	0.3518
R-squared	0.694647			
Adjusted R-squared	0.616499			
Prob (F-statistic)	0.000000			
Hausman Test Sonuçları				
Test Summary	Chi-Sq. Statistics		Chi-Sq. d.f.	Prob.
Cross-section random	14.102383		5	0.0150**

***significant at %1 level; **significant at %5 level; *significant at %10 level

Discussion. The weak and mixed results would be interpreted in different ways. Primarily, it is extremely complicated to assign one single score for complex dimensions of different CG practices. CG consists of several mechanisms ranging from board of directors, ownership structure, public disclosure, shareholders rights, stakeholders rights to legislative regulations. These mechanisms also consist of several sub-categories. Therefore, it is difficult to express such a diverse CG mechanism with a single score.

Besides, experts disagree on the measurement of the CG practices and claims more reliable and valid measurement for CG is required. For the case of Turkey, using the Principles issued in 2003 and revised in 2005 as a base on assessment for all the following years until 2014 where the updated version of the Principles is issued may have produced misleading results. In addition, rating institutions consider the mandatory attributes when they rate firms, and this situation may have resulted in very high CG scores, correspondingly deceptive results. For instance, rating institutions consider the representation of independent board members and Principles state that “independent board members should comprise at least one-third of the board of directors and in any case, two members of the board should be independent”. Consistent with this view, M. Ararat et al. (2016) build a Turkey Corporate Governance Index (TCGI) without including attributes required by Turkish law, and find a positive relation between firm value and profitability.

Another argument is that commercial CG ratings affect firms CG practices. More clearly, if board of directors may focus solely on increasing their CG ratings instead of actually implementing good CG practices. Then CG ratings do not reflect the right information about CG practices at the firm.

Conclusion. The recent financial reporting scandals at world-leading firms make CG one of the important issues should be considered by investors when they make an investment decision. As a result, firms put significant pressure on their CG attributes to attract more investors. Following these development, several rating institutions start publishing CG ratings which demonstrate the overall soundness of CG practices

at the firm. However, criticism about difficulties of assigning a single score for different CG dimensions and very high CG ratings cause doubt on their validity.

In this paper, we investigate the ability of CG ratings provided by authorized Turkish commercial rating institutions in reflecting firm performance. We examine both summary and sub CG ratings. The results indicate that there is no statistically significant relation between summary ratings and firm financial performance. In addition to this, the relation between sub-ratings and firm performance varies based on performance measures. For instance, there is a negative and statistically significant relation between ROA and BOD sub-rating, while there is not statistically significant relation with other sub-ratings. When we use MVA as a performance measure, we find that there is a positive and reliable relation between SHRHLDRS sub-rating and performance, while there is a negative and statistically significant relation with STKHLDRS. Besides, there is no significant relation between BOD and DISCLOSURE sub-rating and MVA. Finally, when we use the Tobin's Q as a performance measure, we find a negative relation with DISCLOSURE sub-rating, while there is not statistically significant relation with other sub-ratings.

Taken together, our results document CG ratings performs poorly in reflecting firm financial performance. These results are similar to results of R. Epps and S. Cereola (2008), Daines et al. (2010) and confirm the suspicion of academic researchers and practitioners for the validity of CG ratings. However, our study has several limitations. The study covers relatively small sample and short time period so further research would larger sample and cover longer time horizon.

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