Available online at www.sciencedirect.com

Borsa İstanbul Review

Borsa İstanbul Review 15-4 (2015) 259–271
http://www.elsevier.com/journals/borsa-istanbul-review/2214-8450

Market reaction to director independence at Borsa Istanbul ☆

Emrah Arioglu

Cukurova Universitesi, IIBF Isletme Bolumu, Balcali, Saricam, Adana, 01330, Turkey

Received 10 April 2015; revised 26 May 2015; accepted 29 September 2015

Available online 11 November 2015

Abstract

This study investigates the market reaction to appointments and departures of independent directors to boards and various board committees, as well as the magnitude of the market reaction based to the expertise and busyness of these directors. The findings suggest that investors in Turkish capital markets do not value the existence of independent directors on boards or committees of boards. In addition, the findings suggest that investors do not value the expertise of independent directors. However, investors appear to value the busyness of independent directors. The findings are robust to various model specifications.
Copyright © 2015, Borsa İstanbul Anonim Şirketi. Production and hosting by Elsevier B.V. This is an open access article under the CC BY-NC-ND license (http://creativecommons.org/licenses/by-nc-nd/4.0/).

JEL classification: G34

Keywords: Independence; Corporate governance; Borsa Istanbul; Expertise; Busyness

1. Introduction

The trend in developed markets in the last decade has been towards boards with a majority of independent directors. In the US stock markets, the legal reforms and laws, such as Sarbanes-Oxley Bill, and the regulations imposed by the stock exchanges require the majority of board members to be independent for public firms. In addition, these firms are required to have their audit committees comprised of all independent directors. Even though scholars still argue whether or not these requirements are necessary (Black & Kim, 2012; Boone, Field, Karpoff, & Raheja, 2007; Coles, Daniel, & Naveen, 2008; Karmel, 2014; Le Mire & Gilligan, 2013), boards in the US today are "more independent" compared to the pre-Bill period (Linck, Netter, & Yang, 2008). On the other hand, director independence at public firms in Turkey has mainly received attention in the most recent years. As suggested by Ararat and Cetin (2008) and Ararat, Black, and Yurtoglu (2014), prior to the corporate governance reform of Turkey, a majority of firms did not have any independent directors on their boards. However, as the Principles of Corporate Governance (PCG) of Turkey became effective, requirements such as those in developed countries regarding director independence are imposed on Turkish public companies.

Boards of directors generally consist of both inside and independent directors. Inside directors, who are executives of firms, have valuable firm specific knowledge and they can deliver this information to outside board members. Still, these insiders are relatively more influenced by CEOs and their careers are more sensitively tied to CEOs, compared to independent directors. Thus, these individuals might not be able to evaluate and monitor CEOs effectively (Jensen, 1993).

This argument highlights the importance of independent directors. The proponents of independent directors argue that they could be considered as "more effective" monitors, compared to insiders since their careers are not tied to CEOs. Thus, they would be expected to be less influenced by CEOs, and be better monitors. Also, for these independent directors,

☆ I would like to thank Ali Kutan (the Editor) and an anonymous referee for very useful comments. In addition, I would like to thank Amy Marie Arioglu, Pinar A. Kaya, Richard Lucas, Onder Uzkaralar, and Ann G. T. Young for their valuable help.

E-mail address: earioglu@cu.edu.tr.

Peer review under responsibility of Borsa İstanbul Anonim Şirketi.

http://dx.doi.org/10.1016/j.bir.2015.09.002
2214-8450/Copyright © 2015, Borsa İstanbul Anonim Şirketi. Production and hosting by Elsevier B.V. This is an open access article under the CC BY-NC-ND license (http://creativecommons.org/licenses/by-nc-nd/4.0/).

reputational concerns would be very important, in terms of future opportunities to obtain additional board appointments in other firms (Hermalin & Weisbach, 1991; Masulis & Mobbs, 2014). Thus, independent directors could potentially be expected to have the incentives to be better monitors (Wang & Le, 2012). In addition, independent directors could be valuable sources for advising (Huang, Hsu, Khan, & Yu, 2008), which, alongside monitoring, is considered as one of the main responsibilities of board members (Arioglu & Kaya, 2015; Coles, Daniel, & Naveen, 2014). These directors could provide boards with valuable connections to external resources.

On the other hand, the biggest potential disadvantage of independent directors is that they could be expected to lack valuable firm specific information, at least when their tenure is not too long at the firm. However, this does not necessarily imply that independent board members would be totally uninformed (Ravina & Sapienza, 2010).

In light of these arguments, researchers have widely investigated the effects of the existence of independent directors on a variety of corporate issues. Gilson (1990) and Fich and Shivdasani (2007) provide evidence supportive of reputational concern arguments. Thus, one could expect independent directors to perform their monitoring functions effectively, leading to improved firm performance and value. However, the majority of empirical findings are not consistent with this expectation. Hermalin and Weisbach (1991), Mehran (1995), and Wintoki, Linck, and Netter (2012) find no relationship between the composition of the board and firm performace. Agrawal and Knoeber's (1996) evidence even suggests that more outsiders present on the board of the firm are negatively related to firm performance. However, Knyazeva, Knyazeva, and Masulis (2013) provide evidence suggesting that board independence has a positive impact on firm value.

Compared to the evidence provided in these studies, evidence suggestive of positive effects of independent directors on other corporate issues is more significant. Byrd and Hickman (1992) provide supportive evidence in acquisition process. Mehran (1995), Core, Holthausen, and Larcker (1999), and Harvey and Shrieves (2001) provide evidence supportive of positive effects in terms of compensation, whereas Weisbach (1988) provides supportive evidence in CEO removal process. Uzun, Szewczyk, and Varma (2004) find evidence supportive of positive effects on financial statement fraud likelihood. However, in contradiction with these findings, Guthrie, Sokolowsky, and Wan (2012) are not able to find a significant effect of board composition on CEO pay.

In other studies, Bradley and Chen (2015) find that the composition of boards has an effect on the risk taking by board members. Brochet and Srinivasan (2014) show that shareholders are likely to hold some independent directors more accountable, compared to other directors, when firms experience financial fraud. Armstrong, Core, and Guay (2014) argue that there might be a simultaneous relationship between board independence and transparency of the company. Ferreira, Ferreira, and Raposo (2011) find a negative relationship between board independence and price informativeness for stocks. Also, there are studies that link the existence of independent directors on boards with CEO power (Boone et al., 2007; Linck et al., 2008).

Yet, the number of studies investigating director independence for Turkish capital markets is very limited. Ararat and Cetin (2008), Kaymak and Bektas (2008), and Caliskan and Icke (2009) investigate director independence at banks. Ararat, Aksu, and Cetin (2010) and Ararat, Orbay, and Yurtoglu (2010) investigate the relationship between independence and firm performance. Ararat et al. (2014) investigate the issue in a governance index context. Different from these studies, in this study I investigate the market reaction to the appointments (departures) of independent directors to (from) boards as well as their appointments to (departures from) various board committees. In addition, I investigate how the magnitude of the market reaction changes based on the expertise and busyness of these directors, which could potentially affect the monitoring capacities of independent directors. To achieve this goal, I use a hand-collected dataset that contains various characteristics of board members. In addition, I utilize from a dataset, which contains the announcements dates of director appointments and departures, that I created by reading each announcement submitted to the Public Disclosure Platform (PDP) by public firms. To cope with any potential concerns regarding econometric issues, I employ various (i) event window lengths, (ii) expected return estimation models, and (iii) market return variables, and conduct various significance tests based on the arguments in Basdas and Oran (2014). I believe that the findings of this study would provide valuable insights for scholars investigating corporate governance in emerging markets, as well as the policymakers in Turkish capital markets.

2. Regulatory background

In this Section, I summarize the regulations that are related to director independence in public firms quoted at the Borsa Istanbul.[1] In this study, the sample covers independent director appointments and departures that were announced between January 1, 2012 and June 30, 2014. Until January 3rd, 2014, the Communique Serial IV No 56 of Capital Markets Board of Turkey (CMB), which regulates the Principles of Corporate Governance of Turkey, was effective. Before I proceed, it should be noted that as opposed to some of the Articles of the PCG that are in the form of suggestions, the Articles regarding independent directors are mandatory for public firms.

The Article 4.3.3 of the PCG states that among the board members, who are not employed in the company as executives, there are independent board members. These

[1] Legal regulations are vital for the practices of companies and could directly or indirectly affect firm performance. Therefore, they could possibly affect investor behavior. In addition, regulations that concern the practices of companies would naturally have an effect on financial development and economic growth of a country (Akisik, 2013; Law, Azman-Saini, & Tan, 2014; Neyapti & Dincer, 2014).

Download English Version:

https://daneshyari.com/en/article/7341944

Download Persian Version:

https://daneshyari.com/article/7341944

Daneshyari.com