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Corporate governance and firm performance in emerging markets: Evidence from Turkey

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ABSTRACT

This is a study of the relationship between context, internal corporate governance and firm performance, looking at the case of Turkey, an exemplar of family capitalism. We found more concentrated ownership, often in the hands of families, led to firms performing better; concentrated ownership means that controlling families bear more of the risks of poor performance. Less predictably, given that the institutional environment is so well attuned to family ownership, we found that mechanisms that accord room for a greater range of voices and interests within and beyond families – larger boards and foreign ownership stakes – seem to also make for positive performance effects. We also noted that increase in cross ownership did not influence market performance, but was negatively associated with accounting performance. Conversely, we found that a higher proportion of family members on boards had no discernable effect on performance. Our findings provide further insights on the relationship between the type of institutions encountered in many emerging markets, internal corporate governance configurations and firm performance.

1. Introduction

This is a study of the effect of internal corporate governance (CG) mechanisms on firm performance in an emerging market setting where institutional arrangements are weak and fluid; it further explores whether any relationships follow on the lines of theories developed in the West, or are context specific. The existing CG literature emphasizes two different systems: Market-based (outsider) and relationship-based (insider) ones (Bozec, 2007; Heenetigala, 2011; Hilb, 2006; Kyereboah-Coleman & Biekpe, 2006; Solomon & Solomon, 2004). The market-based or shareholder value system is mostly seen in Anglo-Saxon countries such as the US and UK, where the protection of minority shareholders is robust, and there is a strong emphasis on maximizing shareholder value (La Porta, Lopez-de-Silanes, Shleifer, & Vishny, 1997). On the other hand, the stakeholder orientated or relationship-based system is encountered in Continental Europe and parts of Latin America East Asia. Here, the role of the firm is much broader than maximizing shareholder profit, and that it seeks to benefit as wide a range of stakeholders as possible (Berghe, 2002; Demirbag, Wood, Makhmadshoev, & Rymkevich, 2017; Dore, 2008). There are also hybrid systems, such as Turkey, which combine some of the characteristics of each; this may translate to weak ownership rights, but not necessarily stronger countervailing rights for stakeholders (Banks, 2004).

There is already an extensive body of literature on the relationship between ownership structure, board composition and attributes, and firm performance (Bauwhede, 2009; Chiang & Lin, 2007; Finegold, Benson, & Hecht, 2007; Górriz & Fumás, 1996; Hillman & Dalziel, 2003; Klapper & Love, 2004; Lam & Lee, 2012; Maury, 2006; Nicholson & Kiel, 2007; Singh & Gaur, 2009). However, rather more contentious is the extent to which such relationships reflect general principles, such as an inherent 'conflict of interest between the shareholders and managers'; how national institutional frameworks might impact on, mitigate or intensify any such tensions; and, indeed, whether alternative, potentially equally valid approaches to CG are valid, and indeed may work better in specific settings (c.f. Aguilera & Cuervo-Cazurra, 2009). The existing literature on boards, ownership and performance has tended to concentrate on variations in internal CG mechanisms within liberal market frameworks, and on exploring the ways in which shareholder rights may be enforced to maximize shareholder value.

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It can be argued that these effects of internal CG arrangements may be amplified – and, hence, much more visible – in contexts with weak and fluid institutions, where external corporate governance arrangements are less effective (Dore, 2008). There has been growing interest in understanding how institutions operate, and the effects of variations in institutional coverage in emerging markets, and in contexts where family ownership is widespread (Witt & Redding, 2013). However, a limitation of much of the existing comparative institutional literature is that the firm is treated as something akin to a transmission belt with contextual features translating into performance outcomes (Wood, Deben, & Ogden, 2014). Yet, institutional arrangements directly impact on intra-organization governance and practice; hence, this study provides a close analysis of the relationship between institutions, internal corporate governance and performance, drawing out the linkages and interconnections between them. Moreover, examining the relationship between institution-specific CG influences and firm performance, measured using both accounting and market-based performance indicators provides a methodological contribution towards a better articulation of CG-firm performance link in the context of an emerging market economy for which only a handful of studies have hitherto been conducted (Singh, Tabassum, Darwish, & Batsakis, 2018). Finally, there has been growing interest in Turkey, a rapidly growing emerging market, but one where there has been increasing concerns as to the direction of institutional change (Bugra & Savaşkan, 2014; Karadag, 2010).

The remainder of the study is organized as follows. In Section 2, we provide a brief information on the development of CG in Turkey. Then, we review relevant literature and develop the study's hypotheses. Research method is presented in Section 4, followed by results and discussion. Conclusion is given in the final section.

2. Corporate governance in Turkey

Turkey is broadly of French legal origin (La Porta et al., 1997), but incorporates some Anglo-Saxon features. Examples of the latter would include monist (one-tier) board systems, that employees are generally not represented on boards, that organizations mostly act for the profit maximization of shareholders (stakeholder countervailing power is weak), whilst banks or financial institutions do not dominate business system through holding shares or voting rights unlike some European countries (Nilsson Okutan, 2007). However, Turkey's security market is not broad enough and market capitalization is low compared to that of Anglo Saxon firms. Ownership structure is not widely dispersed (Atakan, Ozsoy, & Oba, 2008; Demirbag, Fracknall-Hughes, Glaister, & Tatoglu, 2013). Property rights under the law are relatively weak (La Porta et al., 1997). Families in Turkey own 68 of the 100 largest traded companies and 53 percent of these families possess more than 50 percent of voting rights (Demirag & Serter, 2003). Usdiken, Yildirim-Oktem, and Senol (2015) claim that family ownership structure in Turkey has been observed since 1940s. Ararat and Ugur (2006) suggest controlling shareholders in Turkey maintain large stakes and leverage cash flow rights due to privileged shares and pyramidal ownership structures. This causes families hold the majority of shares of one more companies through pyramidal structure (Demirag & Serter, 2003). Due to large and limited number of shareholders in most businesses, Turkish business environment runs as a networking system rather than through formal contracts. Finally, the broadly civil law Turkish legal framework (La Porta et al., 1997) incorporates Anglo Saxon elements (Nilsson Okutan, 2007), but at most, is a hybrid-based system, rather than one that is shareholder rights orientated.

The 1999 OECD Corporate Governance Principles required member countries (including Turkey) to take some initial steps to develop an appropriate CG code. In line with this suggestion, Turkey issued its first governance code in 2003. There were also various codes/principles issued voluntarily by the Turkish Industrialists and Businessmen's Association (TUSIAD), the Corporate Governance Association of Turkey (TKYD), and regulatory agencies such as the Capital Market Board (CMB) up until 2011. These codes were not compulsory and relied on '*comply or explain*' rule. The CMB was designated by the Turkish Government as a formal authority in charge of both issuing and mandating CG rules in 2011. This development was important because until that time there were no centralized structure and no obligation for publicly traded firms who were not willing to adopt CG codes. The CMB's first code, the Communiqué No. 54, brought forward some compulsory rules; this was followed on by three further codes, Communiqués No. 56, No. 57, and No. 60, based on suggestions from public and private companies, but also due to complications arising from the application of the existing CG Code. Finally, the CG principles were updated via Communiqué No. 17, in 2014, in order to comply with the new Turkish Commercial Code, which came into effect in 2012. This new version of CG code brought some compulsory and advisory resolutions regarding the composition of board of directors and shareholders.

It is widely acknowledged that there have been some significant institutional developments since 2003 regarding the development of internal and external CG mechanisms established by the regulatory authorities: The Turkish CG Code was issued; Turkish Commercial Code revised; Public Oversight Accounting and Auditing Standards Authority founded; Turkish Accounting and Financial Reporting Standards were issued; and the Capital Market Board made some serious changes to increase transparency. Although Turkey has experienced major institutional reforms, Turkey nevertheless shares almost all of the salient features of many emerging market CG regimes, including weak institutions (uneven law enforcement, shareholder and creditor protection), pyramidal business groups, dual class shares and concentrated family ownership (Demirag & Serter, 2003).

3. Theoretical background and hypotheses

3.1. Institution-specific CG influences

There are many different strands of institutional theory, from micro level sociological approaches, which focus primarily on internal organizational dynamics (DiMaggio & Powell, 1991) to macro level economic and socio-economic approaches that seek to link firm behavior to wider societal realities. A key concern of the former is on the embeddedness of organizational processes and routines, and how these are legitimized (Greenwood & Hinings, 1996); meanwhile the latter concentrates on the relationship between societal level institutions – and the dominant patterns they assume – and firm level practices (Wood, Dibben, & Ogden, 2014). However, there has been a convergence across the different strands of institutional theory around the recognition of the central role of shared bodies of meaning, systems, regulations and governance (ibid.). Again, institutional theory seeks to explain both stability in, and commonalities between organizations, and how and why systemic and firm level change happens (Greenwood & Hinings, 1996). This study centers on the relationship between contextual dynamics and intra-firm practice. Hence, it focuses on both on how national level institutions and the associated investment ecosystem impact on internal CG, and how the latter may be associated with persistent modes of behavior reflecting internal and external dynamics.

Whilst sharing these concerns with other strands of institutional analysis, the literature on comparative capitalism specifically focuses on the relationship between national level institutional realities, the extent and density of ties between key societal actors, dominant modes of CG and intra-firm practices (Wood et al., 2014). The initial concern of such theories was with the advanced coordinated (e.g. Germany, Japan and Scandinavia) and liberal market economies (e.g. US and UK) (Hall & Soskice, 2001; Hancke, Rhodes, & Thatcher, 2007). Initially, it was felt that emerging markets would evolve towards one or other of these models (ibid). However, there is growing evidence that emerging markets are not so much evolving towards one of the more mature

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