The Relationship between Corporate Governance and Performance of Insurance Firms: Evidence from Turkey

**Mesut Doğan**

*Afyon Kocatepe University, Afyonkarahisar, Turkey*

[mesutdogan@aku.edu.tr](mailto:mesutdogan@aku.edu.tr)

**Bilge Leyli Elitaş**

*Yalova University, Yalova, Turkey*

[bilgeleyli@yalova.edu.tr](mailto:bilgeleyli@yalova.edu.tr)

**Ramazan Nacar**

*Yalova University, Yalova, Turkey*

rnacar@yalova.edu.tr

**Abstract**

There are many studies in the field of corporate governance from all around the world. In accordance with these studies, it is emphasized that it cannot be mentioned about any single corporate governance model which is valid for all countries. Thus, this study aims to research the relationship between corporate governance and performance of insurance firms. Data used in this study is derived from seven insurance firms listed on Borsa İstanbul (BİST) and it is limited to 2005-2011 periods. The effects of corporate governance on performance of insurance firms are analyzed by multiple regression method. In the study, Return on Equity (ROE) is used as performance indicator of insurance firms, namely the dependent variable. And insurance firms’ size of board of directors, free float rate, CEO duality, the block holder ratio, number of owners and total assets have been used as independent variables. The results of the analysis have proven a positive relation between ROE and free float rate, CEO duality and total assets.

**Keywords:** Corporate Governance, Firm Performance, Insurance Firms.

**Introduction**

The most used definition about the corporate governance is “*Corporate governance deals with the ways in which the suppliers of finance to corporations assure themselves of getting a return on their investment”* by Shleifer and Vishny (1997: 737)

Corporate governance aims to manage in a way which maximizes the profits and benefits of corporate shareholders. It has the most important role to gain trust of investors and the public (Pamukçu, 2011: 134).

Corporate governance gives investors a power to prevent CEO and board of directors to expropriate all corporations’ assets. Corporate governance can be summarized in one word as a control (Kula, 2006).

Maher and Andersson (1999) referred that there is an effect of corporate governance on corporate and economic performance. Corporate governance both influences the progress and processing of capital markets and puts forward powerful impact on resource allocation. Corporate governance, which is a significant framework condition, also impresses industrial competitiveness and economies of member countries in the period of high capital mobility and rapid globalization (Maher and Andersson, 1999). In the literature there are many studies that researched the effects of corporate governance on corporate performance, especially for developed markets. Researchers stated that fine governance applications result in the enhancements of economic value added, higher productivity and reduce the risk of systematic financial failure. However, there is no sufficient research for emerging markets, thus researching corporate governance in emerging markets is a fast-growing area (Maher and Andersson, 1999).

Corporate governance cause to change business management philosophy in the field of information systems and accounting system (Aysan, 2007).

There are studies about the relationship between corporate governance and firm performance in the literature. But the originality of this paper comes from assumption that it is the pioneer study that examined how corporate governance effects the performance of insurance firms for Turkey.

This study aims to analyze the effects of corporate governance on the performance of insurance firms. The originality of this paper with this purpose, a sample has been constituted by using financial data of 7 insurance firms traded in Borsa İstanbul (BIST) for the period of 2005-2011. The effects of corporate governance on the performance of insurance firms are analyzed by multiple regression method. In the study, Return on Equity (ROE) is used as performance indicator of insurance firms, namely the dependent variable. And insurance firms’ size of board of directors, free float rate, CEO duality, the block holder ratio, number of owners and total assets have been used as independent variables.

The study consists of five sections. In the second section that follows the introduction part, we summarize academic studies that measure the relationship between corporate governance and firm performance. The third section describes the methodology and the model of the study by introducing dependent and independent variables. The fourth chapter covers the results of multiple regression models. And in the last section we conducted an overall assessment of the research.

**The Literature Review**

Drobetz, Schillhofer and Zimmermann (2003) examine the relationship between corporate governance and firm performance in Germany. Tobin’s Q and market-to-book ratio (MTBR) are used as firm valuation measures. According to the results of the empirical study there is a strong and a significant positive relationship between the quality of firm-level corporate governance and firm valuation.

Beiner et. al. (2004) analyzed the relationship between corporate governance and firm valuation for Switzerland. The results of study show that corporate governance index (CGI), board size and shareholdings of officers and directors have a statistically significant effect on firm valuation. Beiner et. al. (2004) stated that the positive relationship between firm-level corporate governance and Tobin’s Q.

Wu and Xu (2005) investigated corporate financing decisions and corporate governance effects on the firm value. Findings of the study are consistent with major corporate governance theories explaining financing decisions’ roles in a more competitive financial market.

Chhaochharia and Grinstein (2007) founded that the corporate governance rules (Sarbanes-Oxley Act) had a significant effect on firm value.

Javed and Iqbal (2007) analyzed the relationship between corporate governance and firm value for the Karachi Stock Market, Pakistan. The sample of 50 firms is selected for the year 2003, 2004 and 2005 for the empirical study. The Tobin’s q, corporate governance index (CGI)-board composition (board), ownership and shareholdings (share) and disclosure, transparency and auditing (disc.); and size (in assets), leverage (debt/total asset ratio) and growth (average sale growth) are used in estimation. According to the results of the study a positive and significant relation has been found between the quality of firm-level corporate governance and firm performance.

Toraman and Abdioğlu (2008) investigated weak and strong corporate governance practices of Borsa Istanbul (BIST) corporate governance index companies. In this respect rating reports had been investigated. Study results shows that the most powerful corporate governance practices are observed at the stakeholders section and the weakest are at the board of directors section of the guide.

Dinç and Abdioğlu (2009) have studied the relationship between corporate governance and accounting information system with an empirical study for the BIST-100 (Borsa İstanbul-100) companies. Dinç and Abdioğlu (2009) points out that there is a strong positive correlation between accounting information system and corporate governance.

Karamustafa et. al. (2009) investigated the relationship between corporate governance and corporate performance by analyzing Corporate Governance Index of 8 firms listed in BIST (Borsa İstanbul). They used both pre- and post-indexed the firms’ data. They treated current ratio, asset turnover, ROA, profit capital ratio, net profit margin, operating profit margin, debt ratio and financial leverage ratio as financial performance indicators of firms. They founded that there is statistical difference for asset turnover, ROA, and profit capital ratio between pre- and post-index periods.

Najjar (2012) in his study examines the effect of corporate governance mechanisms on the firm’s performance of the insurance industry in Bahrain. A sample of five insurance companies listed on Bahrain Stock Exchange (BSE) has been used for the period of 2005-2010. The Pooled Least Squares method is used for the empirical study. Board size, CEO status, ownership concentration, firm size, industry performance, employees, shares traded is used as the independent variables and ROE is used as a dependent variable. According to the findings Najjar (2012) stated that in Bahrain there is a significant impact for corporate governance on the firm’s performance in the insurance industry. No significant impact of corporate governance has been found expressed by CEO status, ownership concentration, the number of employees, industry performance and number of shares traded on the firm’s performance (ROE). But a significant impact has been found for board size, firm size and number of blocks-holders on firm performance.

Hatunoğlu and Güneş (2012) studied about the effects of the corporate governance practices on accounting information system based on new Turkish Commercial Code.

**Methodology**

The present study aims to analyze the influence of corporate governance on insurance firms' performance. With this purpose in mind, a sample has been constituted by using financial data of 7 insurance firms traded in Borsa İstanbul (BIST) in the years of 2005-2011. All data utilized in the study have been obtained from the official web site of Borsa İstanbul (BIST)[[1]](#footnote-1). Multiple regression and descriptive statistics have been used in empirical analysis. Durbin-Watson d statistic has been used to test if there is an autocorrelation of first degree between the error terms of the sample. Additionally, variance inflation factors (VIF) method has been used to determine multicollinearity. One dependent variable (ROE) and six independent variables (*BOARDSIZE, FFRATE, DUALITY, BLOCKHOLDERS, OWNERSHIP* and *SIZE*) have been used in the multiple regression models. Dependent and independent variables used in the study are as below.

Table 1: Descriptions of Variables Used in Analysis

|  |  |
| --- | --- |
| Variables Description | Variables Description |
| Dependent Variables |  |
| Return on Equity (ROE) | The ratio of net profit after tax to total equity capital |
| Independent Variables |  |
| The Size of the Board of Directors (BOARDSIZE) | It shows the total number of members in board of directors. |
| Free Float Rate (FFRATE) | It is the rate of free float of the business. |
| Ceo Duality (DUALITY) | The cases in which CEO is the chairman of the board of directors=1 other cases=0 |
| Structure of Ownership (BLOCKHOLDERS) | The ratio of blockholder’s stocks to all stocks. |
| Number of Owners (OWNERSHIP) | Number of owners of insurance firms |
| Size of firm (SIZE) | Natural logarithm of total assets |

Below regression model and hypotheses have been developed based on dependent and independent variables introduced in Table 1 as well as considering the studies of Najjar (2012) and Javed and Iqbal (2007) found in literature.

**Model:** *(ROE)it= βit+ β2 BOARDSIZE it + β3 FFRATE it + β4 DUALITY it+ β5 BLOCKHOLDERS it + β6 OWNERSHIP+ β7 SIZE +eit*

*H1: There is significant impact for board size on ROE.*

*H2: There is significant impact for free float rate on ROE.*

*H3: There is significant impact for Ceo duality on ROE.*

*H4: There is significant impact for blockholders on ROE*

*H5: There is significant impact for ownership concentration on ROE*

*H6: There is significant impact for firm size on ROE*

Table 2 shows the results of descriptive statistics concerning dependent and independent variables used in empirical analyses. As shown in Table 1, average return on equity (ROE) of the firms listed in BIST and reviewed in scope of the analysis is calculated as -0.7%. Additionally, the values for insurance firms’ board of directors’ size (*BOARDSIZE)*, their free float rate *(FFRATE)*, the ratio of block holder’s stocks to all stocks (*BLOCKHOLDERS*) and number of owners (*OWNERSHIP*) have been determined as **7.57;** 22.37; 61.26 and 3.14 respectively.

Table 2 Descriptive Statistics

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Variables | Number Of Observations | Minumum | Maximum | Mean | St. Dv. |
| *Roe* | 49 | -1,34 | 0,36 | -0,007 | 0,30 |
| *Boardsize* | 49 | 5 | 14 | 7,57 | 1,58 |
| *Ffrate* | 49 | 1,34 | 41 | 22,37 | 1,45 |
| *Duality* | 49 | 0 | 1 | 0,29 | 0,45 |
| *Blockholders* | 49 | 34,22 | 98,66 | 61,26 | 2,05 |
| *Ownership* | 49 | 2 | 5 | 3,14 | 1,12 |
| *Size* | 49 | 22,45 | 18,68 | 20,53 | 1,01 |

**Findings**

Table 3 shows multiple regression analysis results indicating the relation between performance of insurance firms and corporate governance related to above developed model.

Table 3 Results of Regression Analysis

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| MODEL  ROE | Unstandardized  Coefficients | | Standardized  Coefficients | t | Sig. | Collinearity Statistics | |
| B | Standart  Error | Beta | Tolerance | VIF |
| Constant | -2,497 | ,553 |  | -4,51 | ,000 |  |  |
| BOARDSIZE | ,004 | ,017 | ,023 | ,259 | ,796 | ,547 | 1,828 |
| FFRATE | ,009 | ,004 | ,445 | 2,232 | ,027 | ,108 | 9,233 |
| DUALITY | ,209 | ,055 | ,315 | 3,821 | ,000 | ,634 | 1,578 |
| BLOCKHOLDERS | ,004 | ,003 | ,247 | 1,316 | ,190 | ,122 | 8,219 |
| OWNERSHIP | ,037 | ,032 | ,140 | 1,169 | ,244 | ,299 | 3,342 |
| SIZE | ,090 | ,029 | ,303 | 3,087 | ,002 | ,445 | 2,246 |
| F-Statistic | 7,285 | | | | | | |
| Adjusted R2 | 0,162 | | | | | | |
| DurbinWatson | 1,745 | | | | | | |

\*\*\*, \*\* and \* indicate significance at the level of 1%, 5% and 10% respectively

According to Table 4, the results of regression model may be shown mathematically as below:

**Model :** *(ROE)it= βit+* ***(,023)****BOARDSIZE it +* ***(,445)****FFRATE it +* ***(,315)****DUALITY it+* ***(,247)****BLOCKHOLDERS it +* ***(,140)****OWNERSHIP+* ***(,303)****SIZE +eit*

When Model 1 is analyzed, independent variables of FFRATE, DUALITY and SIZE are observed to influence insurance firms’ performance (ROA). A positive relation has been found between free float rate (*FFRATE),* Ceo duality *(DUALITY)* and total assets *(SIZE)* and performance (ROE) of the insurance firms. In other words performance increases as free float rate and total assets of the insurance firm increase. In addition to this, return on equity rate of insurance firms have been observed to increase in cases in which general manager is also chairman of the board of directors. A positive and statistically insignificant relationship has been determined between insurance firms’ financial performances and other independent variables, namely the size of board of directors (*BOARDSIZE*), the ratio of block holder’s stocks to all stocks (*BLOCKHOLDERS)* and number of owners (*OWNERSHIP*). Although *BLOCKHOLDERS* and *OWNERSHIP* did not have a significant relation with the performance of insurance firms, the positive quality of this relation (β= 0,247 and 0,140) may be considered as an important finding. In conclusion, *H2, H3 and H6* hypotheses are accepted while *H1, H4 andH5* hypotheses are refuted.

Durbin-Watson d statistics have been used in the model to test if there is autocorrelation of the first degree. Durbin-Watson d statistics usually show no autocorrelation around 1.5 and 2.5 (Kalaycı, 2009: 267). Variance Inflation Factor (VIF) has been used to test multicollinearity and to support regression model’s results. Other method used to determine multicollinearity problem is tolerance value of the variables. In cases where VIF value is under 10 and tolerance value is not very close to 0, model is considered to be free from multicollinearity problem (Gujarati, 1995). All three models have pretty good VIF and tolerance values. There are no multicollinearity problems and autocorrelation in the model and this shows soundness and reliability of the model.

**Findings**

The present study aims to analyze the influence of corporate governance on insurance firms' performance. With this purpose in mind, a sample has been constituted by using financial data of 7 insurance firms traded in Borsa İstanbul (BIST) in the years of 2005-2011. In the study, Return on Equity (ROE) is used as performance indicator of insurance firms, namely the dependent variable. And insurance firms’ sizes of board of directors, their free float rates, CEO duality, the block holder ratio, number of owners and total assets have been used as independent variables.

The results of the analysis have proven a positive relation between ROE and free float rate, CEO duality and total assets. . In other words performance increases as free float rate and total assets of the insurance firm increase. In addition to this, return on equity rate of insurance firms have been observed to increase in cases in which general manager is also chairman of the board of directors. A positive and statistically insignificant relationship has been determined between insurance firms’ financial performances and other independent variables, namely the size of board of directors (*BOARDSIZE*), the ratio of block holder’s stocks to all stocks (*BLOCKHOLDERS)* and number of owners (*OWNERSHIP*). Although *BLOCKHOLDERS* and *OWNERSHIP* did not have a significant relation with the performance of insurance firms, the positive quality of this relation (β= 0,247 and 0,140) may be considered as an important finding. In conclusion, *H2, H3 and H6* hypotheses are accepted while *H1, H4 andH5* hypotheses are refuted.

**References**

Aysan, Mustafa A. (2007) “Muhasebe ve Kurumsal Yönetim” Muhasebe ve Finansman Dergisi (MUFAD), Sayı: 35, 17-24.

Beiner, Stefan; Drobetz, Wolfgang; Schmid, Markus M.; Zimmermann, Heinz (2004) “An Integrated Framework of Corporate Governance and Firm Valuation Evidence from Switzerland” European Corporate Governance Institute (ECGI) Working Paper Series in Finance, Working Paper No: 34/2004 January.

Chhaochharia, Vidhi and Grinstein, Yaniv (2007) “Corporate Governance and Firm Value: The Impact of the 2002 Governance Rules” The Journal of Finance Vol. 62, No. 4 (August 2007), pp 1789-1825.

Dinç, Engin and Abdioğlu, Hasan (2009) “İşletmelerde Kurumsal Yönetim anlayışı ve Muhasebe Bilgi Sistemi İlişkisi: İMKB-100 Şirketleri Üzerine Ampirik Bir Araştırma” Balıkesir Üniversitesi Sosyal Bilimler Enstitüsü Dergisi, Cilt: 12, Sayı: 21: 157-184.

Drobetz, Wolfgang; Schillhofer, Andreas; Zimmermann, Heinz (2003) “Corporate Governance and Firm Performance: Evidence From Germany”

http://www.cofar.uni mainz.de/dgf2003/paper/paper146.pdf Erişim Tarihi: 28.04.2013.

Gujarati, N. D. (1995), “Basic Econometrics. 3rd Edition”, *New York McGraw-Hill,* ISBN 0-07-025214-9.

Hatunoğlu, Zeynep and Güneş, Nazire (2012) “Kurumsal Yönetim Uygulamalarının Muhasebe Bilgi Sistemine Etkileri” II. Bölgesel Sorunlar ve Türkiye Sempozyumu, 1-2 Ekim 2012, 238-244.

Javed, Attiya Y. and Iqbal, Robina (2007) “Relationship Between Corporate Governance Indicators and Firm Value: A Case Study of Karachi Stock Exchange” Munich Personal RePEc Archive (MPRA), Paper No: 2225, <http://mpra.ub.uni-muenchen.de/2225/> Erişim Tarihi: 26.04.2013

Kalaycı, Şeref (2010), “SPSS Uygulamalı Çok Değişkenli İstatistik Teknikleri”, 5. Baskı, *Asil Yayınevi*, Ankara

Karamustafa, Osman; Varıcı, İdris and Er, Bünyamin (2009) “Kurumsal Yönetim ve Firma Performansı: İMKB Kurumsal Yönetim Endeksi Kapsamındaki Üzerine Bir Uygulama” Kocaeli Sosyal bilimler Enstitüsü Dergisi (17) /1: 100-119.

Kula, Veysel (2006) “Kurumsal Yönetim, Hissedarların Korunması Uygulamarı ve Türkiye Örneği” Papatya Yayıncılık, İstanbul.

Maher, Maria and Anderson, Thomas (1999) “Corporate Governance: Effects on Firm Performance and Economic Growth” Organisation for Economic Co-Operation and Development (OECD).

Najjar, Naser (2012) “The Impact of Corporate Governance on the Insurance Firm’s Performance in Bahrain” International Journal of Learning & Development, Vol. 2, No. 2, 1-17.

Pamukçu, Fatma (2011) “Finansal Raporlama ile Kamuyu Aydınlatma ve Şeffaflıkta Kurumsal Yönetimin Önemi” *Muhasebe ve Finansman Dergisi,* Nisan 2011: 133-148.

Shleifer, Andrei and Vishny, Robert W. (1997) “A Survey of Corporate Governance” The Journal of Finance, Vol. 52, 737-783.

Toraman, Cengiz; Abdioğlu, Hasan (2008) “İMKB Kurumsal Yönetim Endeksinde Yer Alan Şirketlerin Kurumsal Yönetim Uygulamalarında Zayıf ve Güçlü Yanları: Derecelendirme Raporlarının İncelenmesi” Muhasebe ve Finansman Dergisi (MUFAD), Sayı: 40, 96-109.

Wu, Xueping and Xu, Lily Li (2005) “The Value Information of Financing Decisions and Corporate Governance During and After The Japanese Deregulation” The Journal of Business, Vol. 78, No. 1 (January 2005), pp. 243-280.

1. www.borsaistanbul.com [↑](#footnote-ref-1)