THE IMPACT OF CORPORATE GOVERNANCE ON TURKISH BANKING SECTOR DURING ECONOMIC CRISIS: THE TEST OF INSTRUMENTAL STAKEHOLDER THEORY

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Abstract

The aim of this paper is to show the relationship between corporate governance and bank financial performance during economic crisis. In other words, a stakeholder governance model is developed in order to test the instrumental stakeholder theory during economic crisis. It is found that the average return on equity for the group of banks that use stakeholder governance model is approximately 70% higher than the group of banks that use stockholder governance model in Turkey during the economic crisis period (2007-2009). These findings show the importance of stakeholder governance model during the economic crisis. In other words, it is found that banks immunized themselves against the effects of economic crisis in terms of their financial performance.

Keywords: instrumental stakeholder theory, stockholder governance model, stakeholder governance model, corporate performance, economic crisis

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1. Introduction

The recent global financial crisis (GFC) has introduced many lessons to the business world. The bankruptcy of Lehman Brothers, one of the biggest financial institutions in the world, is one of these lessons. The stockholder governance is the reason of this bankruptcy. Many banks have also bankrupted during GFC in the world. Banks can immunize themselves to economic crisis by using stakeholder governance model. Thus, comparison between stockholder and stakeholder governance models will be given in the second section of the paper. Literature review about instrumental stakeholder theory will be given in the third section. The variables related with stakeholder governance model will be presented in the fourth section. The hypotheses and methodology of the study will be presented in the fifth section. The long term financial performance of banks that use stakeholder governance model during the economic crisis will be compared with the ones that use stockholder governance model in the sixth section. Conclusions will be presented in the seventh section.

2. Comparison of Stockholder Governance and Stakeholder Governance

Corporate governance is polarized in two extreme positions, namely stockholder governance and stakeholder governance (Friedman and Miles, 2002; Gamble and Kelly, 2001; Letza et. al., 2004; Prabhaker, 1998; Sternberg, 1997; Turnbull, 1997, 2002; Vinten, 2001). The stockholder governance perspective tends to be in tension with stakeholder governance perspective because it emphasizes that a firm's primary fiduciary obligation is to its stockholders rather than nonstockholders (Reed, 2002). According to the stockholder governance approach, only the interests of the stockholders should be considered when actions and decisions are taken (O'Higgins, 2001).

The stockholder governance perspective emerges when the interests of the stockholders are emphasized over the interests of nonstockholders in the governance of the corporations. Various lines of reasoning support the stockholder governance approach. Some believe that this model will lead to efficient use of resources (Plender, 1998). According to Argenti (1997), it is clear what stockholders expect profit from a firm, but it is not clear what stakeholders expect. The massive participation of U.S. households in equity markets is one of the underlying reasons of stockholder governance in United States (Mills and Weinstein, 2000). One of the most important rationales for the stockholder governance perspective is that stockholders are the residual risk-takers in a firm. Some argue that stockholders are the residual claimants who bear economic risk, and therefore the value of common stock should be maximized (Alchian and Demsetz, 1972; Fama and Jensen, 1983). Stockholder governance perspective is proposed as a valid model for a firm, based on these types of explanations.

Running a firm not only in the interests of its stockholders, but also in the interests of all stakeholders is the definition of stakeholder theory (Aggarwal and Chandra, 1990; Arthur, 1987; Blair, 1998; Cornell and Shapiro, 1987; Jones and Wicks, 1999; Rose and Mejer, 2003; Werhane and Freeman, 1999). According to stakeholder theory, the legitimate interests of all stakeholders should be given simultaneous attention in stakeholder management (Donaldson and Preston, 1995). The stakeholder governance perspective, which is based on stakeholder theory, emphasizes that the interests of all stakeholders should be important for a firm (Letza et. al., 2004). According to the stakeholder governance approach, a firm is expected to ensure the rights of all stakeholders and satisfy their needs equally (O'Higgins, 2001). Some argue that managing complex extended enterprises from the stakeholder perspective is more valid for the twenty-first century (Post et. al., 2002). A firm dominated by stakeholder governance model recognizes not only its direct stakeholders, such as stockholders, customers, and employees, but also indirect stakeholders that are affected by a firm's activities. Some firms choose this approach because it is a sustainable way for companies to proceed (Vinten, 2001). The continental European models of corporate governance are much more oriented to stakeholders than the Anglo-Saxon model (Vinten and Lee, 1993).

3. Instrumental Stakeholder Theory

The instrumental stakeholder theory establishes a framework for examining the connections between the practice of stakeholder management and corporate performance goals. In other words, the instrumental stakeholder theory treats stakeholders of the corporation as a means (Donaldson and Preston, 1995). The studies in USA show that adherence to stakeholder principles and practices help firms to achieve conventional corporate performance objectives (Aupperle et. al., 1985; Cochran and Wood, 1984). If managers view the interests of stakeholders as having intrinsic value, and they pursue the interests of multiple stakeholders, their firms will achieve better financial performance than the ones that pursue the interests of a single stakeholder group (Donaldson, 1999). This is the proposition of instrumental stakeholder theory. Thus, instrumental stakeholder theory posits an empirically testable link between the organizational behavior and its financial outcomes (Jones, 1995).

The purpose of instrumental stakeholder theory is to explain why certain altruistic behaviors, which are deemed as irrational, lead to economic success (Jones, 1995). The main thesis of instrumental stakeholder theory is that maximization of the shareholder value over an uncertain period of time requires paying attention to key stakeholder relationships (Freeman, 1999). It is difficult to find a relationship between performance and stakeholder orientation (Post et. al., 2002). For example, instrumental stakeholder theory is studied by several scholars, and empirical results of these studies were all disappointing (Griffin and Mahon, 1997; Ullmann, 1985). On the other hand, a firm cannot maximize its value by ignoring the interests of its stakeholders (Jensen, 2001). This rationale can be found in the definition of the stakeholder concept. Since stakeholders are groups without whose support the organization would cease to exist (Freeman and Reed, 1983), ignoring the interests of its stakeholders does not make sense.

4. Variables of Stakeholder Governance Model

There are twenty-two variables that define stakholder governance model. Thirteen of these variables are related with the principles and nine are related with the processes in the corporate governance system.

4.1 Long-term Profit Maximization/ Value Added

Hence, short-term profit/shareholder value maximization is expected to destroy the long-term market value of an organization (Jensen, 2001) because this principle is not consistent with the long-term perspective of a firm (Buchholz, 2005; Monks and Minnow, 2004; Collins and Porras, 2002). Therefore, some scholars (Caldwell and Karri, 2005; Clarkson, 1995; Kotter and Hesket, 1992; Post et. al., 2002) advocate the principle of *long-term profit maximization / value added*, which refers to the stakeholder governance model.

4.2 Bundle of Human Assets

The people who work in a corporation are its principal assets. Therefore, the principle of *bundle of human assets* emerged as a response to the needs of organizations in our age. The *bundle of human* *assets* principle refers to the human values and skills in an organization (Caldwell and Karri, 2005; Post et. al., 2002), to the human resources and stakeholders of a firm (Pitelis and Wahl, 1998), to human rights and values (Garcia-Marza, 2005), to the corporation as a social entity (Handy, 1997; Letza et. al., 2004), or to the corporation as an association of persons (Arthur, 1987). As can be understood from these definitions, this principle is closely related to the mutual interests of stakeholders.

4.3 A Set of Social Contracts

In many cases, an organization interacts with its stakeholders through non-contractual relations. In other words, most of a firm's interactions occur through informal contracts (Bird, 2001) rather than legal and economic contracts. Therefore, *a set of social contracts* principle emerged in order to explain these implicit contracts in the corporate governance system. A network of social contracts, based on normative principles of human conduct, between a firm and its stakeholders (Freeman and Evan, 1990) is the definition of this principle. Corporation as a social entity for the society (Sullivan and Conlon, 1997) or corporation as a social institution (Arthur, 1987) is another definition of this principle. Transactional and psychological contracts between employees and organization (Barnett and Schubert, 2002; Rousseau, 1995; Turnley and Feldman, 1999) also refers to this principle.

4.4 Positive-Sum Strategy

The belief that the value of the whole management team exceeds its separate parts (Pitelis and Wahl, 1998) is an example of the *positive-sum strategy* principle. Mutually beneficial product-service improvement for the customers (Post et. al., 2002) is another example to this principle. *Fortune*'s corporate reputation survey shows that the satisfaction of one stakeholder group does not have to come at the expense of another stakeholder group (Preston and Sapienza, 1990). Therefore, the *positive-sum strategy* principle is proposed as an alternative to the *zero-sum game* principle (Caldwell and Karri, 2005; Vinten, 2001).

4.5 Resource Interdependence

Power is an important concept in terms of explaining the corporate governance phenomenon. According to Tricker (2000), corporate governance is about the exercise of power over corporate entities via board of directors. When one party has the means to get its way, even in the face of the resistance by others (O'Higgins, 2001), or when there is a structurally determined potential for obtaining favored payoffs in relations where interests are opposed by the actors in the relation (Willer et. al., 1997), or when one person is dependent upon another person (Emerson, 1962), power is said to exist at the level of individual. Power, which is vested in the board of directors and delegated to the management, can also be defined as the ability to mobilize people and resources to get things done in the organization (Arthur, 1987).

Unequal dependence between parties (e.g., A and B) in an exchange relationship creates power differentials (Emerson, 1962). When party A depends on party B more than party B depends on party A in terms of resources, there is a power differential in party B's favor (Pfeffer and Salancik, 2003). On the other hand, some scholars believe that resource interdependence exists between a firm and its stakeholders. According to Freeman and Evan (1990), stakeholders are interdependent in terms of their resources to a company. According to Hendry (2001), there is interdependence between a firm and local community. When parties' interests are mutually contingent upon each other in a relationship, interdependency exists (Swift, 2001). When both a firm and a stakeholder group have the ability simply to walk away from a relationship, they are mutually dependent in terms of their resources (Lawler and Bacharach, 1987; Williamson, 1975, 1988). These are some of the definitions for the principle of *resource interdependence*.

4.6 Symmetric Information (Transparency)

Since related parties of a business transaction do not have equal access to specific information, markets are imperfect in reality (Sama and Shoaf, 2005). Since diffused members (i.e., individuals or entities) of stakeholder groups may not be able to finance the information gathering and analysis, there is *asymmetric information* between stakeholders and management. Besides, managers can filter or distort a firm's critical information that is released to their relevant stakeholders (e.g., stockholders or employees), in order to serve their own interests, as in the case of Lehman Brothers.

Stakeholders respond to this *asymmetric information* between them and management by establishing institutional structures such as labor unions or consumer unions, or through legislation (Hill and Jones, 1992). Therefore, an atmosphere of openness and transparency is required in stakeholder–management relations (Post et. al., 2002). Transparency is also one of the principles of good corporate governance (Aras and Crowther, 2009).

4.7 Accountability to Stakeholders

The definition of accountability is that firms should justify or explain their actions by providing information to their stakeholders (Gray et al., 1997). Accountability is another principle that refers to good corporate governance (Aras and Crowther, 2009). There are two kinds of accountability: soft accountability and true accountability. Soft accountability is voluntary, whereas true accountability is obligatory (Swift, 2001). The principle of *accountability to stakeholders* emerged as a response to recent changes in the environment of firms. According to Thomas Clarke (1998), focusing on the interests of the stockholders may have been the key element for good corporate governance in the United States and United Kingdom in recent past, but today stakeholders can conduct effective monitoring over the firms, so there is no reason for the firms not to be accountable to their stakeholders. Since business has become so central to the human welfare, expanding *accountability to stakeholders* via voluntary action is an important issue for the firms (Logsdon and Lewellyn, 2000). Therefore, stakeholder approach argues, corporations should be responsible not only to stockholders but also to nonstockholders (Reed, 2002).

Some argue that the new managerial framework must be closely attentive to the issue of socially accountable business (Chang and Ha, 2001). The problem with *accountability to stakeholders* is that an accounting system permitting a tight chain of accountability by management to all stakeholder groups has not been invented yet. The historic cost accounting cannot describe the value in intangible relationships with stakeholders (Plender, 1998). The emergence of international standards such as AA1000, GRI, and SA8000 speaks to the need to solve this problem about the principle of *accountability to stakeholders*.

4.8 Stakeholders as a Means

This principle is closely related to the instrumental stakeholder theory. The main thesis of instrumental stakeholder theory can be defined as paying attention to key stakeholder relationships in order to maximize the shareholder value over an uncertain period of time (Freeman, 1999). Pursuing the interests of multiple stakeholders is expected to help firms to achieve better financial performance than the firms that pursue the interests of a single stakeholder group (Donaldson, 1999). Stakeholder interests should be recognized due to instrumental reasons because stakeholders serve to increase the wealth of a firm (Shankman, 1999). Profitability, competition, and the economic success of corporations may be improved by giving importance to stakeholder interests (Campbell, 1997; Freeman, 1984; Plender, 1997; Stoney and Winstanley, 2001). As a result, instrumental stakeholder theory is interested in how stakeholders' value can be used to increase the profitability of a firm (Letza et. al., 2004). All of these lines of reasoning about instrumental stakeholder theory try to justify the principle of *stakeholders as a means*.

4.9 Fairness

The belief that burdens and benefits are equally distributed among parties refers to the principle of *fairness* (Garcia-Marza, 2005). Fairness is also one of the principles of good corporate governance (Aras and Crowther, 2009). The notion of *'fair contract*', a Rawlasian 'veil of ignorance', can be devised so that the interests of all stakeholders can be taken into consideration (Freeman and Evan, 1990). Managers should consider the interests of stakeholders because the claims of stakeholders have intrinsic justice on a firm (Jones, 1994). The theories of distributive justice, which is related with the principle of *fairness*, also support the view that the claims made by stakeholders must be recognized (Shankman, 1999).

The *fairness* principle can be examined at the level of individual, organization, and society. It has been found in laboratory experiments that *fairness* is an important issue among players (Guth et. al., 1982), which refers to the level of individual. Social justice (Allen, 1992; Letza et. al., 2004), equal distribution of burdens and benefits (Garcia-Marza 2005), or fair distributions of wealth or income (Donaldson and Preston, 1995) refer to the *fairness* principle at the level of organization. Public perception is also important in terms of *fairness* (Kahneman et. al., 1986), which refers to the *fairness* principle at the level of society.

4.10 Mutual Trust

Trust is the glue that holds corporate culture together (Caldwell and Karri, 2005). Trust is important for firms in terms of product acceptance, a good working atmosphere, smooth relationships with the local government, and investment criteria (Garcia-Marza, 2005). When an investor wants to purchase a company's stock or an employee wants to work in a company or a customer wants to buy a product, trust will be the required principle (Hosmer, 1995). According to Kay and Silberston (1995), managers should be trustees in the eyes of their companies' stakeholders. According to Goodpaster (1991), directors and managers must view themselves as trusted servants of a firm. Stakeholder theory also emphasizes the importance of trust to a firm (Shankman, 1999). Based on these explanations, it is clear that there is a need to believe in the principle of *mutual trust* in the corporate cultures.

Mutual trust is the confident expectation of another party's goodwill, the belief that one's interests will be protected (Ring and Van De Ven, 1992). *Mutual trust* is the belief in the other party's credibility and benevolence (Doney and Cannon, 1997). *Mutual trust* is also defined as the confidence in the other party's reliability and integrity (Morgan and Hunt, 1994).

4.11 Integrity/Honesty

Coherence between what is said and what is done in an organization refers to the principle of *integrity/honesty* (Garcia-Marza, 2005). If there is a significant disconnect between words and action in any area such as leadership, management, mission, or core principles of a firm, this will undermine the firm's credibility and *integrity/honesty* in the eyes of stakeholders (Wheeler and Sillanpää, 1998). Thus, telling different stories and showing inconsistent organizational behaviors will not be tolerated by the stakeholders of a firm (Scholes and Clutterbuck, 1998). Holding the employees to an ethical code of conduct to which the management is not being held is another example of an organizational behavior that generates the principle of *dishonesty* in the minds of employees (Arthur, 1987). If there is consistency in the behaviors of the directors or managers, the principle of integrity/*honesty* may emerge in the corporate governance system.

4.12 Network

Viewing a firm within a set of stakeholders that are tightly connected with each other in a web of relationships (Donaldson and Preston, 1995; Schilling, 2000), perceiving the organization as a nexus of organized interactions (Bird, 2001), and conceiving of a firm as a community, as in the case of Germany's Rhine model (Vinten, 2001), are some of the definitions for the principle of *network*.

Interconnectedness in a stakeholder environment also exemplifies the principle of *network*. High centrality and low centrality are two concepts that refer to the principle of *network*. When the ratio of the number of relationships that exist in network with a firm's relevant stakeholders compared to the total number of possible ties among the network of stakeholders is high, there is a high density in the stakeholder environment of a firm (Rowley, 1997). When there is a high density, there is also a high interconnectedness in the stakeholder environment of a firm. Large-size firms are expected to operate in a complex and high-density network. Ease of communication via the Internet is another factor that enhances the number of relationships that exist in network with a firm's relevant stakeholders.

4.13. Long-term Perspective

The stakeholder perspective requires a *long-term perspective*. For example, putting stakeholder perspective into place has taken ten years in Shell Corporation (Watts, 2000). Similarly, successive generations of managers in Cummins, Shell, and Motorola accepted and used stakeholder-oriented policies (Post et. al., 2002). These examples show the relationship between the *long-term perspective* and the stakeholder governance model. These examples also show the importance of the *long-term perspective* principle at the level of organization. There are also examples that emphasize the importance of this principle at the level of individual. For example, the studies of Pruitt and Kimmel (1977) show that human beings do not cooperate in the short-term, due to self-interest, but it is seen that they do cooperate in the long-term. Thus, there is a positive relationship between the *long-term perspective* and cooperative behaviors among individuals. The principle of *long-term perspective* is also important in the corporate governance system at the level of society. For example, German or Japanese corporate governance systems are based on the principle of *long-term perspective* (Plender, 1998). The Danish corporate governance system is also based on this principle (Rose and Mejer, 2003).

4.14 Active Communication

Since organizations operate in very complex and uncertain environments, the only way for managers to reduce this complexity and uncertainty is to form *active communication* with stakeholders of corporations (Wheeler and Sillanpää, 1998). There is a need for a lively, open, and reciprocal communication with stakeholder groups (Bird, 2001). Thus, according to Royal Society for encouragement of Arts Manufactures and Commerce (RSA), one of the key features of a successful company is the process of *active communication* (RSA, 1995). William Dill (1975) was one of the first scholars to emphasize the importance of *active communication* with stakeholders. According to Dill, strategic managers communicate with stakeholders. Therefore, *active communication* with stakeholders of a firm is important in terms of creating good corporate governance.

Different methods are proposed for the process of *active communication*. Methods such as social and economic audits (Reed, 2002), formal audits, official communiqués, occasional presentations at the board by stakeholder representatives (Bird, 2001), focus groups, interviews, surveys, meetings, publication of corporate social reports (Swift, 2001), stakeholder reports and journals (Scholes and Clutterbuck, 1998), regular conversations, opinion surveys (Wheeler and Sillanpää, 1998), stakeholder dialogue, and stakeholder reporting (Vinten, 2001) promote the process of *active communication* between a firm and its stakeholders. Scholars provide various examples of *active communication*:

- Listening and informing your stakeholders and learning together with them (Scholes and Clutterbuck, 1998)
- Listening, responding, measuring, and reporting on the issues of stakeholders or using the "show me" mode for stakeholders of a firm (Post et. al., 2002)
- Communicating with the relevant stakeholder groups and being judged by them in terms of performance indicators such as financial, social, and ethical reports (Wheeler and Sillanpaa, 1998)
- Collecting information, preparing reports, and obtaining feedback from stakeholders (Logsdon and Lewellyn, 2000)
- Providing channels of communication to listen to the concerns and suggestions of stakeholders (Reed, 2002)

4.15 Stakeholder Participation

Stakeholder participation is a process that refers to the willing and desired activities of stakeholders, rather than regulation and enforcement. Scholars have given different reasons for the importance of this process. According to Donaldson and Preston (1995), each stakeholder group must participate in the corporate governance process because it has a stake due to its relationship with a firm. Stakeholders should participate in the corporate decision making because they have an asset specificity in a firm. Thus, stakeholders are also economic risk bearers (Blair, 1995). Participation of the internal and external stakeholders in the strategy-formulating process is expected to lead to greater commitment of these stakeholders (O'Shannassy 2001). An important study in the United Kingdom showed that *stakeholder participation* is a key feature of a successful company (RSA, 1995).

Scholars have formulated various examples for the process of *stakeholder participation*:

- Letting all the related stakeholders (e.g., employees, creditors, suppliers, and customers) monitor the managers and engage permanently in the important parts of the decision-making process (Blair, 1995; Clarke, 1998)
- Internal or external pressures under equal participating conditions (Garcia-Marza, 2005)
- Community representation on the board of a firm (Freeman and Evan, 1990)
- Delegation of responsibility (Pfeffer, 1994)
- Involvement of employees in problem solving at the board level or at the lower level in an organization (Oakland and Porter, 1999; Wheeler and Sillanpää, 1998; Reed, 2002)
- Negotiated settlements among stakeholders of a firm (Mills and Weinstein, 2000)
- Representation of different stakeholder groups in a board by each board member (Nader, 1984)
- Internal and external participation to the strategy process (Liedtka 1998a, 1998b, 2000)

4.16 Corporate Social Responsibility

Firms may prefer to perform socially responsible activities (i.e., *corporate social responsibility*). John Howard, Australian prime minister in 1998, argued that a firm has obligations to make contributions to the development of a community in which it operates because it derives its profit from this community (Greenwood, 2001). This argument refers to the process of *corporate social responsibility*. In other words, the firm and the community in which it operates are interrelated (Buchholz, 2005; Hendry, 2001). The process of *corporate social responsibility* gained acceptance in the business world because society began to become more concerned with ethical organizational behaviors such as protection of the natural environment (Scholes and Clutterbuck, 1998). Thus, firms are expected to contribute to the local and regional development, to be co-responsible for the social order, and have a position in maintaining and improving the natural environment (Garcia-Marza, 2005).

Firms have become more environmentally sensitive, which is related to *corporate social responsibility*, because of pressures from stakeholders. For example, when Royal Dutch/Shell Group used deep-sea disposal for an oil-drilling platform, it was strongly and violently protested by environmental pressure groups. These protests forced Royal Dutch/Shell Group to reexamine and rewrite its code of business principles in order to behave responsibly toward the natural environment (Julius, 1997). Motorola Corporation is another example that illustrates importance of *corporate social responsibility*. Motorola updated its policies, creating the Motorola Ethics Renewal Process as a response to society's concerns. This initiative was followed by the creation of the Global Corporate Responsibility Task Force, charged to maintain the ethics advantage of Motorola (Moorthy et al., 1998; Post et. al., 2002). As a result, two important concepts, natural capital and social capital have been developed (Elkington, 1998) in order to reflect the need for the firm's concern for the society and natural environment (i.e., *corporate social responsibility*) besides the classic bottom line (i.e., profit).

4.17 Cooperative Behaviors

Some of the definitions for *cooperative behaviors* are as follow:

- Moving with stakeholders of a firm (Scholes and Clutterbuck, 1998)
- Forming collaborative relationships with stakeholders (MacMillan and Downing, 1999)
- Contributing voluntarily to a firm (Simon, 1991)
- The existence of a collective action between the managers and employees (Buchholz, 2005)
- The existence of any unity of action in an organization (Arthur, 1987)
- Honoring contracts, cooperating in joint efforts, and delivering on time (Jones, 1995)

Shared values may be the basis for the unity of action in the organization (Arthur, 1987). Collective action results from shared understandings (Buchholz, 2005). Thus, balancing the interests of all stakeholders (Plender, 1998) is required for initiating the process of *cooperative behaviors.*

4.18 Trust-Based Behaviors

Some scholars believe that *trust-based behaviors* can be the antidote for managerial *opportunistic behaviors* (Ring and Van De Ven, 1994). If a firm honors its contracts, cooperates in joint efforts, and delivers on time (Jones, 1995), *trust-based behaviors* are expected to emerge. According to Aristotle, trust can be seen in human relationships and society or community in general (Hosmer, 1995). The process of *trust-based behaviors* is important in the corporate governance system for different reasons. According to Swift (2001), *trust-based behaviors* may transcend managerial opportunism. *Trust-based behaviors* are necessary to permit stakeholders to invest in relations that are firm-specific. If employees cannot trust that the resulting value they create will be rewarded, they will not invest in learning how to do their job well. If there is a risk that the contracting firm may squeeze the profits of its supplier, this supplier cannot invest in specific new equipments (Plender, 1998). Besides, a firm’s competences, such as long-term collaborative relationships with key customers and suppliers, cannot be built on *opportunistic behaviors*, but should be built on trust-based relationships (MacMillan and Downing, 1999). Finally, *trust-based behaviors* are important for firms because they create competitive advantages such as organizational citizenship (Van Dyne et. al., 1994).

4.19 Fair Behaviors

Creation and distribution of a firm’s wealth and value to all its primary stakeholder groups without favoring one group at the expense of others is the definition of *fair behaviors* of a firm to its stakeholders (Clarkson, 1995; Ertuna, 2005). For example, establishing personnel policies to take care of marginalized groups such as women and the disabled (Reed, 2002) is an example of a firm’s *fair behaviors* regarding its employees. Sharing the wealth created with the employees (Blair, 1998) is another example of a firm’s *fair behaviors* regarding its employees. The study of Kahneman et. al. (1986) shows that giving a lower wage to a replaced employee or decreasing the current wage of an employee in a new business is perceived as a fair behavior by the society in the United States. A firm needs to consider the interests of all stakeholders in order to form fair relationships with its constituencies.

4.20 Stable Relationships with Stakeholders

Different definitions are supplied by different scholars for the process of *stable relationships with stakeholders*, and they are as follows:

- Forming an ongoing relationship between stakeholders and a firm over stipulated periods of time (Bird, 2001)
- Developing strong relationships with stakeholders over time (RSA, 1995)
- Permitting stakeholders to invest in relations that are firm-specific (Conner, 1991; Kogut and Zander, 1992)
- Giving importance to a firm’s internal growth, which is a very slow process to take results, rather than acquisitions, which is a very fast process to take results, (Clarke, 1998)
- Forming long-lasting relationships with stakeholders (Aoki, 1990)
- Forming bonds among individuals in an ongoing endeavor (Buchholz, 2005)
- Compensating and protecting employees from being laid off on short notice, as in the case of Danish firms (Rose and Mejer, 2003)

When a firm wants to form stable relationships with its employees, it may establish ongoing and close relationships with them (Penrose, 1959); make firm-specific investments in human capital (Plender 1998); invest in employee training (Collins and Porras, 2002); or hire at the entry level and promote within (Pfeffer, 1994). Hence, there will be low levels of labor turnover (Blair, 1998; Post et. al., 2002). According to the Financial Times/ Pricewaterhouse Coopers global survey of CEOs, the most worrying issue that companies face today is the recruitment and retention of staff (O'Higgins, 2001). Greer and Ireland (1992) have found that there is a positive correlation between hiring employees during economic downturns and long-term financial performance. James Collins and Jerry Porras (2002) examined eighteen United States–based companies that invested extensively in stable relationships with their employees, in terms of employee training and knowledge transfer. Collins and Porras found that these eighteen companies outperformed the stock market fifteen times. A firm is expected to incur additional costs in terms of efficiency when the employees with asset specificity leave it (Williamson, 1985). Based on these arguments and findings, one could argue that there is a need to form stable relationships with the employees.

A firm is expected to form stable relationships not only with its employees but also with other stakeholders because a dynamic balance must be achieved among the interests of stakeholders in order to form long-term interdependent relationships with them (Caldwell and Karri, 2005). Long-term relationships with a relatively small number of suppliers or stable corporate ownership (Jones, 1995) are examples to the process of *stable relationships with stakeholders*.

4.21 Systematic Communication

Getting feedback from stakeholders consistently (Post et. al., 2002) and systematic disclosure of social information (Clarke, 1998) are some of the definitions for the process of *systematic communication.* A firm may give importance to the process of active communication, but if this active communication is not conducted systematically, this firm's relationships with its stakeholders may be strained, because the needs and expectations of stakeholders constantly change (Wheeler and Sillanpää, 1998). If a firm gives importance to the stakeholder perspective, it is expected to form mutual interests among stakeholders. Since the needs or expectations of stakeholders constantly changes over time, a *systematic communication* with stakeholders is expected to help a firm learn of these changes and respond to them. Thus, the process of active communication is not sufficient when it is conducted haphazardly with stakeholders of a firm.

4.22 Network Relationships

If companies do something wrong, this information spreads very quickly to the society in today's business world. If people do not like the action of a company, it can find itself in a public relations nightmare that can threaten its existence. (O'Higgins, 2001). Since the cost of communication has dropped dramatically due to widespread use of the Internet (Julius, 1997; Sama and Shoaf, 2005), the ease of communication among stakeholders makes companies more visible (Logsdon and Lewellyn, 2000; Wheeler and Sillanpää, 1998). Any bad or good news about the members of a stakeholder group quickly spreads to other stakeholder groups. Thus, these multiple and interdependent interactions among the network of stakeholders constitute a firm (Bird, 2001; Caldwell and Karri, 2005; Frooman, 1999; Hendry, 2001; Mitchell et. al., 1997; Rowley, 1997). This phenomenon is called *network relationships*. Management scholars and managers recognize that complex interactions and network effects exist between a firm and its stakeholders (Post et. al., 2002). Therefore, finding strategies to manage communication across stakeholder groups is the most important issue in today's business world (Scholes and Clutterbuck, 1998).

Using the process of *network relationships* to manage the communication among employees of a firm is relatively easy when compared with other stakeholders. For example, letting employees share their knowledge and ideas via top-down, bottom-up, and horizontal information flows (Kay and Silberston, 1995; Kennedy, 1998; Liedtka 1998a); letting employees form close and ongoing interactions (Penrose, 1959); and allowing employees to challenge rules and norms and invent new ways of working via decentralization (Wheeler and Sillanpää, 1998; Pfeffer and Salancik, 2003) are all practices related to the process of *network relationships* among employees.

Since any information about a firm can easily be conveyed to the world via the Internet (O'Higgins, 2001), *network relationships* also take place among other stakeholders. For example, customers are more aware of the new possibilities and alternative products, due to increased communication technologies (Scholes and Clutterbuck, 1998). Sometimes, the flow of information among stakeholders of a firm is initiated by influencers (Freeman and Reed, 1983) or NGOs (nongovernmental organizations). These institutional structures play the role of catalyst among stakeholders of a firm (Hill and Jones, 1992). The initiation of information flows about the unethical behaviors of StarKist Company by Earth Institute Island is a good example to the formation of *network relationships* among consumers of a firm, created with the help of an NGO (Frooman, 1999). When pressure groups such as NGOs protest the unethical behaviors of a firm, they also initiate the flow of information about the firm's relevant behaviors, forming *network relationships.* In sum, the process of *network relationships* emerged as a result of NGOs and developments in communications technologies. These types of developments have eased information flows among stakeholder groups.

5. The Hypotheses and Methodology of the Study

We have developed four main hypotheses related with the effect of corporate governance on the financial performance of Turkish banking sector during economic crisis. These main hypotheses of the study are as follow:

H_1: Banks that use stakeholder governance model are expexted to have better average return on equity ratio than the banks with stockholder governance model during the economic crisis.

H_2: Banks that use stakeholder governance model are expexted to have better average return on asset ratio than the banks with stockholder governance model during the economic crisis.

H_3: There is no difference between banks that use stakeholder governance model and banks that use stockholder governance model in terms of average return on equity ratio during normal economic period.

H_4: There is no difference between banks that use stakeholder governance model and banks that use stockholder governance model in terms of average return on asset ratio during normal economic period.

Corporate governance makes sense during crisis periods. Besides, stakeholder governance model requires a long term perspective. Therefore, financial performance measures are calculated for three years. The period between 2004 and 2006 is taken as a normal economic period. The period between 2007 and 2009 is taken as an economic crisis period in the study. Since GFC has began to show its effects in the middle of 2007 and turned into global economic crisis during 2008 and 2009, these three years are determined as the economic crisis period in the study. Thus, H_1 and H_2 are formed in order to reflect all of these points about the impact of corporate governance on the financial performances of banks during economic crisis in Turkey. The opposite of these two hypotheses should also be true. In other words, it is difficult to see the difference between stakeholder governance and stockholder governance models during boom periods or normal economic conditions. Thus, H_3 and H_4 are formed in order to serve this need.

Corporate governance model developed by Gunay (2008) is used in this study in order to test the four hypotheses above. All of the related documents (e.g., corporate governance reports, sustainability reports, corporate social responsibility reports, mission and vision statements) published in the web sites of the twenty-four banks in Turkey are coded with the twenty-two variables of stakeholder governance model. If any of these twenty-two variables is declared by a bank in its reports, it is coded as one. If a variable does not exist in the reports, it is coded as zero. Each bank has a corporate governance score as a result of this coding. Then banks are grouped as the ones which are closer to stakeholder and stockholder governance model. Finally, these two group of banks are compared with each other in terms of their average financial performances (return on asset and return on equity) during the economic crisis.

6. The Empirical Findings of the Study

The number of banks is twenty-four in our sample. Thus, sample size is less than thirty. In other words, the data cannot have normal distribution. Therefore, a non-parametric test (Kruskal-Wallis) is decided to be used. Since Kruskal-Wallis test is significant for the ROE variable with grouping variable corporate governance models (banks that use stakeholder governance model vs. banks that use stockholder governance model), our first hypothesis is accepted for the banks in Turkey. This result can be seen in Table 1.

Table 1. Test Statistics

	Average ROE (2007-2008- 2009)
Chi-Square	3,840
df	1
Asymp. Sig.	**,050**

Table 2. Comparison of Banks that Use Stakeholder Governance with the Banks that Use Stockholder Governance Model in terms of their ROEs During Economic Crisis Period

Coprorate Governance Models	**N**	**Average ROE (2007-2008- 2009)**
Stakeholder Governance Model	16	14,50%
Stokholder Governance Model	8	8,50%
Total	24	

The results of Kruskal-Wallis test can be seen in Table 2. The financial performances (ROE) of banks that use stakeholder governance with the banks that use stockholder governance model are compared for the period of economic crisis (2007-2009). As can be seen in Table 2, the average ROE of sixteen banks that use stakeholder governance is 14,5% and the average ROE of eight banks that use stockholder governance model is 8,5%. In other words, banks that used stakeholder governance model during the economic crisis period (2007-2009) performed approximately 70% better than the ones that used stockholder governance model.

Table 3. Test Statistics

	Average ROA (2007-2008- 2009)
Chi-Square	1,217
df	1
Asymp. Sig.	**,270**

As can be seen in Table 3, Kruskal-Wallis test is not significant for the ROA variable with grouping variable corporate governance models. Thus, our second hypothesis is rejected. In other words, banks that use stakeholder governance model do not have better average return on asset ratio than the banks with stockholder governance model during the economic crisis.

Table 4. Test Statistics

	Average ROE (2004-2005- 2006)
Chi-Square	,454
df	1
Asymp. Sig.	**,501**

Since Kruskal-Wallis test is not significant for the ROE variable with grouping variable corporate governance models, our third hypothesis is also accepted. In other words, banks that use stakeholder governance model do not have better average return on equity ratio than the banks that use stockholder governance model during normal economic period. This result can be seen in Table 4.

Table 5. Test Statistics

	Average ROA (2004-2005- 2006)
Chi-Square	,094
df	1
Asymp. Sig.	**,759**

As can be seen in Table 5, Kruskal-Wallis test is not significant for the ROA variable with grouping variable corporate governance models. Thus, our fourth hypothesis is also accepted. In other words, banks that use stakeholder governance model do not have better average return on asset ratio than the banks that use stockholder governance model during normal economic period. In sum, three of the hypotheses (H_1, H_3 and H_4) are accepted and one (H_2) is rejected in the study.

7. Conclusions

The impact of recent global economic crisis on Turkish banking sector is tested in terms of banks' corporate governance principles and practices. All of the reports related with corporate governance are coded with twenty-two variables of stakeholder governance model in the study. Since corporate governance makes sense during crisis periods and requires a long term perspective, financial performances for the group of banks are compared for a long periods of time rather than a single year. Therefore, financial performance measures are calculated for three years. The period between 2004 and 2006 is taken as a normal economic period. The period between 2007 and 2009 is taken as an economic crisis period in the study.

The first finding of our study is that banks that use stakeholder governance model can have better financial performance during economic crisis. The other finding is that there is no difference between banks that use stakeholder governance model with the ones that use stockholder governance model during normal economic period. Stakeholder governance model makes sense during economic crisis period because it is expected that satisfied stakeholders not end their economic transactions during the bad times. But the same is not true for the firms with stockholder governance. Based on the results of this study, this expectation is partially proved in Turkish banking sector. In sum, it is found that instrumental stakeholder theory works during the economic crisis period for the banks in Turkey.

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