Turkish Corporate Governance Principles and Corporate Governance Index Companies

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Abstract

Good corporate governance is the key to the integrity of corporations, financial institutions and markets, and central to the health of our economies and their stability. Many countries in the world has developed codes for corporate governance in order to motivate companies for good governance. Organization for Economic Cooperation and Development (OECD) Principles of Corporate Governance provided a general framework for most of these countries. Codes of good governance can be considered a set of best practices regarding the board of directors and other governance mechanisms. Such codes have been designed to address deficiencies in the corporate governance system, by recommending a set of norms aimed at improving transparency and accountability among top managers and directors.

Due to the recent global scandals of large corporations in the most developed markets of the world, the competition of emerging markets to attract global foreign direct investment and the decreasing returns of the global stock markets, corporate governance is a "hot" topic both in the world and in Turkey. Yet the concept and implementation of corporate governance is relatively new in Turkey. Following OECD principles, Capital Markets Board (CMB) of Turkey published CMB Principles of Corporate Governance in 2003. All companies whose shares are traded in Istanbul Stock Exchange (ISE) are obliged to comply with these principles and publish corporate governance reports yearly. The CMB Principles consist of four main sections, namely shareholders, disclosure- transparency, stakeholders and board of directors.

In addition to the Principles, in order to further motivate Turkish companies for good corporate governance, ISE started to calculate ISE Corporate Governance Index in 2007. ISE Corporate Governance Index aims to measure the price and return performances of ISE-listed companies with a corporate governance rating of minimum 6 over 10. Currently there are 24 companies listed in the index.

The purpose of this study, is to briefly explain Turkish Corporate Governance Principles and why they were developed. Then Corporate governance practises of companies included in the ISE's Corporate Governance Index are analyzed as to the following criteria: privileges regarding voting rights, cumulative voting, restrictions on transfer of shares, disclosure on insider trading, independent members in board of directors, existence of

corporate governance committee. Corporate governance reports of these companies are examined in order to collect information.

1. Introduction

Good corporate governance is key to the integrity of corporations, financial institutions and markets, and central to the health of our economies and their stability. Corporate governance is affected by the relationships among participants in the governance system. Controlling shareholders, which may be individuals, family holdings, bloc alliances, or other corporations acting through a holding company or cross shareholdings, can significantly influence corporate behaviour. As owners of equity, institutional investors are increasingly demanding a voice in corporate governance in some markets. Individual shareholders usually do not seek to exercise governance rights but may be highly concerned about obtaining fair treatment from controlling shareholders and management. Creditors play an important role in a number of governance systems and can serve as external monitors over corporate performance. Employees and other stakeholders play an important role in contributing to the long-term success and performance of the corporation, while governments establish the overall institutional and legal framework for corporate governance. These relationships are subject, in part, to law and regulation and, in part, to voluntary adaptation and, most importantly, to market forces.

The aim of this paper, after giving a brief introduction on corporate governance, is to provide an overall picture of Turkish capital markets, mention about Turkish Capital Market Board's Corporate Governance Principles and why they were developed. The last section of the paper focuses on the corporate governance practises of companies included in the ISE's Corporate Governance Index.

2. Corporate Governance In The World And In Turkey

Corporate scandals which occurred in many countries in the last decade (e.g., Enron, Worldcom in the US; Parmalat and Cirio in Italy) have forced politicians, national stock exchanges, financial authorities, and supranational organizations (such as European Union, Organisation for Economic Co-operation and Development) to search for more effective governance practices. Governance practices reflect, in fact, differences in culture, traditional financing options, corporate ownership patterns, and legal origin. (Zattoni, Cuomo, 2008)

The recent global scandals of large corporates in the most developed markets of the world, the competition of emerging markets to attract global FDI and the decreasing returns of the global stock markets, corporate governance is the "hot" topic both in the world and in Turkey. Yet the concept and implementation of corporate governance is relatively new in Turkey. Corporate governance models can vary according to the system of corporate ownership and management control mechanisms prevailing in a country. In Turkey, a market-oriented corporate governance and control system cannot be said to exist, since the flotation ratios of listed companies and share dispersion levels are low. (Okutan-Nilsson, 2007)

Many countries in the world has developed codes for corporate governance in order to motivate companies for good governance. OECD Principles of Corporate Governance provided a general framework for most of these countries. Codes of good governance can be considered a set of best practices regarding the board of directors and other governance mechanisms. Such codes have been designed to address deficiencies in the corporate governance system, by recommending a set of norms aimed at improving transparency and

accountability among top managers and directors (Fernandez-Rodriguez, Gomez-Anson and Cuervo-Garcia, 2004). Turkey has also developed its own corporate governance code in 2003. The next section summarizes the structure of Turkish capital markets.

3. The Structure Of Turkish Capital Markets

In Turkish economy, CPI inflation ended 2008 at 10.6 percent, up 1.7 points from end-2007. Global economic effects in 2008 have had an important impact on the domestic inflation. Gross Domestic Product (GDP) grew by 6.7 percent in the first quarter of 2008, but the pace of growth moderated in the second and third quarters, up only 2.3 and 0.5 percent. Accordingly, GDP rose by 3 percent in the first nine months of 2008 from a year earlier. (Turkish Central Bank, Annual Report, 2008). GDP growth in the Turkish economy for the year 2008 has been 1.1 percent. Growth in the first quarter of 2008 has been 7.3 percent, and decreased to 2.8 percent and 1.2 percent in the second and third quarters respectively. In the last quarter the decreasing trend has continued and has resulted in a negative 6.2 percent growth rate.(CMB, Annual Report 2008)

Turkish financial system has been experiencing a prosperous growth in recent years. On March 2009, total assets of the financial system was 574 billion USD (Central Bank assets included). Turkey is a bank-based system and the Turkish financial system is dominated by banks with a share of 78.8 percent in assets. Banking sector is very significant for Turkish economy. Private sector banks have more than a 50 % of the market share and are primarily part of a bigger family owned commercial conglomerates. Although the banking system in Turkey dominates the intermediation process, the percentage of loans to the private sector in their total assets is relatively small compared to both bank-based and capital markets-based economies (Erturk, 2003)

Family-controlled groups of companies are a common feature of the Turkish business scene, often with a high degree of cross-ownership between companies. Controlling shareholders play a leading role in the management and strategic direction of company groups, many of which include companies that are listed on the Istanbul Stock Exchange. (Yuksel, 2008) Two basic characteristics of Turkish listed companies are concentrated ownership and insider boards.

The Istanbul Stock Exchange (ISE) was founded in 1986. The main purpose of the ISE is to ensure that securities are traded in a secure and stable environment. The ISE is a public corporation operating as an autonomous and professional institution. The ISE is entitled to issue legal regulations related to the subjects and fields within the scope of its authority. The ISE has contributed to the development of Turkish capital markets and Turkish economy since the date of its establishment. (www.ise.org) By the end of 2008, there are 284 corporations traded in the National Market of ISE, 18 corporations in the Second National Market, 3 corporations in the New Economy Market and 12 corporations in the Watch List Market, making a total number of 317. Stock issues have increased and reached $ 7.7 billion in 2008. In 2008, ISE Share Price Index-100 decreased by 62 percent in US dollar terms. In 2008, average daily trading volume was US $ 1,041 million and total trading volume was US $ 261.3 billion. Table 1 shows total trading volume in the ISE between the years 2000-2008.(CMB Annual Report, 2008)

Table 1: Total Trading Volume in ISE from 2000 to 2008

Year	Total Trading Volume (billion US $)
2000	181.9
2003	100.2
2004	147.8
2005	201.8
2006	229.6
2007	300.8
2008	261.3

Source: Adopted from CMB Annual Report, 2008.

Market capitalization reached US Dollar 120 billion at the end of 2008. For 2008 price/earnings ratio and turnover ratio are calculated as 5.7 % and 128.4 %. Table 2 shows that main indicators for corporations in the ISE.

Table 2: The Main Indicators for Corporations with Shares Listed on the ISE

Year	Corporations with Shares Traded on ISE		P/E (%)*	Turnover Ratio (%)
	Number Of Corporations Traded	Market Capitalization ($ Million)		
2000	315	69,507	16.1	206.2
2001	310	47,689	824.4	161.5
2002	288	34,402	27.0	170.1
2003	285	69,003	12.3	192.4
2004	297	98,073	13.3	182.3
2005	304	162,814	19.4	153.9
2006	316	163,775	14.9	145.0
2007	319	289,986	12.0	137.0
2008	317	119,698	5.76	128.4
*: Total Market Value/Total of the last four quarterly net profits				

Source: Adopted from CMB, 2008 Annual Report, 2008, 43.

According to Ararat and Ugur, Turkey's investment environment is quite slimy for the investors. Low liquidity, high volatility, high cost of capital and limited new capital formation are the characteristics of the Turkish capital market. (Ararat and Ugur, 2003) Shortcomings in the legal and regulatory framework contribute substantially to the risks of investing in equity markets in Turkey. (Ararat, Ugur, 2003) Durukan et.al. conclude that Turkey is still in the process of improving capital market's institutional and legal structures. (Durukan et.al, 2009)

Yurtoglu summarizes the characteristics of Turkish corporate governance system as such: "The characteristics of the Turkish corporate governance regime are to a large degree reflected by the following features of the Turkish capital market. First, only a small fraction of Turkish companies are publicly listed and traded. Second, there is no active market for corporate control due to the concentrated ownership of the typical traded company. It is almost impossible to acquire a traded company through a hostile takeover bid since the controlling owner must approve a control change. A third, feature of the Turkish corporate governance landscape is the presence of business groups." (Yurtoglu, 2003)

4. Capital Market Board's Corporate Governance Principles

Capital Markets Board of Turkey (CMB) is the regulatory and supervisory authority in charge of the securities markets in Turkey. The CMB's main purpose is to make innovative regulations, and perform supervision with the aim of ensuring fairness, efficiency and transparency in Turkish capital markets, and improving their international competitiveness. (www.cbm.gov.tr)

Primarily the "OECD Corporate Governance Principles" of 1999 together with the particular conditions of Turkey have been taken into consideration during the preparation of CMB Corporate Governance Principles. (CMB, 2003) However, they are far more detailed and contain many specific guidelines for companies to follow. The principles were first published in 2003 and revised in 2005 to take into account revisions made to the OECD Principles in 2004. All companies whose shares are traded in Istanbul Stock Exchange (ISE) need to comply with these principles and publish corporate governance compliance reports yearly. According to a Report about corporate governance practises in Turkey by OECD, the CMB Principles represent a comprehensive, high-level statement of recommended governance practices that reflect international good practice standards in many areas. (OECD, 2006)

The CMB Principles consist of four main sections, namely shareholders, disclosure-transparency, stakeholders and board of directors. (CMB, 2003) The first section discusses the Principles on shareholders' rights and their equal treatment. Issues such as shareholders right to obtain and evaluate information, right to participate in the general shareholders' meeting and right to vote, right to obtain dividend and minority rights are included in detail in this section. The second section discusses the Principles regarding disclosure and transparency. Within this scope, Principles for establishment of information policies in companies with respect to shareholders and the adherence of companies to these policies are discussed.

Table 3: Main Parts Of Corporate Governance Principles

Part I - Shareholders 1. Facilitating the Exercise of Shareholders' Statutory Rights 2. Shareholders Right to Obtain and Evaluate Information 3. The Right to Participate in the General Shareholders' Meeting 4. Voting Rights 5. Minority Rights 6. Dividend Rights 7. Transfer of Shares 8. Equal Treatment of Shareholders	**Part III - Stakeholders** 1. Company Policy Regarding Stakeholders 2. Stakeholders' Participation in the Company Management 3. Protection of Company Assets 4. Company Policy on Human Resources 5. Relations with Customers and Suppliers 6. Ethical Rules 7. Social Responsibility
Part II –Public Disclosure and Transparency 1. Principles and Means for Public Disclosure 2. Public Disclosure of Relations between the Company and Its Shareholders, The Board of Directors and Executives 3. Periodical Financial Statement and Reports in Public Disclosure 4. Functions of External Audit 5. The Concept of Trade Secret and Insider Trading 6. Significant Events and Developments That Must Be Disclosed to the Public	**Part IV – Board of Directors** 1. Fundamental Functions of the Board of Directors 2. Principles of Activity and Duties and Responsibilities of the Board of Directors 3. Formation and Election of the Board of Directors 4. Remuneration of the Board of Directors 5. Number, Structure and Independence of the Committees Established by the Board of Directors 6. Executives

Source: CMB, 2003

The third section is concerned mainly with stakeholders. A stakeholder is defined as an individual, institution or an interest group that is related with the objectives and operations of a company in any way. Stakeholders of a company include the company's shareholders and its workers; creditors, customers, suppliers, unions various non-governmental organizations, the government and potential investors who may consider to invest in the company. This section includes the Principles to regulate the relationship between the company and stakeholders.

The fourth section includes Principles concerning functions, duties, obligations, operations and structure of the board of directors; remuneration thereof, as well as the committees to be established to support the board operations and the executives. Under the section concerning the board of directors, it is proposed that the board of directors be composed of two different types of members. These are executive and nonexecutive members. In case a member bears its administrative duty as a managing member, then the mentioned board member is defined as the board member having an execution duty. A non-executive member is defined as an individual not having any administrative duties within the company. The chief executive officer (CEO) is the individual who is responsible for the implementation mentioned under the articles of association at the highest level. In case there is no CEO in corporate structure, same function will be fulfilled by the general director.

The Principles do not provide exceptions to the current regulations. In other words, public companies' obligations defined by the relevant legislation are still effective without any amendments. The Principles also include provisions beyond the current regulations, and they have been prepared in order to fill the gaps in corporate governance practices. Therefore, the Principles also aim to play a guiding role for future regulations. The Principles will be periodically examined in order to ensure that they stay up-to-date.

The CMB made a study regarding corporate governance practices of ISE listed companies in 2004, but the results were not satisfactory. (CMB, 2004) It should be expected that the current situation is different from 2005, but since there is no data concerning all ISE companies, it is not fair to say that corporate governance in Turkey is in a good state. The authors previously examined the corporate governance practices of banks listed in the ISE and found for example, only five out of fifteen banks have independent members in their boards. (Nemli Caliskan, Turan Icke, 2009a) Furhermore, 52% of the non-financial service sector firms listed in the ISE declare that they don't have any independent members in their Boards. (Nemli Caliskan, Turan Icke, 2009b)

5. The ISE's Corporate Governance Index And Implications For Companies

In addition to the Principles, in order to motivate companies for good corporate governance, Istanbul Stock Exchange started to calculate ISE Corporate Governance Index in 2007. ISE Corporate Governance Index (XKURY) is the index in which companies applying CMB's Corporate Governance Principles are included. ISE Corporate Governance Index aims to measure the price and return performances of ISE-listed companies with a corporate governance rating of minimum 6 over 10. The corporate governance rating is determined by the rating institutions incorporated by CMB in its list of rating agencies. As of the beginning of 2010, there are 24 companies listed in Corporate Governance Index of ISE. (Table 4)

Table 4: ISE Corporate Governance Index Companies

Hürriyet Gazetecilik ve Matbaacılık	Dentaş Ambalaj ve Kağıt Sanayi	Y&Y Gayrimenkul Yatırım Ortaklığı
Yapı ve Kredi Bankası	Doğan Yayın Holding	Türkiye Sınai Kalkınma Bankası
Vakıf Menkul Değerler Yatırım Ortaklığı	Otokar Otobüs Karoseri Sanayi	Doğan Şirketler Grubu Holding
Coca Cola İçecek	Şekerbank	Petkim Petrokimya Holding
Arçelik	Tofaş Turk Otomobil Fabrikası	Logo Yazılım Sanayi ve Ticaret
TAV Hava Limanları Holding A.Ş.	Tüpraş- Türkiye Petrol Rafinerileri	İş Finansal Kiralama
Anadolu Efes Biracılık ve Malt Sanayi A.Ş.	Türk Traktör ve Ziraat Makineleri	Türk Prysmian Kablo ve Sistemleri
Asya Katılım Bankası	Vestel Elektronik Sanayi ve Ticaret	Türk Telekomünikasyon

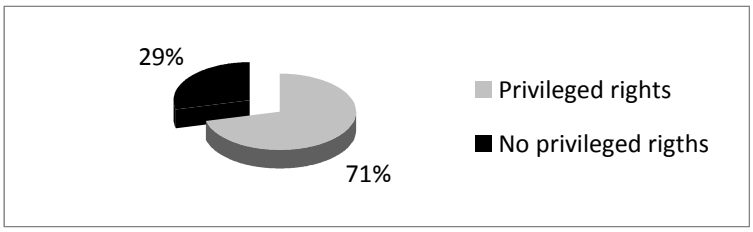
Source: www.imkb.gov.tr

To provide a general picture of corporate governance practises of these companies, the authors tried to summarize the below headings from the corporate governance reports of those companies.

5.1. Privileges Regarding Voting Rights

CMB Principles state that privileges regarding voting rights should be avoided. Shareholders of preferred stock should not have the privilege to nominate in a way that would distort the fair representation of holders of publicly traded shares in the management of the company. 71 % of index companies has privileges regarding voting rights, whereas 29 % has no privileges.

Figure 1: Privileges regarding voting rights



5.2. Cumulative Voting

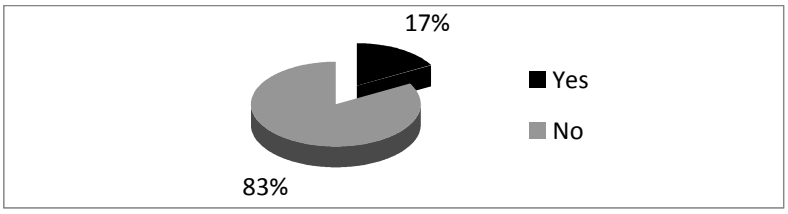
Cumulative voting system may enable minority groups to send directors to the board, depending on the size of the board and the percentage of shares held by the minority. The legal recognition of cumulative voting is seen as an indicator of a good corporate governance system.(Okutan-Nilsson, 2007) According to the Principles, the cumulative voting procedure should be adopted so as to ascertain that minority shareholders send their representatives to the Board of Directors. Within the framework of the legislation, the procedure for the adoption of cumulative voting should be incorporated in the articles of association of the company. The board of directors should inform the shareholders about the cumulative voting system. Although the principles strongly recommend cumulative voting system, none of the companies listed in the Index has cumulative voting procedure.

5.3. Restrictions on Transfer of Shares

CMB Principles asks companies that practices that would hinder shareholders to freely transfer their shares be avoided. The articles of association should not contain provisions to

impede the transfer of shares. 83 % of the index firms has no restrictions on transfer of shares in the articles of association, whereas 17 % has restrictions.

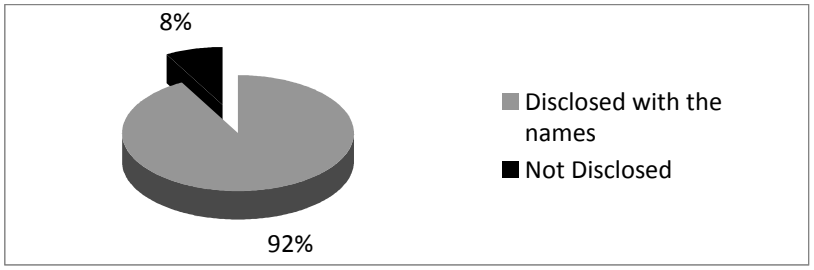
Figure 2: Restrictions on Transfer of Shares



5.4. Disclosure on Insider Trading

In order to prevent insider trading companies need to take all the necessary measures and precautions. A list of the names of executives and other persons/institutions who provide services to the company, and who can potentially possess price-sensitive information should be prepared and disclosed to public in accordance with the information policy. 92% of the companies disclosed the list of individuals who can be classified as an insiders with their names, 8 % did not disclose.

Figure 3: Disclosure on Insider Trading

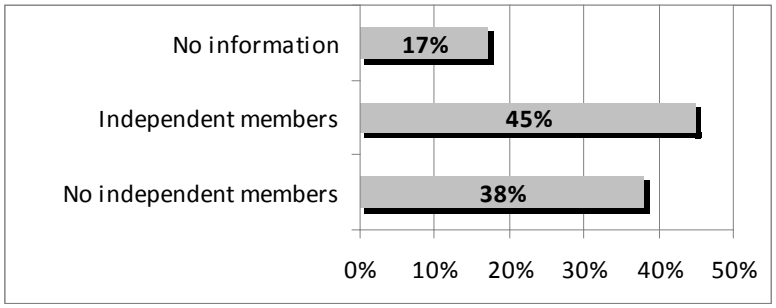


5.5. Independent Members in Board of Directors

The independent board members are assumed to be objective in decision making and have the natural advantage to praise the interests of the company, shareholders and stakeholders equally. Lorsch suggests that one of the important tools to empower Board of Directors is most of the directors coming from outside of the company and have no relationship with it. (Lorsch, 1995) Within this framework, the presence of a clear majority of independent board directors is one of the important elements that ensure corporate governance practices are properly implemented.

However, when country practices are examined, it can be observed that this issue is evaluated differently in each case based on the conditions of each country. Taking into consideration Turkish practice, special clauses have been incorporated to the CMB Principles that emphasize the need for the independence of the board of directors. Moreover, it was recommended that the board of directors be constituted from at least two independent members, and that at least one third of the members fulfill the criteria for independence. Doubtlessly, as the conditions change in time, this ratio is to increase. Figure 4 shows the percentage of companies with independent members in their boards. 38 % of the index companies declare that they don’t have any independent members, the objectivity in the decisions of Board of Directors in the absence of independent members is questionable.

Figure 4: Percentage of Companies With Independent Members in Their Boards



5.6. Existence of Corporate Governance Committee

In spite of the recommendations, it is observed that 50 % of the index firms did not found Corporate Governance Committee, whereas 50 % do have committees.

6. Conclusion

The CMB'S Principles of Corporate Governance is a very useful guideline for companies that want to improve their corporate governance practises. Published in 2003 and amended in 2005, these principles are very comprehensive. The CMB Principles and other legislation in this field in Turkey try to strengthen the position of the individual shareholders against the controlling block of shareholders. The principles specificly focuses on shareholders' rights, public disclosure and transparency, relationships with stakeholders and board of directors.

Although the principles were published in 2003, the acceptance and application of principles is relatively slow among ISE listed companies. To further motivate publicly held companies on corporate governance ISE started to calculate Corporate Governance Index in 2007. Currently there are 24 companies listed in the index. These companies are obviously in a better position than other ISE listed companies but they are also not capturing world standards on corporate governance on privileges regarding voting rights, cumulative voting, restrictions on transfer of shares, disclosure on insider trading, corporate governance committee as the results of this study show.

Although many areas are improving in Turkish corporate governance practice, there remains some challenges ahead. Turkish companies need to consider the CMB Principles not an enforcement but a guideline and try to improve their corporate governance performance if they want to be more competitive and able to find capital from international markets.

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