

Corporate Governance: Turkish Transparency And Disclosure Survey

Governance Analyst(s): Amra Balic, London (44) 20-7176-3637;
amra_balic@standardandpoors.com

Nicholas Bradley, London (44) 20-7176-3548;
nick_bradley@standardandpoors.com

(Editor's note: This article was cowritten by Dr. Melsa Ararat, Director of the Corporate Governance Forum of Turkey at Sabanci University in Istanbul. The survey was based on research conducted by Dr. Mine Aksu, Dr. Arman Kosedag, and Dr. Hakan Orbay from Sabanci University.)

This survey analyses the disclosure practices of 52 Turkish companies. The majority of companies (44) included in the survey are the constituents of the S&P/IFC Global Index. The remainder comprises eight companies from the top 60 listed on the Istanbul Stock Exchange (ISE), selected according to market capitalization and liquidity.

Standard & Poor's Governance Services and the Corporate Governance Forum of Turkey (CGFT) at Sabanci University in Istanbul will monitor corporate response to regulation and market circumstances by conducting the survey over two successive years, with the objective of providing a comparative insight into the disclosure practices of Turkish companies.

This report summarizes the finding of the first survey and will provide a benchmark for successive studies. The data collected will be used for further research by CGFT researchers to analyze the relationship between disclosure and transparency, disclosure and performance, and disclosure and governance quality.

Key Findings

Turkish companies have a moderate level of disclosure, with companies scoring on average five out of 10 (see Chart 1).

The survey was able to distinguish the following top-five Turkish companies in terms of transparency and disclosure:

- Akbank T.A.S;
- Anadolu Efes Biracilik ve Malt Sanayi A.S.;
- Dogan Yayin Holding A.S.;

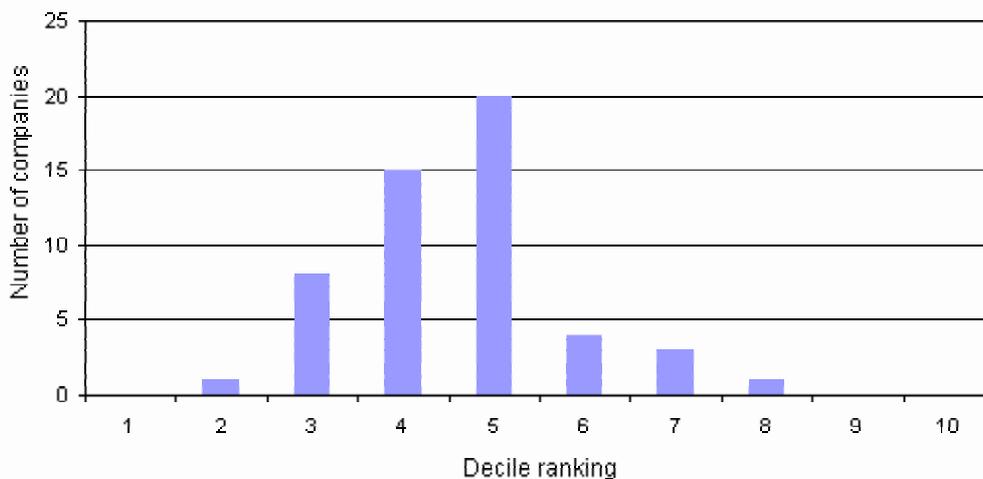
- Kovic Holding A.S.; and
- Turkcell Iletisim Hizmetleri A.S.

The key findings of the survey illustrate that:

- Disclosure levels are highest with respect to financial disclosure and lowest with respect to the board of directors and management processes.
- The average score on financial disclosure is 7, with ownership structure and the board of directors scoring 4 and 3, respectively (see Charts 2, 3, and 4). This is somewhat unsurprising given the fact that Turkish mandatory regulatory disclosure requirements mostly focus on disclosure of financial information, with less emphasis on the ownership structure and board of directors.
- There is very little variation in financial information disclosure. This is due to companies disclosing only what is required and not going beyond current requirements--voluntary disclosure is limited.

There is a greater differentiation between scores in Component 1 (ownership structure and investor relations) and Component 3 (board and management structure and process), where companies, at least theoretically, have a greater choice with respect to levels of disclosure.

Chart 1
**Overall Decile Ranking:
 Number Of Companies Per Decile**



Governance In Turkey Relative To Transparency And Disclosure

Turkey has made considerable steps forward in improving the quality of its institutions and investment environment during the past few years, with the influence of the IMF and potential EU membership being the external anchors. These improvements, combined with the increasing importance of portfolio equity flows to emerging markets and the prospect that Turkey's share of foreign capital inflows will grow, have raised the importance of the quality of corporate governance at companies listed on the ISE.

The issuance of Corporate Governance Principles by the Capital Markets Board (CMB) of Turkey in July 2003 was an important milestone that triggered an extensive debate in the corporate sector. Although compliance with these principles is voluntary, from 2004 onward annual reports must include and explain the level of compliance, based on a standard reporting format. In addition to the Principles, which have been introduced on a comply-or-explain basis, legally binding directives relating to the adaptation of International Financial Reporting Standards and auditing standards issued in 2003 are expected to contribute to the increased transparency of ISE-listed companies.

Current levels of disclosure in Turkey vary substantially between companies, and the deviation between the actual and required or recommended disclosure by the CMB depends on a number of parameters.

Methodology

The survey analyzes disclosure from the perspective of international investors, and has therefore focused on sources of information that are most readily accessible by those investors: typically, the latest available English language company annual reports, the local language annual reports, and both English and local language Web sites.

The survey leverages Standard & Poor's expertise in corporate governance, index construction, and analysis of accounting information. It is designed to help international investors better understand the differences in the level of reporting between Turkish companies and, to an extent, between Turkish companies and companies in other countries.

Transparency and disclosure is evaluated by searching for the inclusion of 106 possible information items ("attributes") in

companies' disclosure. These 106 attributes were selected after examination of the annual report and accounts, regulatory filings, and Web sites of leading companies around the world and the identification of the most common disclosure items (see examples below). These attributes are grouped into three subcategories:

- Ownership structure and investor relations;
- Financial transparency and information disclosure; and
- Board and management structure and process.

The inclusion of each attribute is scored on a binary basis representing "yes" (included) or "no" (not included) answers to ensure objectivity. Each "yes" answer is equal to one point.

Companies are ranked in decile order. An overall ranking will reflect the total number of the 106 possible attributes included in a company's annual report, accounts, and Web sites. Individual rankings for each of the three subcategories are calculated in a similar way, by reference to the maximum possible number of attributes for each subcategory.

The Survey And Corporate Governance Scores

This survey is a research project conducted in co-operation with CGFT. It uses only publicly available information, and therefore should not be compared with Standard & Poor's Corporate Governance Scores (CGS). A CGS is an assessment by Standard & Poor's of corporate governance practices and is not limited to information disclosure. Scores are assigned on the basis of an in-depth, interactive analytical process involving both public and nonpublic data. Standard & Poor's does, however, view corporate transparency as an important factor affecting a company's attractiveness to investors, and as a vital element of corporate governance.

In this survey, Standard & Poor's assesses the average level of corporate transparency in relation to the level desired by practical investors. We evaluate the amount of easily accessible disclosure of the major parameters of a company's operations, performance, and governance structure.

Coverage

In 2002, we published our first transparency and disclosure surveys, which included companies in the following Standard & Poor's indices:

- S&P/IFC Asia;

- S&P/IFC Latin America;
- S&P Asia Pacific 100; and
- S&P/TOPIX 150 (Japan).

We conducted a similar survey in Russia in 2002 and 2003. Furthermore, we released a survey of the S&P Europe 350 companies in 2003, and, in response to continued interest from investors and analysts, we conducted a third Russian survey in 2004.

To address the specifics of certain markets and regions more clearly, the methodologies used in Russia and Turkey have been modified. The list of questions (attributes) has been extended in the case of Turkey to incorporate some market-specific issues, including family ownership and relationships between holding companies and their subsidiaries.

Key Conclusions

Overall, we found that companies do not generally disclose more than is legally required (except the voluntary adaptation of International Accounting Standards [IAS] by some of the largest and most liquid companies). This reduces the explanatory power of the disclosure data. We expect the situation to improve in 2005 due to a number of factors, including:

- Changes to the legal and regulatory environment requiring mandatory compliance with reporting and reporting standards.
- Increased investor interest.
- Increased growth potential.

One of the most important conclusions of the survey is that business groups do not have a consistent disclosure policy. Holding companies and their subsidiaries are in most cases dispersed over extreme quartiles. This dispersion is not affected by sector, size, or ownership structure (pyramidal level or floatation rate) and raises serious concerns as to the transparency of groups and the importance of consolidated reporting.

We would like to draw attention to a number of specific issues that international investors should be aware of:

- In Turkey, the fundamental document governing shareholders' rights is a company's articles of association, which is not typically disclosed.

- Most companies have multiple classes of shares, with shareholders' agreements between the holders of different classes. We observed no disclosure of such agreements.
- Given the typical family ownership structure of Turkish companies, the right to nominate board members is particularly important for noncontrolling shareholders. Any nomination procedure must therefore be binding for the shareholders and clearly observed and articulated in the articles of association. We observed no disclosure of the board nomination process.
- It is fairly common for representatives (often executives) of holding companies to sit on the boards of subsidiary companies with an explicit mandate to deliver/impose the policies of the holding company. We observed no disclosure of such policies, which raises concerns with respect to the effectiveness of subsidiary boards.

Disclosure Patterns

Analysis of the disclosure of each individual attribute reveals that patterns of disclosure vary not just between the three main components, but also between different attributes within the components. As an example, we have looked at both the most and the least disclosed attributes in the subsections below.

Component 1: Ownership Structure And Investor Relations

Most companies disclose the following information:

- The number of issued and outstanding ordinary shares.
- The identity of the largest shareholder.

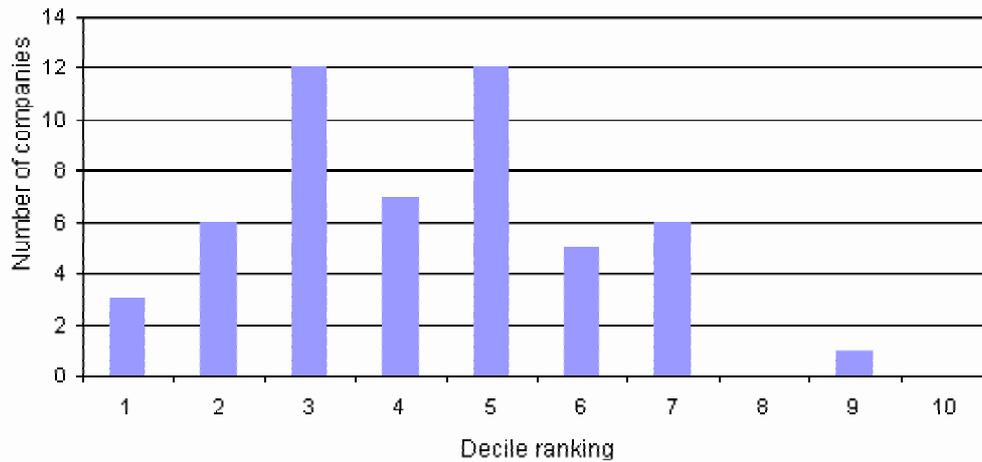
While almost none of companies disclose:

- The percentage of cross-ownership.
- The ultimate beneficiaries in the case of institutional investors--companies or cross-shareholdings.

Chart 2

**Component 1:
Ownership Structure And Investor Relations**

Number Of Companies Per Decile



Component 2: Financial Transparency And Information Disclosure

The large majority of companies disclose the following information:

- Accounting policies.
- Accounting standards used.
- Accounts adjusted for inflation.
- Name of audit firm.
- Auditors' report.
- Details of the nature of the business.
- Details of products/services produced/provided.
- Output in physical terms.
- Method of asset valuation.

Surprisingly, the results show that hardly any companies disclosed information on:

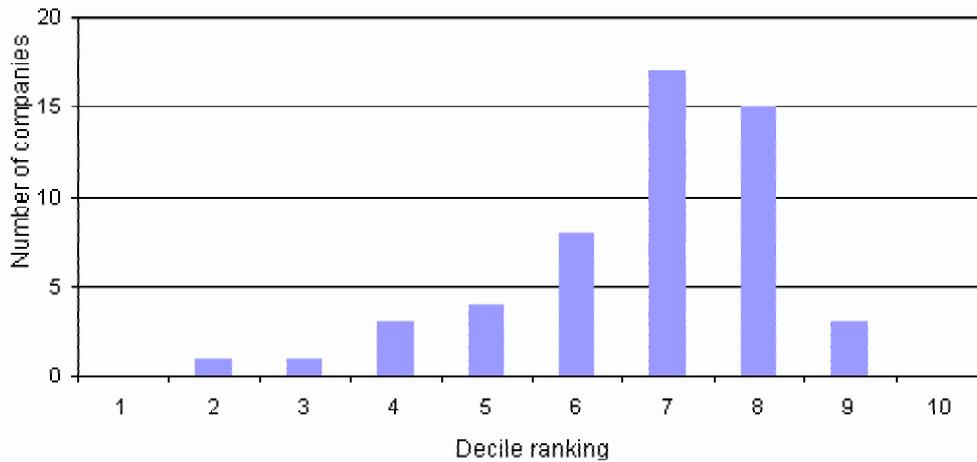
- Fees paid to auditors for audit and nonaudit work.

Disclosure trends over the past three-to-four years have greatly emphasized the importance of this information, as it helps investors to assess potential conflicts of interest for external auditors.

Chart 3

Component 2: Financial Transparency And Information Disclosure

Number Of Companies Per Decile



Component 3: Board And Management Structure And Process

Most of the companies disclose the following information:

- A list of board members.
- The identity of the chairman.

The list of nondisclosed items is extensive and includes the following attributes:

- The form of directors' salaries.
- Specifics of performance-related pay for directors.
- Decision-making process for managers' pay.
- The form of managers' salaries.
- Specifics of performance-related pay for managers.
- Details of the CEO's contract.
- Information about directors' training.
- The number of shares managers hold in other affiliated companies.
- Whether any policies exist regarding the nature of the relationship between the holding company and affiliated companies.
- Whether a nomination committee exists.
- Details of the members of the nomination committee.
- Whether a remuneration/compensation committee exists.

- Details of the members of the remuneration committee.

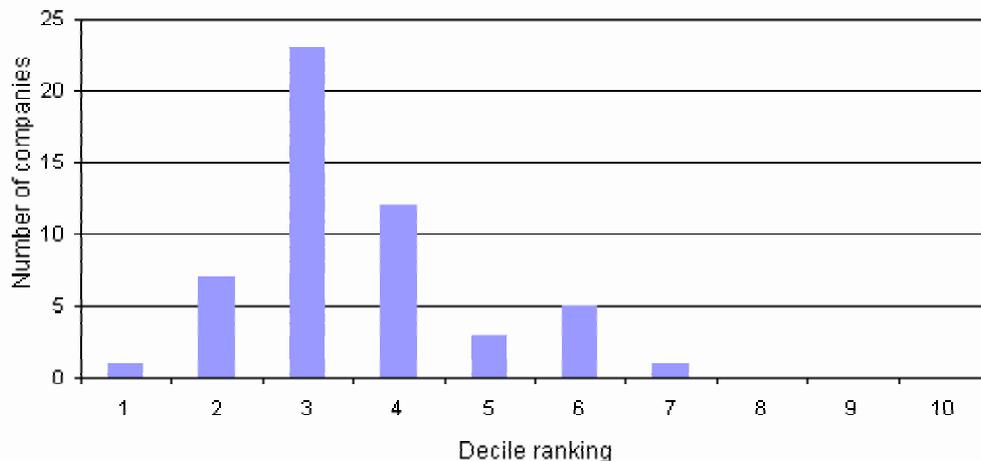
We have further analyzed the extent of disclosure of important governance items. Given the typical ownership structure of Turkish companies, which generally includes a family-owned blockholding/majority shareholding of the holding entity, disclosure of the following attributes is considered crucial for overall transparency:

- Details of related-party transactions (disclosed by approximately 60% of companies).
- Information on the presence of independent or nonexecutive directors on the board (25% disclosure).
- Whether an audit committee exists (40% disclosure).
- Information on the articles of association (approximate 30% disclosure).
- Details of the ultimate ownership structure (less than 5% disclosure).
- Information on any (in)formal voting agreements or blocks (approximate 5% disclosure).
- Details of different types of shares (50% disclosure).
- A description of the board nomination process (not disclosed).
- Whether groupwide policies applicable to subsidiaries exist (not disclosed).

Chart 4

**Component 3:
Board And Management Structure And Process**

Number Of Companies Per Decile



Comparative Analysis

The tables presented below (Tables 1 and 2) provide some comparative information about disclosure levels in other countries and regions. The results show that Turkish disclosure levels are broadly in line with those of some other European countries, although they remain below the European average.

We should, however, draw attention to the fact that the comparative data for country clusters are on average three years old. Given the market and/or regulatory requirements now in place, we would expect that disclosure levels in all surveyed countries would be considerably higher for 2004.

Country	Average decile score
Austria	5
Belgium	5
Denmark	5
Finland	7
France	6
Germany	5
Greece	4
Ireland	8
Italy	5
The Netherlands	6
Norway	6
Portugal	5
Russia¶	5
Spain	5
Sweden	7
Switzerland	5
Turkey	5
U.K.	8

*With the exception of Russia, results are based on 2001/2002 data. ¶Results based on 2004 survey.

Country/region	Average decile score
Latin America	4
Emerging Asia	4
Asia-Pacific	5
S&P Europe 350	6
U.S./S&P 500	7
Turkey	5

*With the exception of Turkey, results are based on 2001/2002 data.

Variables	Number	Minimum	Maximum	Mean	Standard deviation
Overall	52	16.19	71.43	41.11	11.06
Ownership Structure	52	3.13	88.00	38.57	18.26
Financial Disclosure	52	19.44	86.11	64.21	14.25
Board/Management	52	2.70	54.05	20.42	12.18

Source: Aksu and Kosedag (2005): "The Relationship Between Transparency & Disclosure And Firm Performance: Evidence From The Istanbul Stock Exchange," Working Paper, Sabanci University.

Appendix 1: 106 Transparency And Disclosure Attributes

Component 1: Ownership Structure And Investor Relations

Does the company in its annual accounts or on its Web site disclose:

- The number of issued and outstanding ordinary shares?
- The number of issued and outstanding other shares (preferred and nonvoting)?
- The par value of each ordinary share?
- The par value of other shares (preferred and nonvoting)?
- The number of authorized but unissued and outstanding ordinary shares?
- The number of authorized but unissued and outstanding other shares?
- The top shareholder?
- The top-three shareholders?
- The top-five shareholders?
- The top-10 shareholders?
- The number and identity of shareholders holding more than 3%?
- The number and identity of shareholders holding more than 5%?

- The number and identity of shareholders holding more than 10%?
- The identity of the shareholder(s) holding at least 50% in total?
- The free float rate?
- The details of different share classes, if applicable?
- Shareholders by type?
- The percentage of cross-ownership?
- The existence of a Corporate Governance Charter or Code of Best Practice?
- The details of the Corporate Governance Charter/Code of Best Practice, if applicable?
- All information about its articles of association (changes, for example)?
- Details about the articles of association?
- The voting rights for each voting share?
- The way directors are nominated to the board and which shareholders nominate?
- The way shareholders convene an extraordinary general meeting?
- The procedure for putting inquiry rights to the board?
- The procedure for putting proposals forward at shareholder meetings?
- A review of the last shareholder meeting (such as minutes)?
- A calendar of important shareholder dates?
- Whether there are any formal or informal voting agreements or voting blocks (relevant to family ownership)?
- Whether senior managers hold shares?
- Whether the ultimate beneficiaries are disclosed in the case of institutional, company, or cross shareholdings?

Component 2: Financial Transparency And Information Disclosure

Does the company in its annual accounts or on its Web site disclose:

- Its annual report (specifically, is this available on the company's Web site)?
- Its accounting policies?
- The accounting standards under which it reports?
- Its accounts according to local accounting standards?
- Its accounts according to an internationally recognized accounting standard (IAS/U.S. GAAP)?

- Its balance sheet according to an international accounting standard (IAS/U.S. GAAP)?
- Its income statement according to an international accounting standard (IAS/U.S. GAAP)?
- Its cash flow statement according to an international accounting standard (IAS/U.S. GAAP)?
- Inflation-adjusted accounts?
- A basic earnings forecast of any kind?
- A detailed earnings forecast?
- Financial information on a quarterly basis?
- A segment analysis (broken down by business line)?
- The name of its auditing firm?
- A copy of the auditors' report?
- The amount paid in audit fees to the auditor?
- Any nonaudit fees paid to the auditor?
- Consolidated financial statements?
- Its method for asset valuation?
- Its method for fixed-assets depreciation?
- A list of affiliates in which it holds a minority stake?
- A reconciliation of its domestic accounting standards to IAS/U.S. GAAP?
- The ownership structure of affiliates?
- Details of the kind of business it operates in?
- Details of the products/services produced/provided?
- Output in physical terms (number of users, for example)?
- The characteristics of assets employed?
- Efficiency indicators (ROA and ROE, for example)?
- Any industry-specific ratios?
- Information on corporate strategy?
- An overview of investment plans in the coming year(s)?
- Detailed information about investment plans in the coming year(s)?
- An output forecast of any kind?
- An overview of industry trends?
- Its market share for any or all of its businesses?
- A list/register of related-party transactions?
- A list/register of group transactions?

Component 3: Board And Management Structure And Process

Does the company in its annual accounts or on its Web site disclose:

- A list of board members (names)?

- Details about directors (other than name/title)?
- Details about the current employment/position of directors?
- Details about directors' previous employment/positions?
- The date that each of the directors joined the board?
- Whether directors are classified as executives or outside directors?
- The name of the chairman?
- Details about the chairman (other than name/title)?
- Details about the role of the board of directors?
- A list of matters reserved for the board?
- A list of board committees?
- The existence of an audit committee?
- The names on the audit committee?
- The existence of a remuneration/compensation committee?
- The names on the remuneration/compensation committee)?
- The existence of a nomination committee?
- The names on the nomination committee?
- The existence of internal audit functions besides the audit committee?
- The existence of a strategy/investment/finance committee?
- The number of shares in the company held by directors?
- A review of the last board meeting (such as minutes)?
- Whether training is provided for directors?
- The decision-making process for directors' pay?
- The specifics of directors' pay (such as salary levels)?
- The form of directors' salaries (such as cash or shares)?
- The specifics of performance-related pay for directors?
- A list of senior managers (not on the board of directors)?
- The backgrounds of senior managers?
- The decision-making process for managers' pay?
- The specifics of managers' pay?
- The form of managers' pay?
- The specifics of performance-related pay for managers?
- The details of the CEO's contract?
- The number of shares held by managers in other affiliated companies?
- Whether board members are employees of the parent company (if the company is a consolidated affiliate/subsidiary)?
- Whether any group policies exist regarding the nature of the relationship between the parent and its affiliates

(with respect to the corporate governance of the affiliates/subsidiaries)?

- Whether any members of senior management are related (family, joint business, or similar) to any major shareholder?

The results from the 106 questions are then converted into a percentage and translated into deciles.

Group E-Mail Address

Governance@standardandpoors.com