Corporate Governance Reforms in Turkey, Scope for Optimism

Located at the crossroads of Eurasia, Turkey, is a rapidly growing emerging market and the largest economy lined-up to join the EU. Following a prolonged period of instability underpinned by both the absence of a rule based economy and poor institutional quality, Turkey's restructuring reforms under an IMF stand-by agreement has delivered tangible results. Fiscal discipline has been restored and inflation has been reduced to single digits. 18 public and private sector banks have been taken over by the newly established independent Banking Agency at a total cost of US$ 47.2 billion – after it was established that these banks were unviable - either because of non-functioning credits or outright tunnelling.

Structural reforms constituted, in essence, the final phase in establishing a market economy in Turkey. With the return of moral credibility to the "rule makers" and visible prospects of growth, the Capital Markets Board (CMB) took radical steps forward by issuing a number of significant directives to improve Corporate Governance. These steps included the adoption of IFRS, mandatory audit committees, the disclosure of material events, auditor rotation, and separation of audit services from consulting.

In July 2004, CMB issued the Corporate Governance Principles. Driven from OECD guidelines and inspired by the SOX Act, these Principles, although only recommendations, were presented as a road map for future regulations. The corporate sector did not embrace the Principles immediately. In 2005 the CMB responded by clearly articulating that the voluntary nature of these Principles should not be taken lightly and mandated the listed companies to include a compliance report in their annual reports from 2004 onwards. Reporting guidelines were also issued together with a second version of the CG Principles which incorporated the 2004 amendments to the OECD Guidelines. When 2004 annual reports were issued in May 2005, a radical improvement in the level of CG disclosure by Turkish listed companies was observed. A recent survey of listed company web-sites also indicated the start of these being transformed from being merely a PR tool, to a medium for communicating investor information.

My personal view is that regulations in Turkey have played a crucial role in providing the necessary framework for market forces to act by inducing transparency. Although some observers may argue that most companies only responded to regulations by adopting a "box ticking" approach, this should l lead to behavioural improvement. As Ira said, "box ticking is a first step; it gets people into a pattern of doing things right, and eventually it turns to substance."

Corporate reforms will continue through 2005; both the new Company Law and Banking Law are expected to be enacted shortly. The new Banking law has strict rules to ensure independence of board members. Furthermore, in order to encourage compliance with the CMB's Principles, a stock market index based on compliance with these Principles will be calculated and tracked separately by ISE with rating agencies assessing compliance. Qualified companies will be exempted from 50% of their listing fees. The CMB is at the final stages of upgrading its information infrastructure and the Electronic Signature project, which is currently in a pilot phase, will encourage a more timely disclosure of material events and discourage manipulation. As CGFT, we do our best to support CMB's work and we are happy that our input is sought and welcome.

Despite these developments, a number of key problems remain. The majority of listed companies are controlled by 5 families which jointly control approximately 70% of business in Turkey - rendering much protection for minority shareholders ineffective. Although financial disclosure has y improved, the disclosure of board structures, processes and ultimate ownership structures however, remains remarkably low. Market manipulation and, although reduced, the channelling of corporate profits through from companies at the lower end of the pyramidal structures upwards are still key areas of concern.

My real concern is the low investor confidence globally; I worry about the massive amounts of cash surplus which are not being invested whereas unemployment remains high and pension bomb is ticking. Despite improvements in the corporate governance framework, reforms will be short lived if long term capital does not flow to better run companies in emerging markets. Emerging markets with higher growth and return prospects may in turn help to energise global markets if innovative investment vehicles supported by quality information infrastructures become available; this does not only concern Turkey, but all emerging markets.

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