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Corporate Governance:

Turkish Transparency And Disclosure Survey 2008: A Year Of Little Or No Progress

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Turkish Transparency And Disclosure Survey 2008: A Year Of Little Or No Progress

(Editor's Note: This article is coauthored with Prof. Melsa Ararat {melsaararat@sabanciuniv.edu}, Director of the Corporate Governance Forum of Turkey at Sabanci University in Istanbul.)

If the past year is anything to go by, Turkish companies have little appetite for improving their disclosure practices above current levels. Moreover, the latest survey of transparency and disclosure in Turkey undertaken by Standard & Poor's Ratings Services in conjunction with the Corporate Governance Forum of Turkey (CGFT) at Sabanci University in Istanbul finds that the score achieved for financial reporting has slipped slightly: For example, among the 50 firms in our sample, the average score for financial reporting dropped to 73% in 2008 from 75% last year. Nevertheless, we do note some positive developments, predominantly the shrinking gap between the top performers and the remainder of our sample.

The 2008 survey represents the fourth and final phase of the joint Standard & Poor's and CGFT "Turkish Transparency and Disclosure Study" (the Study; see section headed "Related Articles" below for details of our research from the previous three phases). Over the past four years, we and the CGFT have been monitoring and assessing corporate responses to regulation and market circumstances in order to provide a comparative insight into the disclosure practices of Turkish companies. During that period, laws and regulations concerning corporate governance and their enforcement have drastically improved: The current legal and regulatory framework includes Corporate Governance Guidelines issued in 2003, directives related to audit and accounting standards and practices issued in and after 2003 by the Capital Markets Board of Turkey (CMB), a new Banking Law, and directives issued by the Banking Regulatory and Supervisory Agency.

Early Promise Of Continuing Disclosure Gains Evaporates

After initially promising results in the early phases of the Study, our latest survey confirms that companies' efforts to improve their disclosure levels have stalled, showing little or no change year-on-year from last year's results. Although the reasons for this slowdown are not entirely clear, we believe that one factor is a general lack of voluntary disclosure (that is, disclosure that goes beyond the level required by regulation). That said, it's important to note that as disclosure levels rise, there is less room for improvement. Nevertheless, the scores seem to converge around the disclosure required and captured under International Financial Reporting Standards (IFRS). Further evidence that disclosure is mainly driven by regulations is shown by the continuing very low levels of information related to the board of directors.

Turkey has taken considerable steps forward in improving the quality of its capital market institutions and investment environment since 2001, when substantial macroeconomic reforms were implemented with the International Monetary Fund (IMF) and EU as external anchors. These reforms focused on restructuring the banking industry and on fiscal transparency in the public sector. Strong economic gains in 2002-2006, which were largely driven by renewed investor interest in emerging markets, along with IMF backing and tighter fiscal policy, paralleled the efforts of the CMB to improve transparency in the Turkish capital markets. At the same time, the introduction of higher auditing standards in 2003, plus the adoption of IFRS as a mandatory standard in 2005,

transformed the quality of financial reporting.

The CMB's decision to launch Corporate Governance Principles in 2003 was an important milestone, but it had little effect on the disclosure practices of Turkish companies until the introduction of mandatory compliance reporting on the Principles in 2004. While the latter increased the transparency of governance practices and created awareness of the elements of good corporate governance, the main improvements followed the introduction of IFRS. We expect further progress in disclosure levels through the prospective enactment of the New Commercial Code, which requires disclosure of control relations between the parent company and its subsidiaries. As yet, however, there is no firm date set for introducing the Code.

Disclosure Levels Stabilize

As already indicated, this year's survey shows no notable change in disclosure levels compared with the 2007 results. The average score per company remains at 61%, compared with 57% in the second phase and 41% in the first. What's more, three of the top five firms (in alphabetical order)--Anadolu Efes Biracilik ve Malt Sanayi, Koç Holding, and Turkcell Iletisim Hizmetleri--feature at the head of all four of our studies from 2005 to 2008 (see table 1). Notably among this trio, Anadolu Efes and Turkcell are subject to the stricter disclosure regimes of the London Stock Exchange and New York Stock Exchange, respectively, where they are cross-listed.

Table 1

Top Five Turkish Companies For Transparency And Disclosure 2005-2008*			
2008 [¶]	2007 [§]	2006 [§]	2005 [§]
Anadolu Efes Biracilik ve Malt Sanayi	Akbank	Akbank	Akbank
Aygaz	Anadolu Efes Biracilik ve Malt Sanayi	Anadolu Efes Biracilik ve Malt Sanayi	Anadolu Efes Biracilik ve Malt Sanayi
Koç Holding	Enka Insaat ve Sanayi	Koç Holding	Dogan Yayin Holding
Migros	Koç Holding	Petrokimya Holding	Koç Holding
Turkcell Iletisim Hizmetleri	Turkcell Iletisim Hizmetleri	Turkcell Iletisim Hizmetleri	Turkcell Iletisim Hizmetleri

*In alphabetical order. [¶]Data cover 50 companies from the S&P/IFC Global Index and ISE-100 Index, selected on the basis of being the largest in terms of market capitalization and liquidity. [§]Data cover 52 companies. Source: Standard & Poor's and the Corporate Governance Forum of Turkey.

The key findings of the 2008 survey are that:

- There have been no further improvements in disclosure levels compared with the 2007 survey, the average score for financial disclosure showing some worsening and board disclosure showing only a marginal improvement (see chart 1). Although disclosure continues to be highest with regard to financial information, the average score has slipped to 73% in 2008 from 75% in 2007 (2005: 64%).
- While average disclosure scores have seen no improvement, there has been a small improvement in disclosure regarding Component 3: Board and Management Structure and Process (see Appendix). Here, the average score per company rose to 46% from 44% in 2007, 38% in 2006, and 21% in 2005. Although disclosure of board information has improved in the past three years, this remains the weakest of the three transparency and disclosure categories.
- For Component 1: Ownership Structure and Shareholders' Rights, the average disclosure score per company remains at 64% as in 2007 (2005: 61%).
- The overall improvements in disclosure levels continue to be greatest among the companies that scored lowest in

the previous years' surveys.

- Holding companies and their subsidiaries continue to have different disclosure levels, and therefore concerns remain about the transparency of business groups.

The difference between the top performers and the remainder of the sample has been drastically reduced, with only very few companies being at the very top or very bottom. The vast majority of companies in the sample now show greater uniformity in their disclosure levels (see chart 2).

Chart 1

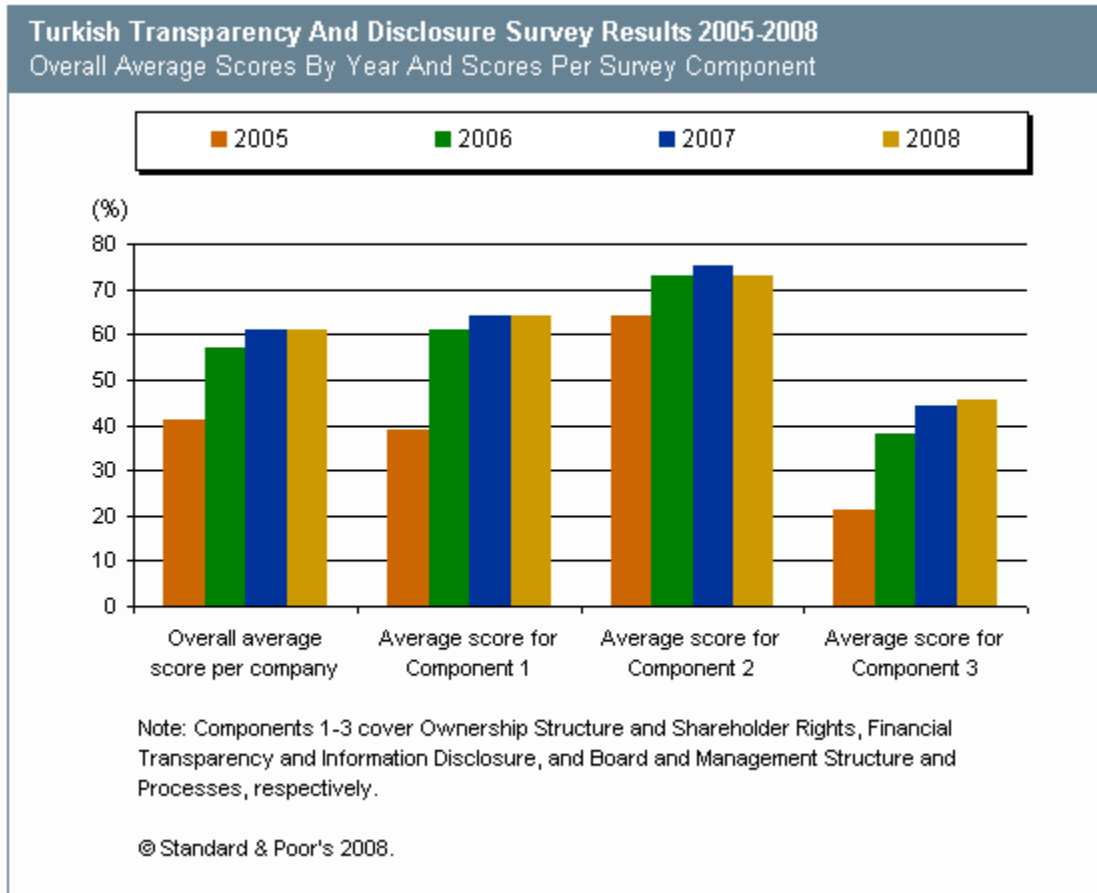
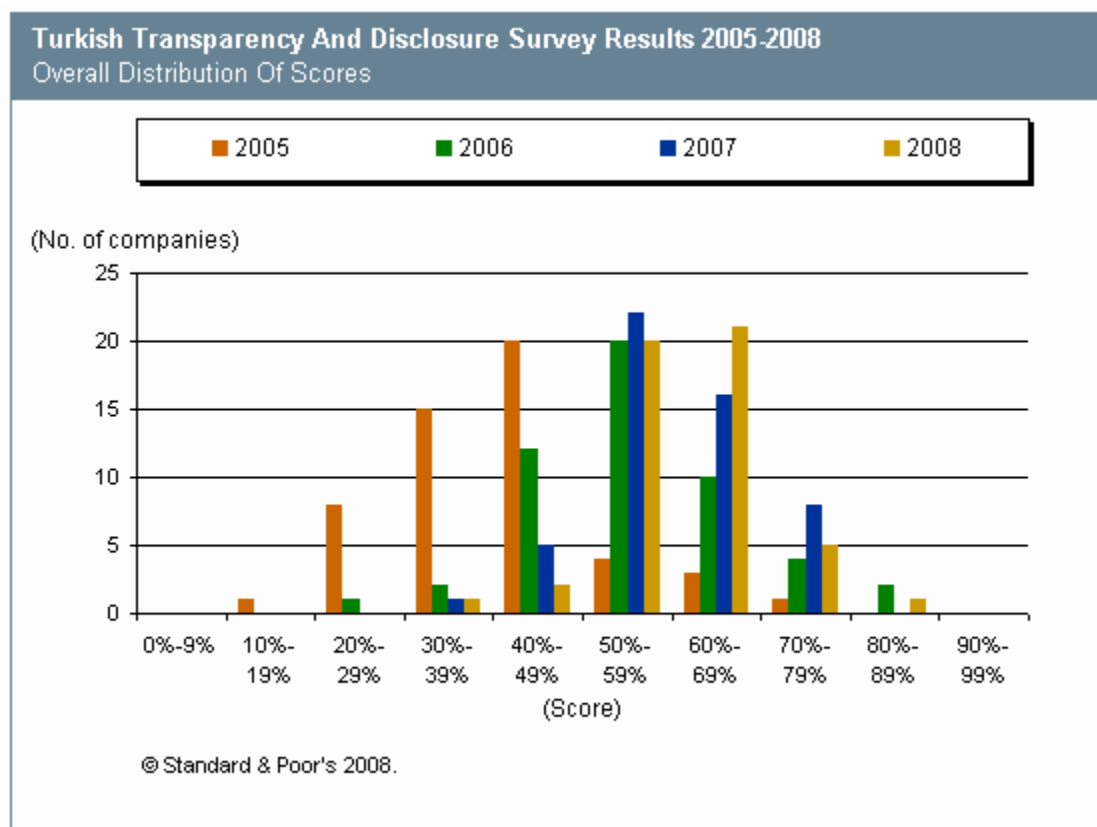


Chart 2



International investors should also be aware of the following issues:

- Companies' articles of association, which previously were not usually disclosed, are now increasingly becoming available on companies' Web sites as recommended by the CMB. This is particularly important because shareholders' rights are primarily governed by the articles of association.
- Board nomination is a shareholder right according to the existing Turkish Commercial Code, and this is not expected to change. However, many companies have multiple share classes, some of which are collectively assigned board nomination--hence control--privileges. Publicly traded shares of such companies normally are not assigned nomination rights. This practice does not violate the "one share, one vote" principle as all shares are common shares, but it does disguise the disparity between ownership, control rights, and cash flow rights by assigning privileges collectively to one or more class of shares. With the increasing availability of articles of association on company Web sites, shareholders can access information on the nomination privileges of share classes; that said, the identity of the ownership of these shares is not self-evident in most cases. To date, cumulative voting has not been adopted by any company in Turkey, although the legal framework is in place to support it.
- Given the existence of share classes with nomination privileges, the process by which the representatives or owners of share classes with nomination rights select the board members is particularly important for minority shareholders. Only one company disclosed its board nomination process in our 2008 survey.
- It's fairly common for representatives (often executives) of holding companies to sit on the boards of subsidiary companies with an explicit mandate to deliver or impose the policies of the holding company. We observe no

disclosure of such policies or practices, which raises concerns about the role and effectiveness of subsidiary boards within holding company structures.

Most of the areas where we observe opacity will be made more transparent by law if and when the draft New Commercial Code is enacted. We predict a radical improvement in the disclosure scores for Components 1 and 3 under the new Code.

Disclosure Patterns By Component Reveal Persistent Blind Spots

Analysis of the disclosure of each individual attribute in 2008 shows almost the same trends of disclosure between the three main subsections (termed Components), and also between different attributes within the Components, as in 2007.

Component 1: Ownership Structure and Shareholder Rights

No change is evident in this component, which has the same average disclosure score of 64% as in 2007. Although the list of disclosed items is extensive, 90% of companies disclose items such as:

- The number of issued and outstanding ordinary shares;
- The par value of each ordinary share;
- The top shareholder;
- The free float rate;
- Voting rights for each voting share (not the voting privileges collectively exercised by a group of shares);
- All information about articles of association; and
- A review of the last shareholders' meeting.

We also note that companies continue to be more explicit in disclosing their corporate governance policies, albeit to varying degrees. Since 2005, companies have been required to issue a report on their compliance with the recommended corporate governance provisions, including disclosure practices. If the information related to the recommended disclosure is readily available at no additional cost (such as the disclosure of articles of association), we find that companies comply with the requirement. In other cases, such as disclosure of board nomination processes, we see no improvement, as this would require an agreement among the shareholders and a possible amendment of the articles of association.

Furthermore, companies continue to be reluctant to disclose:

- Their top 10 shareholders (including major shareholders of publicly traded shares, which would in most cases involve the disclosure of shares held by institutional investors and management); and
- Any formal or informal voting agreements or blocks between major shareholders.
- Information about top executives' holdings of company shares.

Fewer than 20% of companies disclose the first two of these items, and fewer than 5% disclose the third.

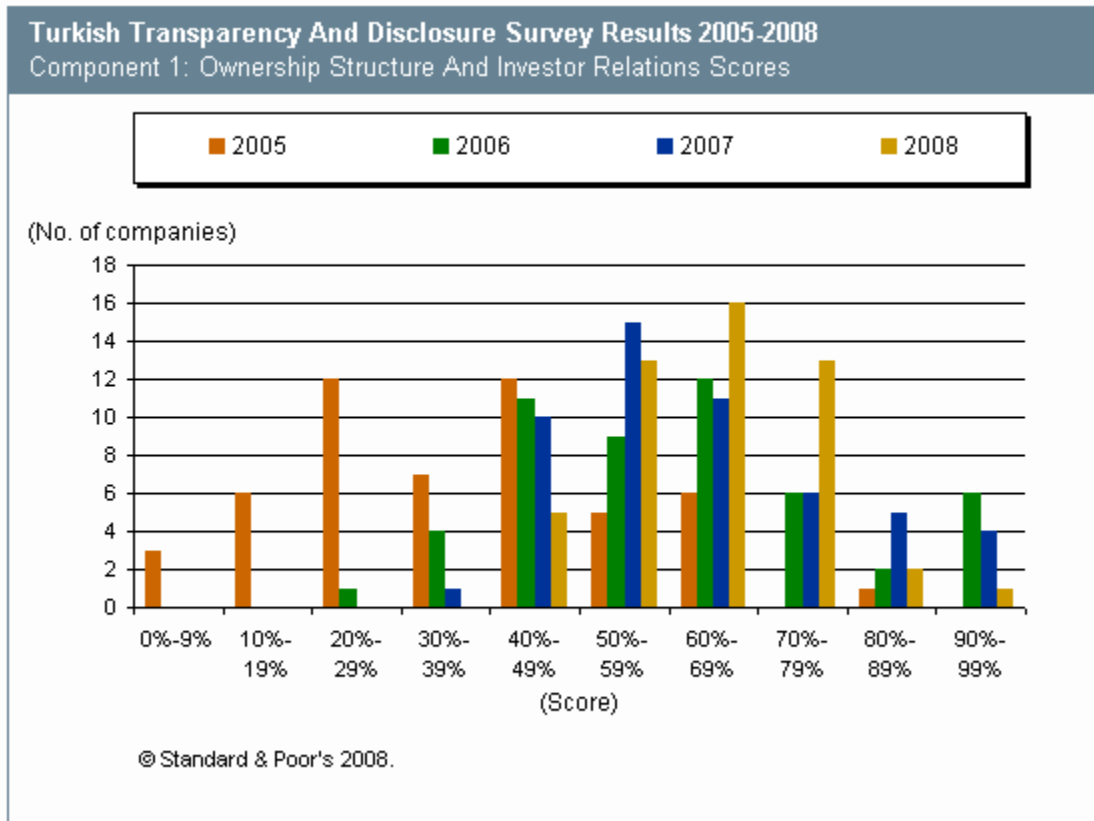
The top five companies in terms of disclosure of ownership structure and shareholders' rights (in alphabetical order) are:

- Anadolu Efes Biracilik ve Malt Sanayi;
- Koç Holding;

- Petkim;
- Tofas OTO; and
- Turkcell.

The distribution of scores for Component 1 is presented in chart 3.

Chart 3



Component 2: Financial Transparency and Information Disclosure

Disclosure of financial information continues to be the strongest category for all Turkish companies, despite the fact that we have seen a deterioration in the average score for this category in 2008. Reasons for this are not clear and require further study. More than 90% 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 or services produced or provided;
- Output in physical terms;
- Method of asset valuation;
- Method for fixed-asset depreciation;

- Discussion on corporate strategy;
- An overview of industry trends; and
- A list or register of related-party transactions.

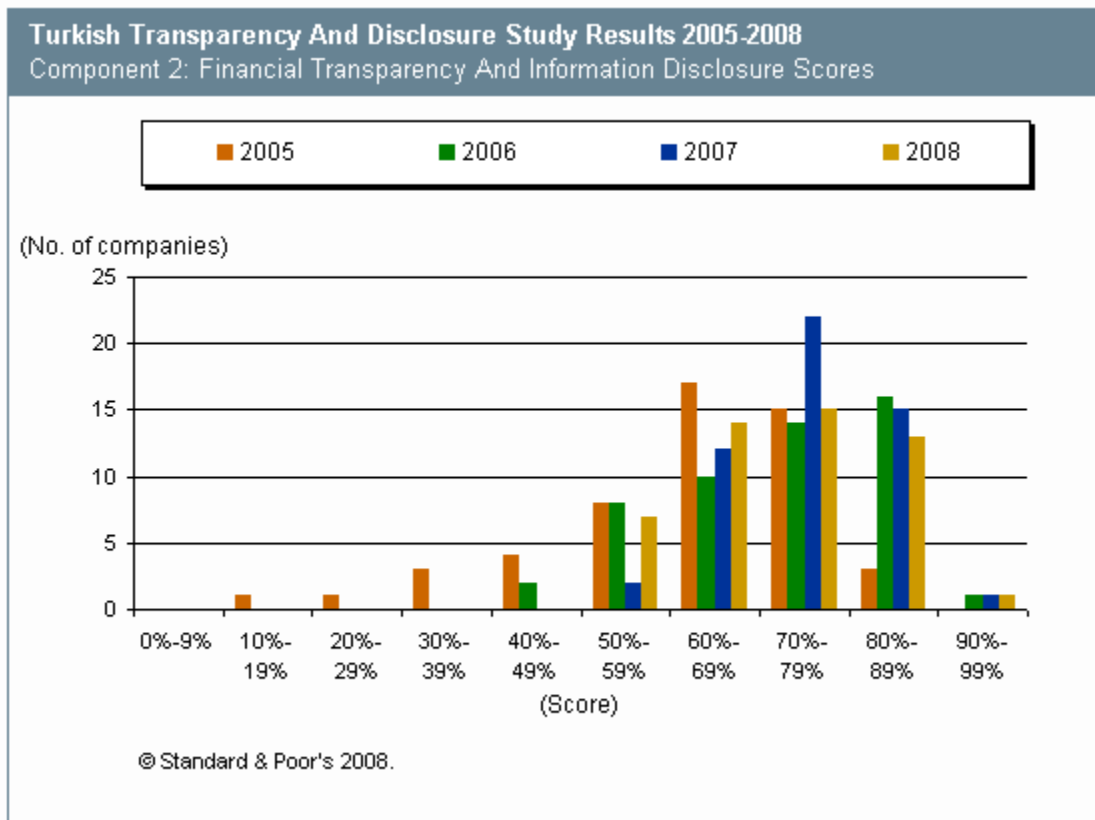
In 2008, there is no change from 2007 in terms of the disclosure of fees paid to auditors for audit and non-audit work. Although disclosure trends over the past three to four years greatly emphasize the importance of this information, as it helps investors assess potential conflicts of interest for external auditors, fewer than 5% of companies have made it publicly available.

The top five companies in terms of financial disclosure (in alphabetical order) are:

- Anadolu Efes Biracilik ve Malt Sanayi;
- Aygaz;
- Eczacibasi Ilaç;
- Enka Insaat; and
- Migros.

The distribution of scores for Component 2 is presented in chart 4.

Chart 4



Component 3: Board and Management Structure and Processes

This component shows a small improvement from the 2007 study, with the average score per company increasing to 46% from 44%. Nevertheless, we note that the average score per company is still below average. In analyzing

specific disclosure items we find that the remuneration of directors and executives continues to be the weakest area of disclosure overall, with slightly more than 10% of companies disclosing information on:

- The decision-making process for managers' pay;
- Whether a nomination committee exists; and
- Whether a remuneration or compensation committee exists.

Less than 5% of companies disclose the following information:

- The decision-making process for determining executive pay;
- The specifics of executive pay, such as salary levels and bonuses;
- The form of executive pay;
- Specifics of performance-related pay for board members and senior managers;
- Information on the CEO's contract;
- The number of shares managers hold in affiliated companies;
- Details of the nomination process; and
- Details of the remuneration process.

Given the typical ownership structure of Turkish companies, which generally includes a family-owned block holding/majority shareholding of the holding entity, we also believe that disclosure of related-party transactions is crucial to overall transparency. These are disclosed by a substantial majority of companies, but in the absence of a clear definition of "related party" in the Capital Markets Law and Regulations, the completeness of this disclosure is questionable.

Most group companies report transactions between group companies under the heading of "related party transactions." We have no evidence that this includes indirect relations, where there is a lack of transparency regarding the ultimate owners. This is especially true of entities registered offshore, possibly as a trust.

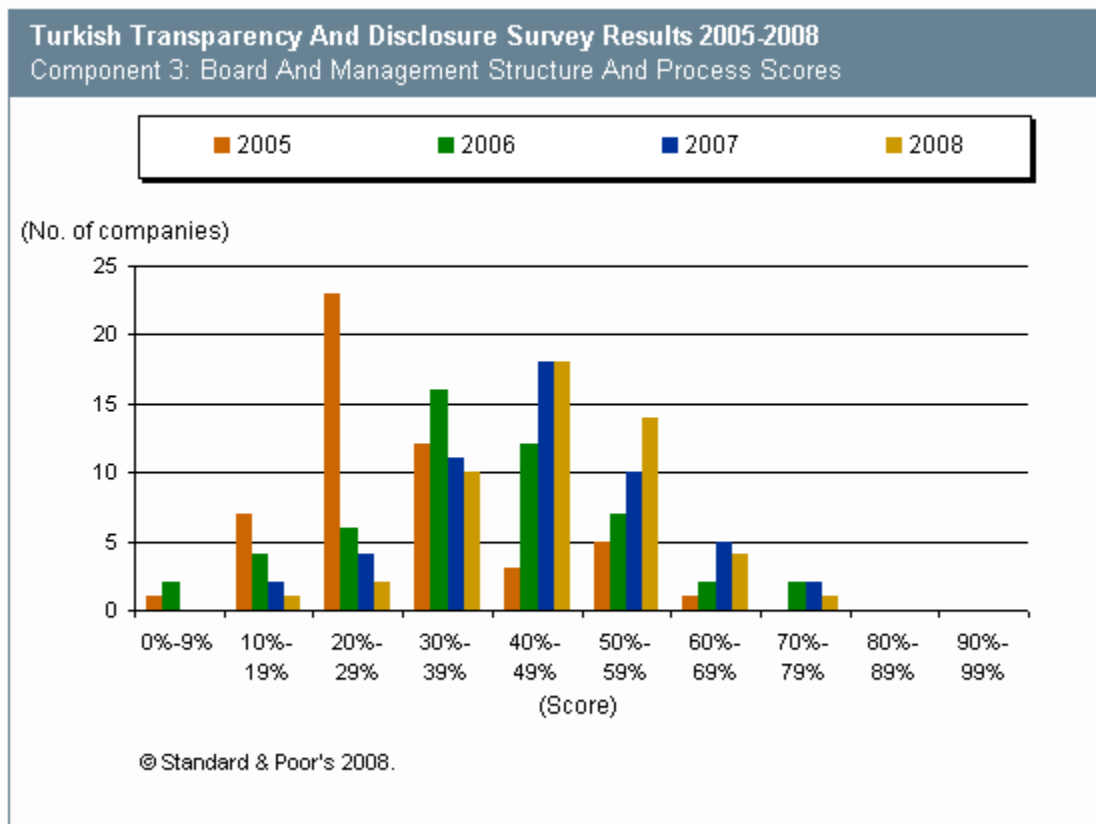
A further concern is that most Turkish companies include a standard agenda item for the annual general meeting to authorize the board members to trade with the company and authorize the board to make important decisions, such as selling substantial amount of assets, entering into new businesses, or issuing new shares, without shareholder approval. The CMB issued new regulations in 2008 requiring a special audit for all transactions above 10% of the asset value of the company to evaluate whether the transaction price is at fair market value.

The top five companies in terms of disclosure in board and management structure and processes (in alphabetical order) are:

- Anadolu Efes Biracilik ve Malt Sanayi;
- Çelebi Hava Servisleri;
- Ihlas Holding;
- Koç Holding; and
- Migros.

The distribution of scores for Component 3 is presented in chart 5.

Chart 5



Sample Size And Methodology

Market capitalization and liquidity form basis of selection

The fourth and final phase of the Study, undertaken in conjunction with the CGFT at Sabanci University in Istanbul in the first quarter of 2008, analyses the disclosure practices of 50 Turkish companies. These include 44 firms that were constituents of the S&P/IFC Global Index in October 2004 when the original sample was selected, the remainder being taken from the top 100 companies listed on the Istanbul Stock Exchange (ISE). The companies in the Study sample are selected by the researchers on the basis of being the largest in terms of market capitalization and liquidity.

This year's survey covers two fewer companies than in the previous three phases of the Study, Dis Bank and Tansas having been excluded following acquisitions by Fortis Bank and Migros, respectively. The omission of these companies from last years' data set does not result in any changes in component and total scores of the 2007 study, and therefore does not distort the current year's comparative analysis.

In a separate exercise, the CGFT expanded the Study sample in 2006 for a specific survey to cover all companies included in the ISE-100 index. The findings from this expanded sample are the subject of a separate report to be published by the CGFT.

Survey focuses on information readily available to investors

The survey analyzes disclosure from the perspective of international investors, and therefore focuses on sources of information that are most readily accessible by those investors. These sources usually comprise the companies' latest available English-language annual reports; their local-language annual reports; and both English- and local-language Web sites (the Web site disclosures for all the companies in the sample were captured in October 2006).

The survey leverages Standard & Poor's expertise in corporate governance, index construction, and analysis of accounting information. It's 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 assessing the inclusion of 106 possible information items ("attributes;" see Appendix for a full listing) in companies' disclosures. These attributes were originally selected after examining the annual reports and accounts, regulatory filings, and Web sites of leading companies around the world, and identifying the most common disclosure items. The attributes are grouped into three subcategories, or Components:

- Ownership structure and shareholders' rights;
- Financial transparency and information disclosure; and
- Board and management structure and process.

The inclusion of each attribute is scored as either "yes" (included) or "no" (not included). These binary answers ensure objectivity.

Overall rankings reflect the total number of attributes included in a company's annual report, accounts, and Web site. 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.

Related Articles

Table 2

Previously Published Research	
Article title	Publication date
Turkish Transparency And Disclosure Survey 2007: Pace Of Improvement Has Slowed	May 3, 2007
Turkish Transparency And Disclosure Survey 2006: Significant Developments At Turkey's Largest Companies	June 22, 2006
Corporate Governance: Turkish Transparency And Disclosure Survey	June 6, 2005

The above articles are available on RatingsDirect, the real-time Web-based source for Standard & Poor's credit ratings, research, and risk analysis, at www.ratingsdirect.com.

Appendix: Transparency And Disclosure Attributes

The Study identifies 106 attributes covering transparency and disclosure. Results from the 106 attributes are converted into a percentage and translated into deciles.

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?
- The breakdown of 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 process by which directors are nominated to the board and which shareholders nominate?
- The process by which 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-asset 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?

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