

**Turkish Transparency And Disclosure Survey 2006:
Significant Developments At Turkey's Largest Companies**

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

Julia Kochetygova, Moscow, (7) 495-783-4040;
julia_kochetygova@standardandpoors.com

Additional Contact: Governance Services Europe;
Governance@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 Corporate Governance Forum researchers at Sabanci University.)

Over the past few years, the legal and regulatory framework for corporate governance in the Republic of Turkey (foreign currency BB-/Positive/B; local currency BB/Positive/B) has improved considerably. Recent structural reforms include the issuance by the Capital Markets Board (CMB) of Corporate Governance Principles, the CMB's directives on audit and accounting standards and practices, a new banking law, and directives issued by the Banking Regulatory and Supervisory Agency. Weaknesses remain, however, with substantial variation in levels of transparency and disclosure between companies.

It is in this context that the second phase of Standard & Poor's Governance Services transparency and disclosure survey analyses the disclosure practices of 51 Turkish companies. The majority of companies (44) included in the survey were constituents of the S&P/IFC Global Index as of October 2004. The remainder comprises seven companies from the top 60 listed on the Istanbul Stock Exchange (ISE), selected according to market capitalization and liquidity.

Standard & Poor's and the Corporate Governance Forum of Turkey (CGFT) at Sabanci University have been monitoring and assessing corporate response to regulation and market circumstances over two successive years, with the objective of providing a comparative insight into the disclosure practices of Turkish companies. 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.

This report summarizes the findings of the second survey and provides an insight into the impact of the regulatory changes in the market environment on disclosure levels. 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 company characteristics.

Methodology

In assessing the average level of corporate transparency from the perspective of international investors, we have evaluated the amount of easily accessible disclosure of the major parameters of a company's operations, performance, and governance structure. Our analysis focuses on sources of information that are most readily accessible by these investors: typically, the latest available English language company annual reports, the local language annual reports, and both English and local language Web sites.

Transparency and disclosure is evaluated by searching for the inclusion of 106 possible information items ("attributes") in companies' disclosure. These attributes were selected after examining the annual report and accounts, regulatory filings, and Web sites of leading companies around the world to identify the most common disclosure items (see Appendix 2 below). The 106 attributes are grouped into three subcategories:

- Component 1: Ownership structure and investor relations.
- Component 2: Financial and operational information.
- Component 3: 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.

Companies are ranked in decile order. An overall ranking reflects the total number of the 106 possible 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.

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;
- S&P/TOPIX 150 (Japan); and
- S&P 500 (U.S.).

We conducted a similar survey in Russia in 2002. In 2003, we released a survey of the S&P Europe 350 companies, and, in response to continued interest from investors and analysts, we conducted three further Russian surveys in 2003, 2004, and 2005.

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.

Governance In Turkey Relative To Transparency And Disclosure

Turkey has taken considerable steps forward in improving the quality of its institutions and investment environment during the past few years, with the IMF and the EU 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 (foreign direct investments rose to \$15 billion in 2005, compared with an average \$1 billion per year over the past decades), have raised the importance of the quality of corporate governance at companies listed on the ISE.

The issuance of Corporate Governance Principles by the CMB in July 2003 was an important milestone that triggered an extensive debate in the corporate sector. Although compliance with these principles is voluntary, annual reports of public companies must include or explain their level of compliance, based on a standard reporting format. In addition to mandatory reporting on compliance with the Principles, the CMB has issued legally binding directives that seek to bring financial reporting and audit standards in line with international best

practice, and these have also contributed to the increased transparency of ISE-listed companies.

Despite recent initiatives, however, disclosure levels continue to vary substantially between companies. Deviation between the actual and required or recommended disclosure by the CMB depends on a number of parameters such as the previous years' disclosure levels, the size of the company, and the sector it operates in.

Turkish Companies Make Progress In Overall Disclosure

Turkish companies have shown substantial improvements in their disclosure levels since the first phase of the survey. The average score per company is 57% for 2006, compared with 41% in 2005 (see charts 1 and 2).

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

- Akbank T.A.S.;
- Anadolu Efes Biracilik ve Malt Sanayii AS;
- Koc Holding A.S.;
- Petrokimya Holding A.S.; and
- Turkcell Iletisim Hizmetleri A.S.

The above companies, with the exception of Petrokimya Holding A.S., were also in the top five in last year's survey.

The key findings of the survey illustrate that:

- Disclosure levels remain highest with respect to financial transparency. The average score in this component is 73% (compared with 64% in 2005). This is somewhat unsurprising given that Turkish mandatory regulatory disclosure requirements continue to focus on the disclosure of financial information.
- The greatest improvements in disclosure levels concern ownership structure. The average score per company is 61% (compared with 39% in 2005).
- Although disclosure of information pertaining to the board of directors has improved (38% in 2006 compared with 21% in 2005), disclosure levels in this category remain the lowest of the three components.

Chart 1

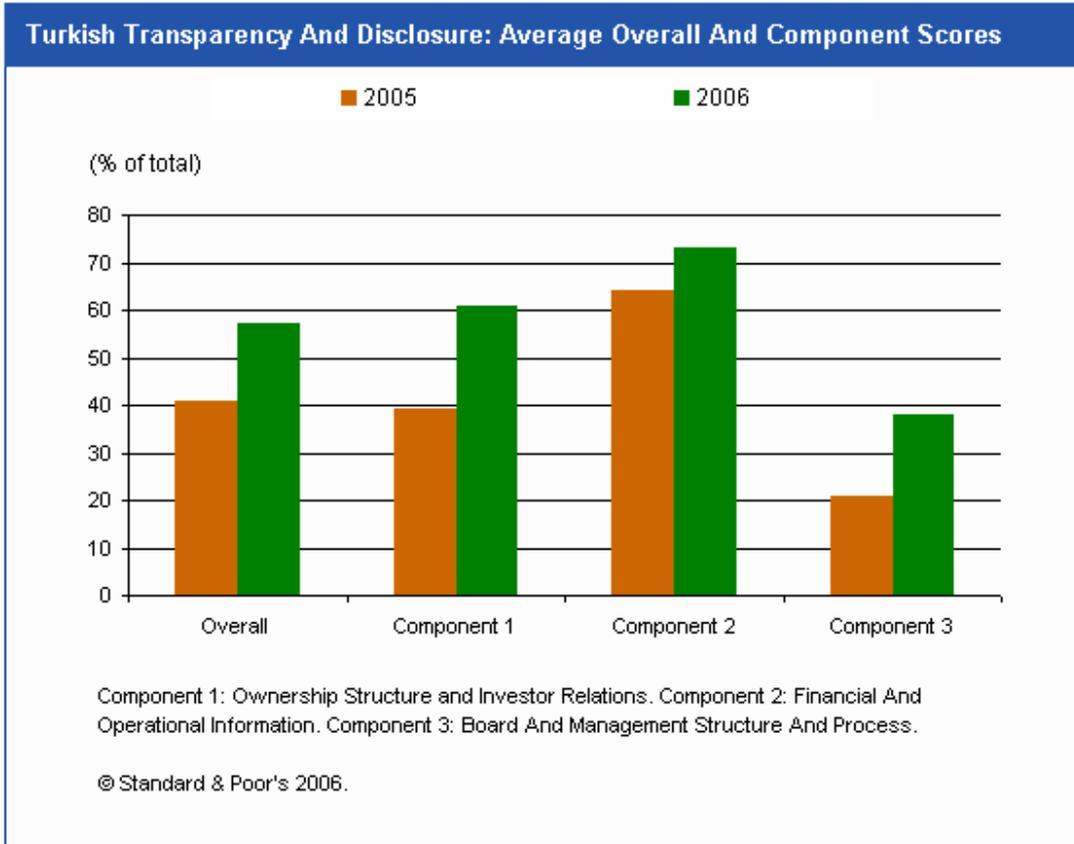
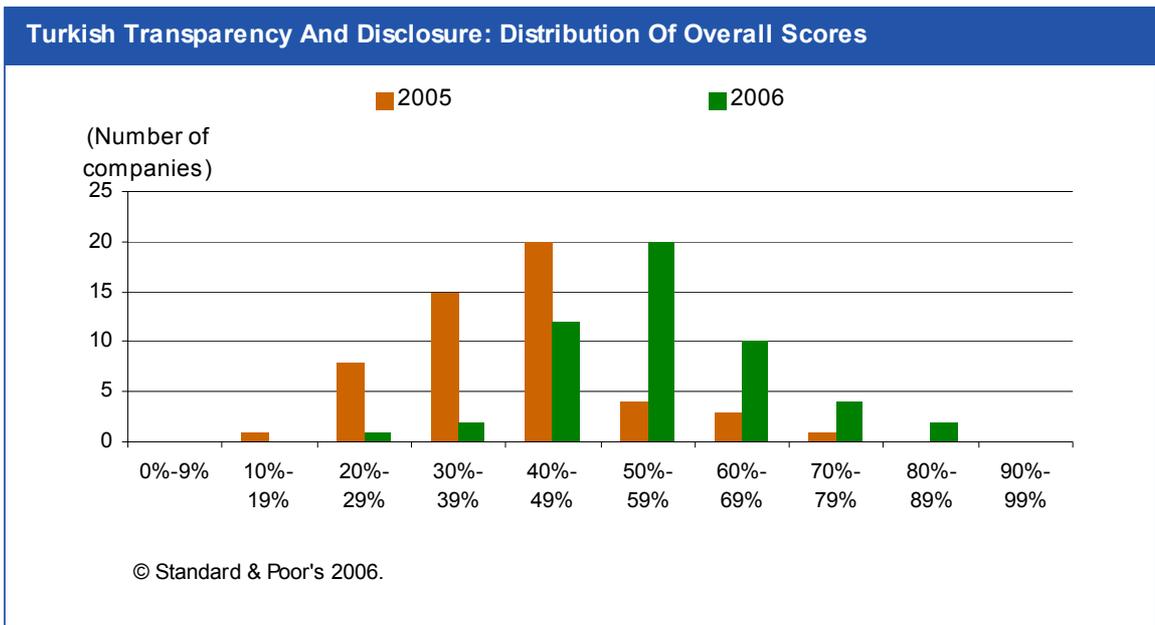


Chart 2



Despite This Headway, Room For Improvement Remains

Together with changes to the legal and regulatory environment requiring mandatory compliance with accounting and reporting standards, increased investor interest and increased growth potential have resulted in significant improvements in overall disclosure levels, as predicted in the 2005 survey, although certain aspects require further improvement. This is particularly the case for information disclosure pertaining to the board of directors and, more specifically, executive and director compensation.

Our key conclusions from the 2006 survey are outlined below:

- Overall improvements in disclosure levels are greatest among those companies that scored lowest in 2005.
- Disclosure levels between holding companies and their subsidiaries continue to diverge. Concerns therefore remain with respect to the transparency of groups.
- The banking sector shows the greatest improvement in disclosure levels, which Standard & Poor's considers to be a reflection of the new banking regulation.
- Some of the listed companies with state participation and control have demonstrated a radical improvement in disclosure levels. This may be related to the ongoing preparations for the privatization of state shares.

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

- Companies' articles of association (AoA), which were not typically disclosed, are now increasingly becoming available on company Web sites, as recommended by the CMB. This is particularly important because shareholders' rights are primarily governed by the AoA.
- Some companies have multiple classes of shares, with shareholder agreements between the holders of different classes. We observed no disclosure of these 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 shareholders and clearly observed and articulated in the AoA. We observed no disclosure of board nomination processes.
- 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 or practices, which raises concerns with respect to the role and effectiveness of subsidiary boards.

Disclosure Patterns: Financial And Operational Information Is Still The Strongest Component

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. We have looked at both the most and the least disclosed attributes in the subsections below.

Component 1: Ownership structure and investor relations

Disclosure levels of ownership structure and investor relations have increased substantially since 2005 (see chart 3). The list of disclosed items is extensive, with 80% of companies now disclosing 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.
- The existence of a Corporate Governance Charter or Code of Best Practice.
- Details of the Corporate Governance Charter/Code of Best Practice, if applicable.
- Full information on the AoA (changes, for example).

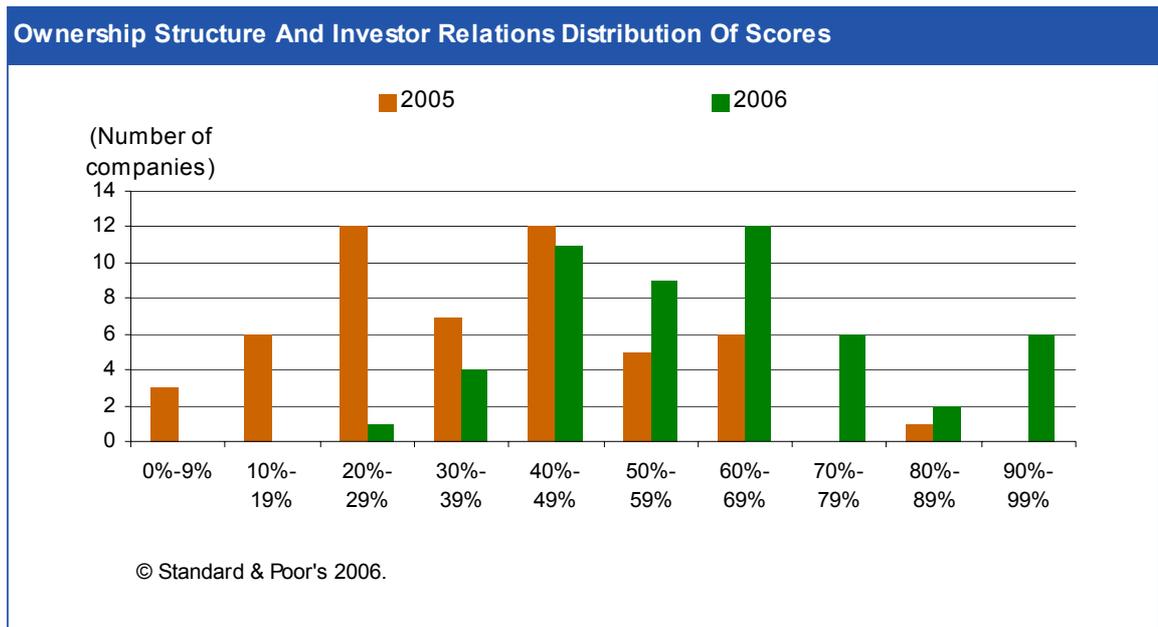
We further observe that companies are now more explicit in their disclosure of information relating to corporate governance policies. We believe that this is a direct result of the provisions of the Corporate Governance Principles. Since 2005, companies have been required to issue a report on their compliance with the recommended disclosure practices. If the information related to the recommended disclosure is readily available at no additional cost (such as the disclosure of the AoA), companies generally comply with the requirement. In other cases, such as disclosure of the board nomination process, we do not see an improvement as this would require an agreement between shareholders and the possible amendment of the AoA.

Companies remain reluctant in the disclosure of:

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

Only about 20% of companies disclose the above items. Furthermore, only 5% of companies disclose company shares held by top executives.

Chart 3



Component 2: Financial and operational information

This is still the strongest category for all Turkish companies (see chart 4). 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/services produced/provided.
- Output in physical terms.
- Asset valuation method.
- Method for fixed-asset depreciation.
- Discussion on corporate strategy.
- An overview of industry trends.

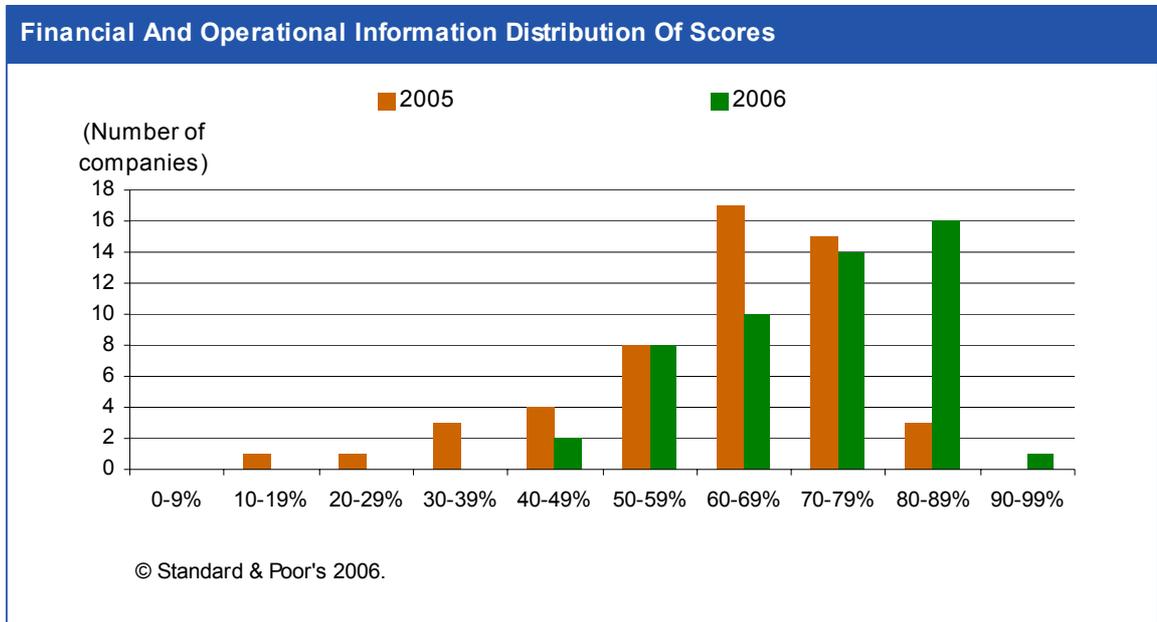
- A list/register of related-party transactions.

This year's results have not shown any improvement in terms of disclosure of:

- Fees paid to auditors for audit and nonaudit work.

Despite the emphasis placed by international disclosure requirements over the past three to four years on the importance of this information, which helps investors to assess potential conflicts of interest for external auditors, less than 5% of companies have made details of audit fees publicly available.

Chart 4



Component 3: Board and management structure and process

Although the overall results in this component have seen improvements since last year (see chart 5), we note that the average score per company remains relatively low. Our analysis of the disclosure of specific items illustrates that the remuneration of directors and executives is the weakest area of disclosure overall, with only slightly more than 10% of companies disclosing information on:

- The specifics of performance-related pay for directors.
- The decision-making process for managers' pay.
- Whether a nomination committee exists.
- Whether a remuneration/compensation committee exists.

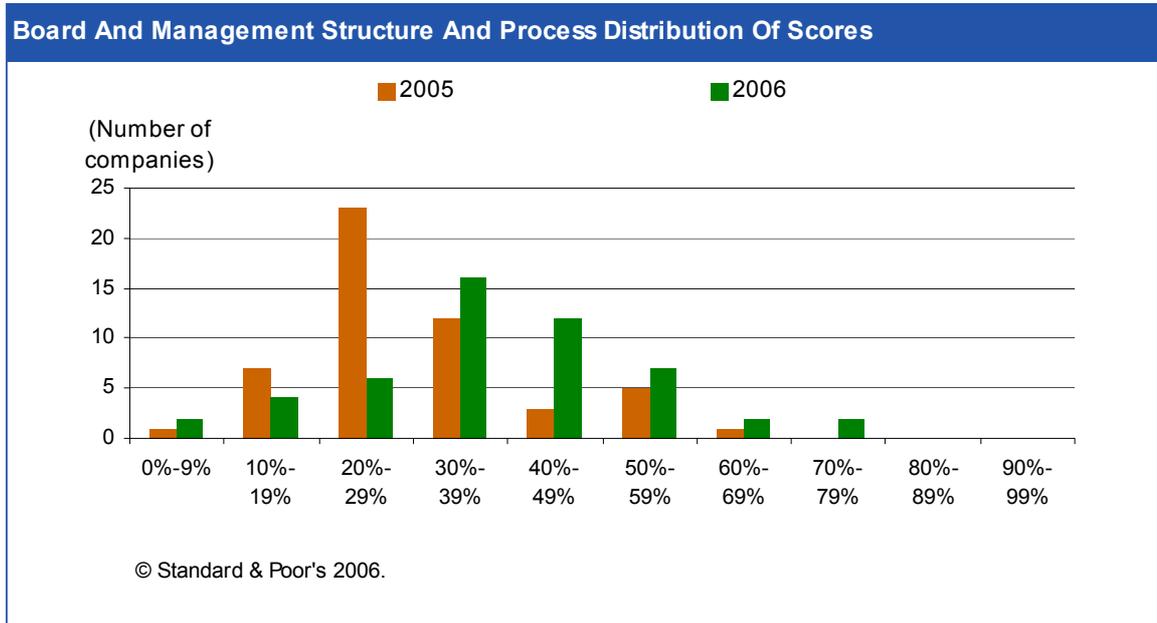
Only 5% of companies disclose the following information:

- The form of managers' salaries.
- Specifics of performance-related pay for managers.
- Details of the CEO's contract.
- Information on 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.
- Details of the members of the nomination committee.
- Details of the members of the remuneration committee.

We have further analyzed improvements in 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 90% of companies; 60% in 2005).
- Information on the presence of independent or nonexecutive directors on the board (60%; 25% in 2005).
- Whether an audit committee exists (approximately 70%; 40% in 2005).
- Information on the AoA (approximately 75%; 30% in 2005).
- Information on any (in)formal voting agreements or blocks (approximately 30%; 5% in 2005).
- Details of different types of shares (approximately 60%; 50% in 2005).
- A description of the board nomination process (approximately 50%; none in 2005).
- Whether group-wide policies applicable to subsidiaries exist (no real change: less than 5% disclosure, compared with nondisclosure in 2005).

Chart 5



The Survey And Corporate Governance Scores

This survey is a research project conducted in co-operation with the 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 indepth, 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.

Appendix 1

Transparency And Disclosure Scores In 2005 And 2006

	Component 1*	Component 2	Component 3	Overall
Average				
2005	38.57	64.21	20.42	41.11
2006	60.69	72.53	38.38	57.15
Difference in means ("t-value") ¶	--	--	--	9.17
Standard deviation				
2005	18.26	14.25	12.18	11.06
2006	17.89	11.98	15.37	11.47
Minimum				
2005	3.13	19.44	2.70	16.19
2006	25.00	44.44	5.41	28.30
Maximum				
2005	88.00	86.11	54.05	71.43
2006	96.55	94.59	74.19	82.22
Sample size				
2005	52	52	52	52
2006§	51	51	51	51

*Component 1: Ownership structure and investor relations; Component 2: Financial and operational information; Component 3: Board and management structure and process. ¶As the corresponding "p-value" (1.6608E-12) is less than 1%, the difference between the overall scores in 2005 and 2006 is statistically highly significant. §The decline in sample size in 2006 is due to the unavailability of a sample company's annual reports and Web site as at Dec. 31, 2005. Source: Mine Aksu, 2006, "Transparency and Disclosure Scores in the Istanbul Stock Exchange: Do IFRS and Corporate Governance Principles Make a Difference?", Working Paper, Sabanci University.

Appendix 2: 106 Transparency And Disclosure Attributes

To determine the transparency and disclosure score, the answers to the 106 questions below 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?
- Shareholders by type?
- The percentage of cross-ownership?
- The existence of a Corporate Governance Charter or Code of Best Practice?
- Details of the Corporate Governance Charter/Code of Best Practice, if applicable?
- Full information on the AoA (changes, for example)?
- Details of the AoA?
- 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 operational information

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 on 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 on directors (other than name/title)?
- Details on the current employment/position of directors?
- Details on directors' previous employment/positions?
- The date on which each of the directors joined the board?
- Whether directors are classified as executives or outside directors?
- The name of the chairman?
- Details on the chairman (other than name/title)?
- Details on 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?