Sustainable Investment in Turkey 2010

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IFC International Finance Corporation
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Sustainable Investments in Turkey 2010

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Foreword

For the first time in history, the very survival of the human race has become a serious and immediate issue. We can no longer think of growth or prosperity without integrating our economic goals with our social and ecological aspirations, and our vision for the future. Such thinking requires a fundamental change in the way we do business.

The recent global financial crisis, the upsurge of viral discontent in the Middle East and North Africa, and the environmental disasters taking place in different continents on an unprecedented scale all serve to remind us that economic, social and environmental sustainability issues are global and, as such, require globally coherent responses. Globally integrated financial markets have great potential and power to transform business practices towards sustainability, and nudge economic development towards more sustainable models.

With its diverse portfolio of businesses both in Turkey and the rest of the world, Sabanci Holding manages its investments with an increasing awareness of sustainability risks. This awareness is founded on, and enriched by, our industrial past and our respect for scientific thought, and serves to reflect the duty of care. As such, the assessment and proactive management of environmental, social and governance related risks represent a fundamental part of our strategy. We are always ready to contribute to the transformation of the Turkish business environment so that sustainable businesses would be rewarded. I believe that such transformation requires a shift in the way we think, whereby sustainability issues are viewed from a value creation perspective. Additionally, functional changes required to manage investment risks associated with sustainability issues are equally crucial.

I would like to take this opportunity to thank IFC and ILLAC, and the professors affiliated with Sabanci University, for all their efforts and contributions to the assessment of the sustainable investments industry in Turkey. The analysis and the recommendations of this report is food for thought for us all. It will hopefully inspire the reforms necessary in the business environment for a healthier future for our investments and our societies.

Güler Sabancı

Chairman, Sabancı Holding

Abbreviations

AFD	Agence Francaise de Development
BIT	Bilateral Investment Treaty
BoD	Board of Directors
BRIC	Brazil, Russia, India And China
BRSA	Banking Regulatory and Supervisory Agency
CDP	Carbon Disclosure Project
CDS	Credit Default Swaps
CEDBIK	Turkish Green Building Council
CEEE	Center for Energy Environment & Economy
CG	Corporate Governance
CGCR	Corporate Governance Compliance Reporting
CGFT	Sabanci University Corporate Governance Forum
CGG	Corporate Governance Guidelines
CMB	Capital Markets Board
CML	Capital Market Law
CoP	Communication on Progress
CPI	Corruption Perception Index
DEG	German Development Bank
EC	European Comission
E/S/G	Environmental/Social/Governmantal
ECHR	European Convention on Human Rights
EEA	European Economic Area
EIB	European Investment Bank
EM	Emerging Markets
EPI	Environmental Performance Index
ESI	Environmental Sustainability Index
ETF	Exchange Traded Fund
EU	European Union
FDI	Foreign Direct Investment
FMO	Dutch Development Bank
GDP	Gross Domestic Product
GHG	Greenhouse Gas
GIP	ISE's Emerging Comapanies Index
GRI	Global Reporting Initiative
HDI	Human Development Index
IAC	Investment Advisory Council of Turkey
IBRD	International Bank for Reconstruction and Development
ICM	International Capital Management
ICSID	International Center for the Settlement of Investment Disputes
IDA	International Development Association
IFC	International Finance Corporation
IFRS	International Financial Reporting Standards
ILO	International Labor Organization
IMF	International Money Fund
IPA	Investment Promotion Agency
IPO	Initial Public Offering
ISE	Istanbul Stock Exchange
ISESI	Istanbul Stock Exchange Sustainability Index
JSC	Joint Stock company
KAGIDER	Women Entrepreneurs Association of Turkey
KGF	Credit Guarantee Fund
KOSGEB	Small and Medium Scale Enterprises Development Organization
LLP	Limited Liability Partnership
MSCI	Morgan Stanley Capital International
MENA	Middle East and North Africa
MIGA	Multilateral Investment Guarantee Agency
MTP	Medium Term Program
NGO	Non-governmental Organization
NYSE	New York Stock Exchange
OECD	Organisation for Economic Co-operation and Development
OTC	Over-the-Counter
PE	Private Equity
PRME	Principles for Responsible Management Education
SI	Sustainable Investment
SME	Small and Medium Sized Enterprizes
SPF	Social Policy Forum
TBCSD	Turkish Business Association for Sustainable Development
TCC	Turkish Commercial Code
TEPAV	Economic Research Foundation of Turkey
TESEV	Turkish Economic and Social Studies Foundation
TKYD	Corporate Governance Association of Turkey
TKYD	Turkish Association of Institutional Investment Managers
TMS	Turkish Accounting Standards
TOBB	Turkish Union of Chambers and Commodity Exchanges
TRIMS	Trade Related Investment Measures
TSKB	Industrial Development Bank of Turkey
TTGV	Turkish Technology Development Foundation
TUBITAK	Scientific and Technological Research Council of Turkey
UCITS	Undertakings for Collective Investments in Transferable Securities
UN	United Nations
UNEP FI	United Nations Environment Program Finance Initiative
UN PRI	United Nations Principles for Responsible Investment
VAT	Value Added Tax
WEF	World Economic Fund
WIPO	World Intellectual Property Organization
WTO	World Trade Organization
XKURY	The ISE Corporate Governance Index
YOIKK	Coordination Counsil for the Improvement of Investment Environment

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Executive Summary

*"Not a destination for manufacturing because the costs are already high, Turkey remains a promising regional centre which has benefited from relative stability and ties to the West in a volatile part of the world." **

* "The new BRICS on the Block: Which Emerging markets Are Up and Coming?" Knowledge@Wharton, January 19, 2011 (http://knowledge.wharton.upenn.edu/article.cfm?articleid=2679).

Although the Turkish market is relatively small when compared with BRIC[1] countries, Turkey is growing and is the largest emerging market (EM) in the process of accession to the European Union (EU). With prospective EU membership as an anchor and support from the IMF standby agreement, Turkey has made significant improvements in overcoming macroeconomic instability since 2001. Turkey is now a functioning open market economy with an ongoing democratic consolidation process. With its solid banking system, robust public finances, and strong growth prospects, Turkey has become a market that investors can no longer ignore. The nation still faces structural problems. Low savings rates and a current account deficit contribute to a persistent reliance on external finance. Turkey's economy remains vulnerable to changes in external financing conditions.

Emerging Supply-Side Interest in Environmental, Social, and Corporate Governance (ESG) Disclosure

The concept of sustainability has gained currency within Turkey's corporate sector recently; contributing factors include proximity with Europe, the exposure to energy security risks exacerbated by the growth and Turkey's reliance on external finance.

The concept of sustainability has gained currency within Turkey's corporate sector recently. Contributing factors include proximity with Europe, the exposure to energy security risks exacerbated by growth, and Turkey's reliance on external finance. This interest, in line with the increasing importance attributed worldwide to the notion of sustainability, and also as a response to civil society influences, is demonstrated in the following developments which took place in 2010:

- Istanbul Stock Exchange's (ISE) launch of its Sustainability Index project
- United Nations' Principle of Responsible Investment (UN PRI) program and Carbon Disclosure Project (CDP) had their first investor signatories from Turkey
- CDP-Turkey project launched with corporate funding
- An apparent increase in the number of Global Reporting Initiative (GRI) and Corporate Social Responsibility (CSR) reports published.

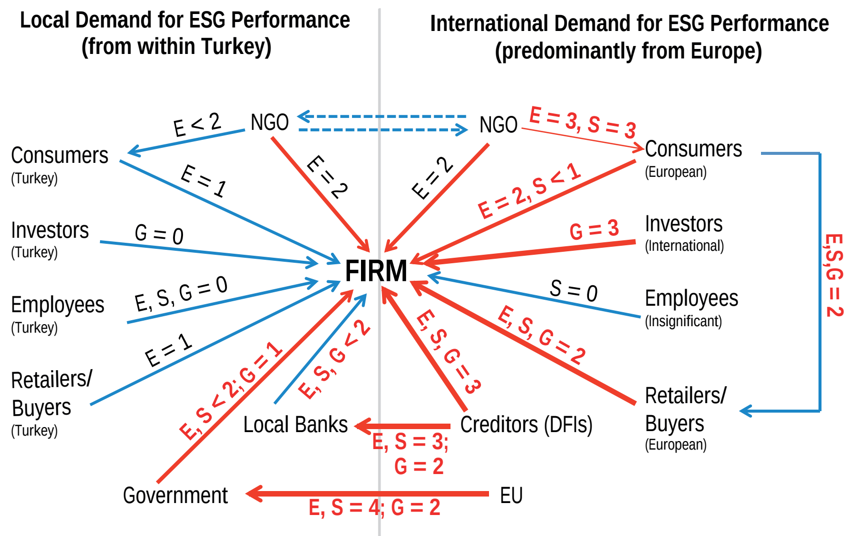
As illustrated in Figure E.1 below, the influences and drivers behind this phenomenon are predominantly external and regulatory. Further details are explained in Chapter 4 (Key Sustainability Issues) of this report.

1 Brazil, Russia, India, and China.

Figure E.1 Demand for Sustainability Performance

E: Demand/Pressure /Influence for Environmental Performance
S: Demand/Pressure /Influence for Social Performance
G: Demand/Pressure/Influence for Economic and Governance Performance

Red arrows indicate effective influence. (Rated between 0-4)
Thickness of the arrow indicates the strength of influence.



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Corresponding Demand-Side Interest in ESG Not Apparent

The growing interest in sustainability and/or CSR themes among Turkish businesses does not yet appear to be reflected among investors. There are structural reasons for this deficiency:

- Low domestic savings are largely directed toward short-term deposits and fixed-income instruments— predominantly government bonds. Equity investments represent a very small share of portfolio investments partly due to historically high interest rates. State pensions are based on a pay-as-you-go system, and substantial losses generated by this system add to public sector deficits funded directly by the treasury. Private pension funds are growing fast, but they are still in their infancy.

- Turkey's sovereign bond rating has not yet reached investment grade. Although International portfolio investments have historically dominated equity investments in Turkey by 60 to 70 percent, their average holding period is less than a year. An estimated 30 to 50 percent of shares held by foreign investors are held by hedge funds. These figures reflect international investors' perceptions of Turkey's risk profile.

Despite the shallowness of the stock market and low floatation rates, individual investors' and hedge funds' trading activities keep stock markets highly liquid, meeting the fundamental investment criteria for international portfolio investments and allowing Turkey to finance its current account deficit. Intensive trading activities gravitate around a small fraction of listed companies, however.

Turkey's sovereign bond rating has not yet reached investment grade. Although International portfolio investments have historically dominated equity investments in Turkey by 60 to 70 percent, their average holding period is less than a year. An estimated 30 to 50 percent of shares held by foreign investors are held by hedge funds. These figures reflect international investors' perceptions of Turkey's risk profile.

There is no local independent research assessing ESG risks or the performance of Turkish firms. Equity research into Turkish firms conducted by local brokerage houses tends to focus on sell-side financial analysis and does not cover ESG factors.

Challenges for the Turkish Sustainable Investment (SI) Market

SIs in Turkey have yet to emerge. The main obstacles are related to the size of capital markets, local investment capacity, structure of the local asset management industry, availability of information on sustainability factors, and independent research.

The size of Turkey's equity market as a fraction of its GDP is considerably smaller than the main EMs. Banks remain the main source of finance for all Turkish companies; however, local interest rates remain too high for long-term local currency lending. Large cap companies which can borrow from international markets thanks to the global surplus of money are exposed to currency risks. Access to external finance remains the single most important issue for the highly leveraged Turkish corporate sector.

Currently there are no instruments available for sustainable investments in Turkish assets, and there is also almost no indication of Turkish stocks being included in internationally managed labeled funds. Foreign asset managers select those large cap Turkish stocks that are included in global indices without considering ESG criteria. Investors manage their own reputational risks and investment risks through engagement policies in the post-investment period.

There is no local independent research assessing ESG risks or the performance of Turkish firms. Equity research into Turkish firms conducted by local brokerage houses tends to focus on sell-side financial analysis and does not cover ESG factors. International ESG research firms' coverage of Turkish stocks is restricted to members of MSCI EM Index members and, to a great extent, limited with sector screening and reputational risk alerts based on Web calling capabilities.

Currently, two channels of financial capital supply incorporate the explicit use of ESG factors in financing decisions in Turkey:

1 Local private equity (PE) funds whose limited partners/investors are international development finance institutions (DFIs). ESG criteria are applied in asset selection in compliance with investor requirements and, to some extent, monitored during the post-investment period.

2 Local banks channeling programmed loans from DFIs to local firms with ESG conditionality. IFC appears to be leading this effort, although with some competitive pressures, because the global money surplus forces some of the DFIs to water down their lending conditionality.

Opportunities

- Recently, favorable market conditions and growth projections have encouraged some larger privately held firms to consider floatation. A series of long awaited initial public offerings (IPOs) took place in 2010. Privatization of the remaining state-owned firms (and shares owned by the state) is also expected to continue through 2011 via IPOs or secondary offerings.

- Although owners of Turkish firms typically distrust stock markets, Turkey's regulators have taken drastic measures to encourage the IPO supply to help overcome the financing needs of small and medium-sized enterprises (SMEs) and attract portfolio flows. A separate SME market has been established with substantial incentives for listings.

- The newly established primary Bonds and Bills Market is expected to grow fast.

- Deregulation of the energy sector and a heavy reliance on energy imports, which distorts trade balances, provides a basis for attractive investments in energy efficiency and renewable energy projects. Renewable energy legislation enacted in January 2010 will speed up this process.

- The new Commercial Code which will come to effect in July 2012, will force privately held companies to reduce informality through mandatory accounting rules and external audits, which would encourage listings in the stock exchange and enable borrowing.

- There are indications that Turkey may receive investment grade status following the elections and perhaps earlier.

All of the above developments represent opportunities that would encourage long-term portfolio investments in Turkish assets.

Notwithstanding the above conditions, banks will continue to play an increasing role in financing the growth of the Turkish economy in the midterm. The implications of the continued dominance of banks, which also dominate the fund management industry in Turkey, are reflected in our recommendations.

Conclusions

Without the demand for sustainability and sustainable investments, the emerging interest in ESG disclosure in Turkey will not be materially instrumental in improving the ESG performance of Turkish firms; and the current upsurge in voluntary disclosure may remain an inefficient practice.

Turkey's corporate sector is rapidly internationalizing. Its growth depends on its ability to receive sustainable investments and long-term loans from international sources.

Meanwhile, a number of interventions listed below, can help SI to flourish and add momentum to the emerging interest in "sustainability" observed in Turkey's corporate sector:

- Involving banks in assessing sustainability risks by operationalizing the implementation of ESG conditionality in the channeling of programmed loans from DFIs to Turkish firms and by incorporating sustainability factors into corporate bond ratings

- Improving the information value and accessibility of current corporate governance compliance reporting

- Developing a differentiation framework for sustainable SMEs using the newly launched emerging companies market (GIP)

- Increasing the amount and spread of development finance invested in those PE funds that comply with ESG criteria and extending support to emerging independent local asset management companies in setting up sustainability-themed investment funds

- Facilitating collaboration between leading pension firms and independent asset management firms to pool pension funds' allowable mutual fund investments in a theme-based mutual fund

- Supporting the availability of and investors' accessibility to EM firms' ESG disclosures, including those of Turkey, by leveraging existing global platforms and innovative business models

SI can however, only develop if local investors take an active interest in sustainability, and locally conducted research on sustainability factors is available. Fast-growing pension funds will inevitably play an important role, but this will take time. Without the demand for sustainability and sustainable investments, the emerging interest in ESG disclosure in Turkey will not be materially instrumental in improving the ESG performance of Turkish firms; and the current upsurge in voluntary disclosure may remain an inefficient practice.

1 Introduction

A. Objectives

This report has been prepared by Illac Ltd. (ILLAC) and its associates for the International Finance Corporation (IFC) as a part of the Sustainable Investment Program of IFC's Sustainable Business Advisory Department. The main objectives of this report are as follows:

1. To understand and provide a review of the current state of the Sustainable Investment (SI) market in Turkey;

2. To identify the drivers and obstacles for sustainable investments and assess the commercial feasibility of different approaches and initiatives that may stimulate the SI market in Turkey; and

3. To analyze the institutional prerequisites and interventions that will fuel the development of investments, which would, in turn, encourage a better allocation of local and international capital to sustainable enterprises and hence support sustainable development of the Turkish economy.

This study forms part of a series of assessments of Sustainable Investment (SI) in Brazil (2009), India (2009), and China (2009) and draws on earlier reports published by IFC jointly with the Economist Intelligence Unit: "Sustainable Investing in Emerging Markets: Unscathed by the Financial Crises" (2010); and with Mercer: "Gaining Ground, Integrating Environmental, Social, and Governance (ESG) Factors into Investment Processes in Emerging Markets" (2009).

ILLAC's analysis and recommendations are built on the authors' previous academic research as well as the findings of this study.

B. Approach

There is a growing belief that firms can and should pursue strategies that address economic, social, and environmental problems that, if unresolved, may erode the basis for businesses' continuity. Economic sustainability is of fundamental importance to firms and is best reflected in their business models and governance choices. Social sustainability emphasizes the embedded nature of business in society. Issues such as poverty, access to medicine, access to clean water, polarization of income, and social exclusion are all related to the context in which businesses operate. Environmental sustainability considers the impact of economic activities on natural resources, ecological balance, and global warming.

Adopting sustainability strategies and policies has potential benefits for firms; it can be viewed as a signal of a long-term perspective and as a proxy of management quality and is often linked to competitive advantage, customer loyalty, worker commitment, and legitimacy. Reconciliation with financial return of the sometimes conflicting goals of sustainability practices with financial return is helped by long-term investments.

Adopting sustainability strategies and policies has potential benefits for firms; it can be viewed as a signal of a long-term perspective and as a proxy of management quality and is often linked to competitive advantage, customer loyalty, worker commitment, and legitimacy. The costs associated with pursuing these potential benefits however, need to be reconciled with investors' expectations of financial return. Reconciliation with financial return of the sometimes conflicting goals of sustainability practices with financial return is helped by long-term investments.

Turkey is included in all groupings of markets which are identified as 'up and coming.' For example, so-called CIVETS (in Columbia, Indonesia, Vietnam, Egypt, Turkey and South Africa), Next Eleven (so called N-11; Bangladesh, Egypt, Indonesia, Iran, Korea, Mexico, Nigeria, Pakistan, Philippines, Turkey and Vietnam). New terms such as "*graduating emerging markets*" are tossed around to describe countries moving up the continuum. "*The name is less important than the fact that people recognize this is a part of the world that is no longer a backwater and no longer peripheral, but an increasingly important part of the world.*" *

* Antoine van Agtmael, the CEO of Emerging Markets Management in asset management firm Arlington. Cited in " When Are Emerging Markets No Longer "Emerging?". Knowledge@Wharton (http://knowledge.wharton.upenn.edu/article.cfm?articleid=1911).

Although it has many definitions, in practice, SI explicitly integrates environmental (E), social (S), and governance (G)-related risk factors into traditional financial analysis used in making investment decisions. ESG integration is particularly important for emerging markets (EM), both because EMs are less predictable, and investments are exposed to higher ESG risks resulting from weak institutional frameworks and legal enforcement of stakeholders' rights. Therefore, EMs pose multifaceted risks for investors, pushing down the investment periods. As Benabou and Tirole (2010) indicate, short-termism often involves both an intertemporal loss of profit and an externality on stakeholders. SIs, on the other hand, encourage voluntary actions by corporations to manage their ESG risks, monitor their negative externalities, and favor business strategies that increase their positive externalities.

We note that Turkey is a small emerging market, frequently referred as a "satellite" market, compared to the economies of Brazil, Russia, India, and China (BRIC). Opportunity size in the larger EMs attracts dedicated investment strategies. Some satellite markets benefit from geographical proximity to main markets, and some others are included in clusters based on common economic fundamentals (for example, Asia or the Middle East and North Africa). Even though Turkey is not among those markets, it draws attention from the global investment community for two reasons: First, due to its unique geopolitical position, Turkey's macroeconomic and political stability is more important than what its economic fundamentals would suggest. Second, Turkey is the largest EM to join the European Union (EU). The accession process will undoubtedly create adjustment costs and regulatory risks for businesses, but the EU will push Turkey's ESG standards up and serve as anchor for Turkey's institutional development, aligning Turkey's economic and political choices with that of Europe.

Our findings and recommendations were derived from the results of discourse analysis, desk research, and face-to-face interviews conducted in Istanbul, London, Beijing, and Toronto with various stakeholders over the period October–November 2010. Where face-to-face meetings were not possible, we conducted telephone interviews and exchanged electronic messages to gather information and opinions.

Two small roundtable meetings were organized to cross-fertilize the thinking on the subject. The first roundtable brought together distinguished scholars from various subdisciplines of economics whose research is focused on Turkey. The other roundtable, organized together with the Corporate Governance Association of Turkey (TKYD), brought together selected professionals from firms that attract long-term investors, including the two cross-listed firms on the Istanbul Stock Exchange (ISE).

Sustainable investments aim to maximize the 'intrinsic' value of firms- which can be thought of as firms' full information value.

C. Construct and Scope

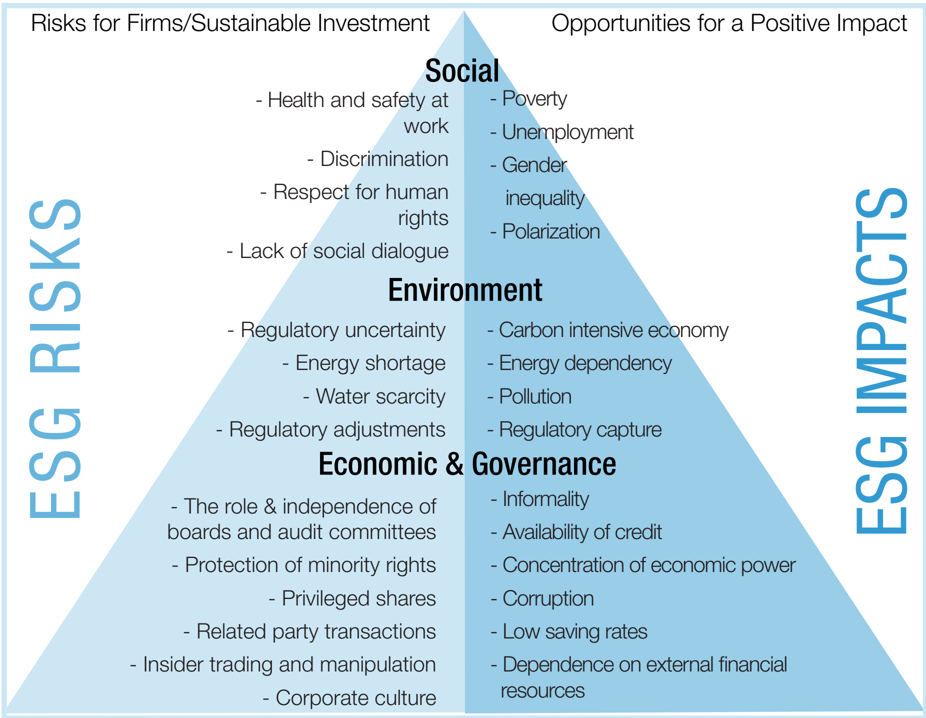
For the purposes of this report, we investigate SI in Turkey through two tracks:

1 Supply of financial capital to publicly listed firms in the form of equity investments through the stock markets, using strategies that incorporate ESG risks into the investment processes with a long- term perspective - *a market driven, risk based approach*,

2 Supply of financial capital in various classes and forms to listed or privately held firms with due consideration of the investment's impact on economic and social development: *a mission driven, sustainable development approach*.

Both applications share the common presumption that there is a conflict between the objectives of maximizing the "intrinsic" values of firms—which can be thought of as firms' full -information value—and maximizing their short-term value. Figure 1.1 below, illustrates this construct in Turkey's context.

Figure 1.1: Sustainability Risks and Sustainability Impact Areas for Turkey



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The issues listed on the left of figure 1.1 represent the ESG risks to which companies and therefore investors are exposed. Investors concerned with sustainability assess those risks and the risk management strategies of investee firms. The issues listed on the right indicate structural issues that hinder sustainable development. Private investments that generate a positive externality by addressing those issues can be encouraged by incentive schemes or subsidies or are realized by mission-related targeted investments of governments, development finance institutions (DFIs), and social entrepreneurs.

In accordance with the conventions common to the IFC's previously published country reports, we focus on SI by investors concerned about ESG risks, but we also report on various forms of targeted investments that can mitigate sustainability threats. Although we focus on SI in Turkey, we look at Turkey as a "case" and draw more general conclusions for EMs where possible.

We treat those forms of ethical and philanthropic investments that are based on beliefs and preferences other than financial returns as outside of the scope of this study because their economic impact will remain marginal in our view.

D. Structure of the Report[1]

Section 2 of this report, **Country Overview**, provides an overview of Turkey's economy and its stock markets. Where possible, indicators are presented in comparison with BRIC countries. This chapter also includes an overview of Turkey's investment climate and its financial sector.

Section 3, **Key Sustainability Issues**, examines Turkey in the perspective of globally recognized country surveys alongside with our analysis of key ESG issues and their implications for sustainable development in Turkey.

Section 4, **Sustainable Investment Industry**, takes a closer look at Turkey's demand side. Following a brief overview of SI in EMs, the chapter addresses both foreign and domestic institutional investment activities in Turkey. An overview of the catalyst role played by DFIs is also presented.

Section 5, **Enabling Environment**, provides a closer look at the institutional drivers and supply side of SI in Turkey. An overview of the current status of, and trends in, nonfinancial disclosure in Turkey is presented by looking at Carbon Disclosure Project (CDP) disclosures, United Nations Global Compact (UN GP) members' Communications on Progress, Global Reporting Initiative (GRI), and other sustainability themed reporting. We continue with the direction of changes in the legal and regulatory framework and the Istanbul Stock Exchange's Sustainability Index project. We cover civil society organizations as instruments through which society puts pressure on businesses. The current status and potential role of media are also included.

Section 6, **ESG Research and Labeled Indices**, provides a brief overview of the global ESG research industry. Information on the coverage of Turkey's stocks by international research houses is followed by a review of local research capacity and local indices using nonfinancial criteria. ISE's Sustainability Index project is discussed in this section.

Section 7 explains the **Challenges and Opportunities** and Section 8, **Looking into the Future**, concludes with our recommendations.

1 The prefix "A" preceding the reference number of Tables and Figures indicates those that are included in the Appendix.

2 Country Overview

- Turkey is the world's 16th largest economy and is expected to grow at a rate close to 5 percent until 2015.
- The reforms of the last decade produced both political and macroeconomic stability. EU accession will set the direction of future institutional reforms.
- Low saving rates and current account deficits make Turkey vulnerable to external financing conditions.
- Compared to BRIC countries, Turkey has a small but liquid stock market where foreign investors play a dominant role.
- Foreign investment inflows through the equity market have been more than $21 billion since 2000.
- Bank finance is the dominant source of external finance for Turkish firms.

Sustainable investment trends in Turkey need to be understood in the wider context of Turkey's overall economic development. This section offers a broad overview of Turkey with an emphasis on its economic structure, capital markets, and the regulatory and policy framework for ESG issues. We start by looking at general macroeconomic conditions and then turn to micro issues.

A. The Current State of Global Developments

The Turkish economy experienced boom-and-bust cycles throughout the 1990s, culminating in an economic crisis in 2001. Since then, the Turkish economy has benefited from in-depth structural reforms in many key areas, including banking, restructuring of enterprises, privatization, education, and energy. Although the recent global financial crisis has had a severe impact on the Turkish real economy, earlier regulatory and supervisory reforms have helped to stabilize the growth process. Global economic developments have continued to dominate the domestic economic outlook throughout 2010. Economic activity data indicate that the recovery in developed economies will be slow and gradual, increasing the likelihood that the loose monetary policy in most developed economies will continue. As a consequence, capital inflows to EMs are on the rise, with a significant increase in commodity prices. The availability of global liquidity and the extended efforts to find investment opportunities with attractive returns continues to affect Turkey as well as many other emerging markets.

A number of favorable developments specific to Turkey have enhanced these effects: A better-than-expected recovery in economic activity, a possible credit rating upgrade, easing political uncertainty following the referendum process, and the government's updated Medium Term Program (MTP), signaling that fiscal discipline will be maintained despite the forthcoming elections, have all added to Turkey's relatively better performance. Consequently, interest rates continue to follow a declining pattern, Turkish stocks appreciate, and the Turkish

"The markets have taken note of Turkey's rapid growth and prudent economic and financial management. When the latest crisis hit Europe, credit-default swap (CDS) spreads rose sharply for countries such as Greece, Hungary, Portugal and Spain, yet they barely budged for Turkey. Indeed, this summer Turkey was able to boast a CDS spread below that of Italy, a G7 economy. Turkey is now on the verge of achieving an investment-grade rating for the first time. Foreign investors have begun to see it as a good thing. In the 1990s foreign direct investment was running at less than USD 1 billion a year, but ten years later, before the crisis briefly sent it back down again, it was closer to USD 20 billion."

The Economist, 2010 *

* "Doing it by the book," A special report on Turkey, Oct 21st 2010

lira (TR) remains strong.

The EU accession process remains an important anchor for the Turkish economy. The EU-Turkey Customs Union continues to contribute to the enhancement of EU-Turkey bilateral trade. Turkey is the EU's seventh biggest trading partner while the EU is Turkeys' biggest trading partner. Almost half of Turkey's total trade is with the EU, and more than two thirds of foreign direct investments (FDIs) into Turkey come from the EU (EC, 2010).

B. Turkey's Economy

Size and Growth of the Economy

Turkey is a functioning market economy. Based on IMF estimates of worldwide GDP, Turkey is the world's 16th largest economy. Turkey's GDP per capita has increased from approximately $1,300 to $4,000 in 2000 and exceeded $8,000 in 2009. Although this level stands at 46 percent of the EU average, it is similar to figures reported by major EMs such as Brazil and Russia. When the recent global crises hit Turkey, 2009 GDP contracted by about 5 percent, in sharp contrast to the average 6 percent average annual growth rate during the 2004–2008 period (see Table 2.1 below).

Turkey's growth between 2004 and 2008 was slightly better than Brazil's but considerably lower than China (10.8 percent) and India (8.41 percent). The IMF projection for real GDP growth is 7.8 percent in 2010 and 3.6 percent in 2011 (IMF, 2010). The IMF further predicts that Turkey will grow at a rate close to 4.5 percent until 2015 (see Table 2.1).

The size of the population is close to 71 million, and it is projected to reach 84 million in 2025. Unlike other countries in the Central and Eastern Europe region, Turkey has a young population; the proportion of the population under the age of 24 is 44 percent. This represents a demographic potential that can contribute to economic growth if future policies focus on improving the state of the labor market. Removing rigid labor market regulations, reducing the tax wedge, and, more importantly, enhancing human capital through education reforms are essential policies for accelerating the economic growth rate on a sustainable basis. Currently, the Turkish economy is using less than half of its workforce.

Table 2.1 Macroeconomic Indicators

	GDP	GDP Rank	GDP per Capita	Growth Rate of Real GDP (%)	Projected Growth Rate	Unemployment (%)	Population 2009	Population 2015	Gross Domestic Savings (%)	Exports	Imports	Current Account Balance (%)	FDI Inflows	FDI (%)
Brazil	1,574.039	9	8,220.357	4.70	4.69	8.10	191.48	231.89	16.15	180,723	174,679	-1.54	25.948	1.65
China	4,984.731	2	3,734.608	10.80	9.66	4.30	1,334.74	1,453.12	54.17	1,581,710	1,232,840	5.96	78.193	1.57
India	1,236.943	4	1,031.592	8.41	7.15	10.70	1,199.06	1,396.05	29.84	290,861	371,616	-2.88	34.577	2.64
Russia	1,231.892	7	8,681.411	7.00	4.18	8.40	141.90	128.18	33.04	345,110	253,400	4.02	37.134	3.02
Turkey	614.466	16	8,711.161	6.00	4.47	14.03	70.54	83.57	13.68	109,700	134,500	-2.27	7.955	1.29

Notes: GDP is in current prices ($ billion), GDP per capita is in current prices (USD), the growth rate of real GDP is the average of the growth rates between 2004-2008, the projected growth rate is based on the average of the projections from 2010 to 2015, Unemployment is expressed as % of total labor force, Population is in million. Gross domestic savings are expressed as % of GDP. Imports and Exports are in from the IMF (Figures for India and Russia reflect 2008 data), Balance of Payments Statistics Yearbook and they are expressed in current $ million.. FDI inflows are in $ million. and FDI in % is expressed as a fraction of GDP.

Source: All data are from the World Development Indicators (September 2010) and International Monetary Fund, World Economic Outlook Database (October 2010).

"In agribusiness, the lack of proper irrigation, the relatively small and uneconomic size of individual family-owned farms and the shortage of capital for modern production inputs, including machinery, prevent the country from realizing its full agricultural potential." *

* EBRD 2010 Recovery and Reform, London, UK.

Sector Breakdown

The contribution of industrial production to Turkey's GDP shows a declining trend. The share of industrial value-added to GDP went down to 31.48 percent in 2000 and to 28 percent in 2009. Over the same period, the share of agricultural production decreased by about two percentage points, whereas the share of services increased by almost six percentage points. Table 2.2 indicates that, qualitatively, this increasing contribution of service industries can also be observed in BRIC countries.

Savings and the Importance of the International Economy

Foreign trade is increasing in importance for the Turkish economy. Exports have increased from $30 billion in 2000 to almost $110 billion in 2009. Imports have increased from $51 billion to $135 billion over the same period (Table 2.1), inducing a current account deficit of 2.27 percent of GDP in 2009.

In contrast to many EMs, Turkey is a net commodity importer. Approximately, $35 billion worth of oil and natural gas each year has to be imported, which corresponds to almost 5 percent of GDP. Turkey's imports are mainly commodities and intermediate goods, whereas industrial goods cover more than 90 percent of total exports. Therefore, promoting Turkey's competitiveness is the key to the nation's future performance in international markets.

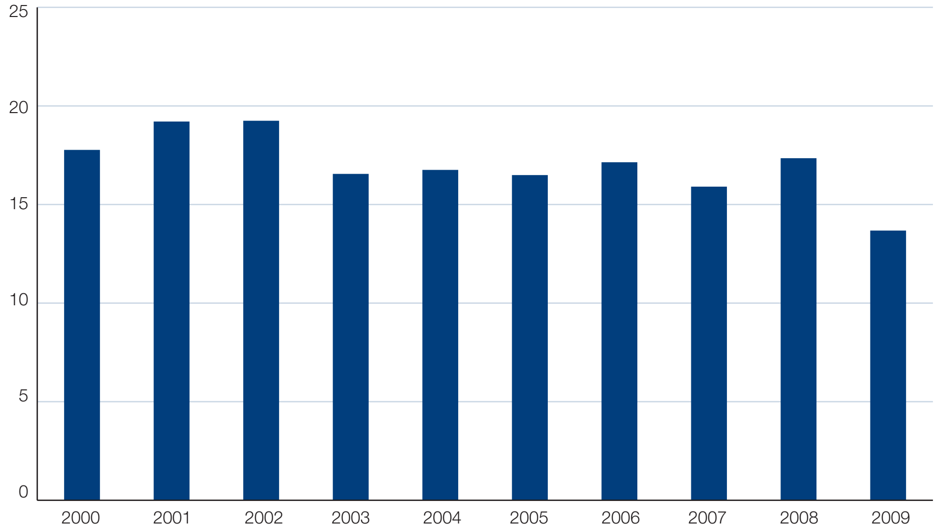
The savings rate in Turkey is, by international comparison, very low. Domestic savings expressed as a fraction of GDP were 13.68 percent in 2009, considerably lower than the domestic savings rate in e.g. China (54.17 percent), India (29.84 percent), and the other EMs listed in Table 2.1.

Figure 2.1 shows that the trend in domestic savings exhibits a decline since 2000. This low savings rate means that Turkey needs to attract foreign savings to finance capital investments. There is a strong and direct positive relationship in Turkey between growth rate and current account deficit. The upward trend in global energy prices has the potential to contribute to the widening of the current account deficit (which amounted to 5.8 percent in 2007).

Although the current account deficit is a structural problem and a source of vulnerability, statistics show that Turkey did not have difficulty in financing it over the period 2000–2009. The quality of foreign capital flows also improved during this period; the current account deficit can now be financed through FDIs and somewhat continuous capital inflows. FDI inflows amounted to $20 billion since 2006, putting Turkey among the top five developing countries in FDI inflows. Expressed as a fraction GDP, net FDI flows to (and from) Turkey have been less than 2 percent over the period 2000–2009. (See Table 2.1 for 2009 figures.)

An analysis of the capital and finance account of the balance of payments shows that, although FDI followed a downward trend throughout 2009 due to the global financial crisis, this remained the most stable financing item of the current account deficit.

Figure 2.1 Gross Domestic Savings (% of GDP over the period 2000-2009)



Source: World Bank national accounts data, World Development Indicators, The World Bank Group.

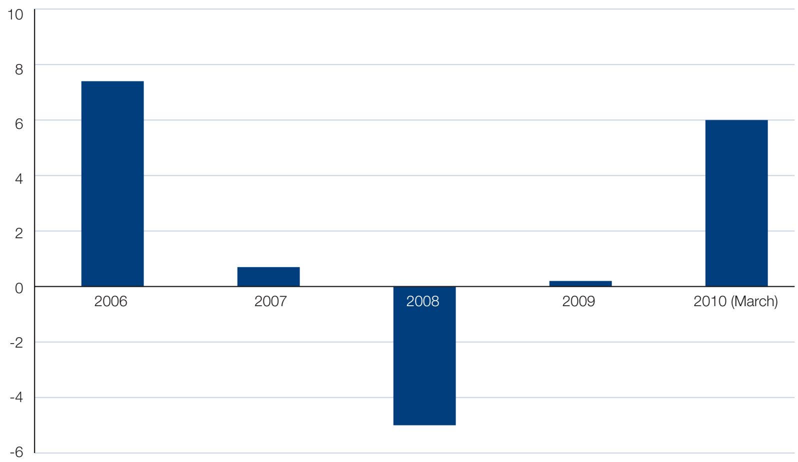
An analysis of the capital and finance account of the balance of payments shows that, although FDI followed a downward trend throughout 2009 due to the global financial crisis, this remained the most stable financing item of the current account deficit. Capital flows in the form of portfolio investments, which turned outward in the second half of 2008 due to the global turmoil, turned inward again in 2009. Portfolio investments have generally followed an unstable trend since 2006 (Figure 2.2).

"Most emerging markets suffered a collapse in FDI as a result of the financial crisis, but it is a surprise that Turkey is among the countries where flows have been slow to recover. Despite economic growth of about 8 percent in 2010, FDI into Turkey declined to $6.2 billion in the first 11 months of 2010, down from $7.6 billion in 2009. The shortfall was due not only to the euro-zone's problems and a lull in mergers and acquisitions activity, but also to low international interest in state auctions of power distribution grid. (...) Musfik Cantekinler, head of corporate finance for Ernst & Young's Turkey office, said foreign investors were deterred partly by concerns over transparency."

Financial Times, 2011 *

* "Turkey: unloved by foreign investors", January 18, 2011

Figure 2.2 Foreign Portfolio Investments ($ Billions)



Source: Capital Market Board of Turkey, Annual Report 2009.

The composition of household financial assets shows that almost 75 percent of these assets are in TR and foreign exchange deposits. Mutual funds, stocks, and private pension funds constitute 6.2 percent, 5.9 percent, and 2.1 percent of these assets, respectively (Table A2.3).

The Corporate Sector

Structure of the Industry

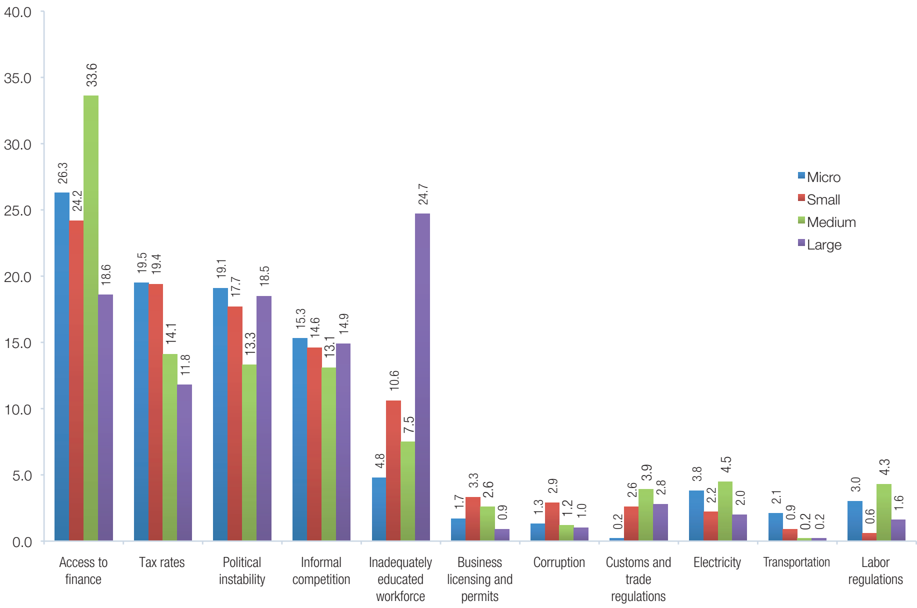
In Turkey, small and medium-size enterprises (SMEs: 51–250 workers) play a crucial role in the economy. They account for 76.7 percent of employment, almost 40 percent of investments, 26.5 percent of total value-added to the economy, and 25 percent of bank credit. Analysis of firm dynamics in Turkey

Turkish firms are more dependent on bank financing to fund their investments in fixed assets than are their peers in other countries. This is especially true for medium-size firms where bank financing accounts for 47 percent of total funding.

shows that SMEs are the slowest growing group in the economy. Moreover, SMEs are growing at a slower rate in Turkey than in several comparator countries in the Eastern Europe and Central Asia region.

Access to finance is perceived as the single most severe obstacle by firms of all sizes (see Figure 2.3). Turkish firms are more dependent on bank financing to fund their investments in fixed assets than are their peers in other countries. This is especially true for medium-size firms where bank financing accounts for 47 percent of total funding (Seker and Guilherme Correa, 2010).

Figure 2.3 Most Severe Investment Climate Obstacles by Firm Size



Source: Seker and Guilherme Correa (2009, pp. 12)

In Turkey, there are several organizations that address the financial bottlenecks to the expansion of SMEs. These organizations such as the Small and Medium Scale Enterprises Development Organization (KOSGEB), the Credit Guarantee Fund (KGF), and the Union of Chambers and Commodity Exchanges of Turkey (TOBB), provide financial and/or nonfinancial assistance for SME development. The integration of ESG concerns into lending policies, together with the advisory functions of these organizations, is likely to be an effective instrument for enhancing sustainable development in Turkey.

C. Investment Climate

Empirical evidence suggests that international investors invest less in firms from countries with poor outsider protection and disclosure and with ownership structures conducive to governance problems. There is also clear evidence that funds systematically invest less in countries with less transparency; moreover, funds have a greater propensity to exit nontransparent countries during crises. The fund industry is larger in those countries where mutual fund investors' rights are better protected.

As shown by empirical research, ownership structures and governance arrangements are determinants of the attractiveness of a country's stocks for investors.

Empirical evidence suggests that international investors invest less in firms from countries with poor outsider protection and disclosure and with ownership structures conducive to governance problems. There is also clear evidence that funds systematically invest less in countries with less transparency; moreover, funds have a greater propensity to exit nontransparent countries during crises. The fund industry is larger in those countries where mutual fund investors' rights are better protected.

Ownership structures matter for investors. Empirical studies show that large shareholdings by institutions are more prevalent among widely held rather than closely held firms. Furthermore, institutions are less likely to hold large owner-

Sovereign Bond Ratings
Selected Countries (as of 10.12.2010)

Rating	S&P	Moody's	Fitch
A+	China	China	China
A	Korea	Poland	Israel
A-	Poland	S. Africa	Malaysia
BBB+	Thailand	Russia	S.Africa
BBB	Mexico	Kazakh-stan	Hungary
BBB-	Brazil / India	Brazil/ India	Brazil/ India
BB+	Egypt	Greece	Turkey
BB	Turkey	Turkey	Philippines
BB-	Venezu-ela	Vietnam	Serbia

Investment Grade

ship stakes where the ultimate controlling shareholder is an individual (or family) and where control is maintained through a pyramid structure. These findings suggest that ownership structures of Turkish firms are likely to be considered problematic by institutional investors. Institutional investors, in general, have a strong preference for the stock of large firms and firms with good governance, while foreign institutional investors tend to overweight firms that are cross-listed in the United States and members of the Morgan Stanley Capital International (MSCI) indices.

The presence of foreign and independent investment institutions with large stakes has the potential to enhance a firm's value through direct or indirect monitoring. Firms with higher ownership by foreign and independent institutions (mutual fund managers and investment advisers) have higher firm valuations, better operating performance, and lower capital expenditures—leading to better relationships with all stakeholders through accountability, which helps improve social and labor relations.

Institutional investors have become a significant driver of sustainable investments in many countries. Although institutional investment has not yet reached a critical mass in Turkey, recent liberalization and privatization initiatives are likely to move both foreign and domestic institutional investors in this direction. Since 2001, the Turkish government has been implementing a comprehensive investment climate reform program. This program aims to streamline all investment-related procedures and is focused on FDI. A national platform jointly formed by the public and private sectors, the Coordination Council for the Improvement of Investment Environment (YOIKK), provides technical guidance for issues relating to the investment environment. In addition, the Investment Advisory Council of Turkey (IAC) was created in 2004 to provide an international perspective for the reform agenda of Turkey. IAC members include executives from multinational companies; representatives of international institutions such as the IMF, the World Bank, and the European Investment Bank (EIB); and the heads of Turkish nongovernmental organizations (NGOs) representing the private sector. The IAC's recommendations serve as a guideline for the YOIKK platform, and developments regarding council recommendations are published in the Turkish Treasury's annual IAC Progress Reports.

Governance structures in Turkey remain weak in offering investor protection due to low director liability and the difficulty in bringing shareholder lawsuits. The World Bank Group's Doing Business 2010 report ranks Turkey 57th among 183 countries surveyed with respect to investor protection. This report measures the strength of minority shareholder protection against directors' misuse of corporate assets for personal gain, using a composite index of investor protection in each country by averaging three separate indicators: transparency of transactions, liability for self-dealing, and shareholders' ability to sue officers and directors for misconduct. The report shows that Turkey lags behind the average of OECD countries and other EMs. Although Turkey compares favorably on the extent of disclosure, it scores significantly lower on director liability and ease of shareholder suits. The report highlights the following problematic areas:

- Turkey ranks high overall on disclosing details of related-party transactions but falls short of offering external review of the proceedings. Such reviews are a regulatory requirement in many countries such as Singapore, South Africa, Chile, China, Mexico, and France.

- The current legal framework, despite recent improvements, does not hold directors adequately liable for unfair transactions.

- Weaknesses in the liability of directors and controlling shareholders are exacerbated by difficulties for shareholders in pursuing lawsuits. Turkey ranks behind most other strong emerging economies on the ease-of-shareholder-suit index. In addition, Turkey does not provide a legal framework that allows shareholders (except those with more than a 10 percent interest) to request inspector investigation of transactions potentially unfair to minority shareholders, which is required in countries such as the United Kingdom, Greece, India, Colombia, and Argentina.

- Enforcement of laws and regulations is weakened by the overlapping mandates and limited coordination among the authorities involved. The overlap creates opportunities for inconsistencies and results in a lack of clarity and coordination among the authorities, including the Capital Markets Board of Turkey (CMBT), the Banking Regulatory and Supervisory Agency (BRSA), the State Ministry (which oversees the Capital Markets Law) and the Ministry of Trade and Industry (which oversees the Commercial Code).

Improving the investment climate is a key policy instrument for promoting economic growth and mitigating the institutional, legal, economic, and social factors that are constraining the convergence of per capita income and labor productivity of Turkey relative to more developed countries. With the exception of some sectors (see below), areas open to the Turkish private sector are generally open to foreign participation and investment. Turkish law guarantees the free transfer of profits, fees, and royalties and the repatriation of capital. There is no difficulty in obtaining foreign exchange, and there are no foreign exchange restrictions. The TR is fully convertible. However, a foreign investor must use a Turkish intermediary for capital market activities, such as buying and selling securities, repo, portfolio management, investment consultancy, underwriting, margin trading, securities lending, etc. The tax policy for investment instruments changed dramatically at the beginning of 2006 and was significantly simplified. Currently, foreign investors are not subject to any taxes on securities.

The Turkish legal system still requires the shareholders of listed forms to block their shares two weeks before a general shareholders' meeting. This practice conflicts with the liquidity constrains of international institutional investors. Most investors block only a small percentage of their shares to attend the meeting, albeit with reduced representation of their total voting rights. Many emerging markets eliminated share blocking requirements and moved to the record date system.

As we discuss in more detail in a separate section in chapter 5, a new Commercial Code aims to align Turkish commercial code with EU directives.

"Turkey has the ambition to become a financial center in the region. To achieve that we need to develop our capital markets in all aspects, and we can only do that by the help of institutional investors."

Prof. Dr. Vedat Akgiray, CMBT *

* *Kurumsal Yatirimci*, October-December 2010, pp 10-14

D. Financial Markets

The Turkish government's Istanbul Financial Center Project, announced in 2009, has the ambition of making Istanbul a regional financial center within the next five years. Istanbul currently ranks 70 among 75 global financial centers in the Global Financial Centers Index (GFCI). The city is classified mainly as a local center, lacking the breadth and depth required to become a serious contender in the contest among financial centers. Shanghai and Shenzen rank 6th and 14th respectively, Sao Paolo 44th, Mumbai 57th, and Moscow 68th in GFCI.

The Stock Market

As of April 2010, there were 327 stocks listed on the Istanbul Stock Exchange (ISE). 233 of which were listed on the National Market and 36 others on the

Second National Market, the New Economy Market, and the Watch List Companies markets. Additionally, there were a total of 37 "collective products"--that is, exchange traded funds (ETFs), real estate investment trusts (REITs), and venture capital investment trusts and investment funds (Table A2.4). There were 22 initial public offerings (IPOs) during 2010, following two consecutive years with few IPOs (one in 2009 and two in 2008).

Table 2.5 below shows that ISE had a stock market capitalization of $233,997 million at the end of 2009. This amounts to almost 37 percent of GDP. The value of stocks traded amounted to 39 percent of GDP in 2009. ISE was ranked 27th in international comparison in 2009. These figures are significantly lower than BRIC figures; the floated part of total equity is also much smaller. Moreover, significant amounts of floated shares are held by block holders and kept out of circulation. In 2010 Turkcell was the only ISE-listed company with a listing on the NYSE. A small number of listed companies have over-the-counter (OTC) or portal listings in the United States while Coca-Cola Icecek had a listing on the London Stock Exchange. A historical comparison of stock market capitalization with BRIC countries is given in Table A2.6.

Table 2.5 Stock Market Indicators in Turkey and in BRIC

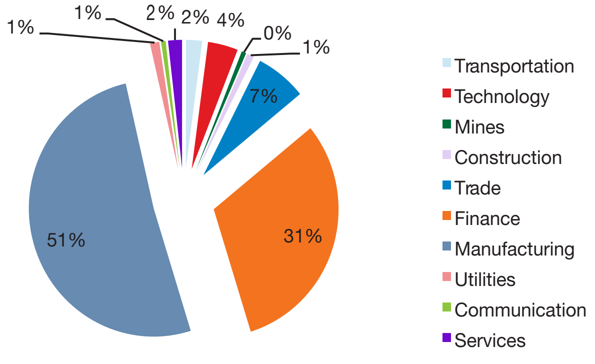
	Exchange	Market Capitalization ($ Millions)	Number of Listed Companies	Market Capitalization to GDP (%)	Stocks Traded, Total Value (% of GDP)	Change in the Index Value (% USD)
Brazil	BM&FBOVESPA	1,337,248	386	74.26	41.30	143.1
China	Shanghai SE	2,704,778	870	100.46	179.67	79.9
China	Shenzhen SE	868,374	830			117.1
India	Bombay SE	1,306,520	4,955	90.01	83.11	98.6
India	National Stock Exchange India	1,224,806	1,453			96.9
Russia	MICEX	736,307	234	69.99	55.45	114.5
Turkey	Istanbul SE	233,997	325	36.58	39.46	101.8

Source: Standard & Poor's, Emerging Stock Markets Factbook and supplemental S&P data, and World Bank and OECD GDP estimates. All figures reflect 2009 data. Index returns are computed from the end of 2008 to the end of 2009 and are taken from WFSE (World Federation of Stock Exchanges) Historical Statistics. Measures of Market Performance and Efficiency.

ISE had its first foreign listing in December 2010. DO&CO, an Austrian catering company cross-listed in Vienna, raised approximately $1 billion.

The majority of companies listed on the ISE are from the manufacturing sector, and approximately 31 percent come from the Finance industry. The sectoral distribution of listed companies is provided in Figure 2.4 on the left. The largest banks in Turkey are listed on the ISE, whereas a large proportion of the largest manufacturing companies in Turkey are privately held. ISE also had its first foreign listing in December 2010. DO&CO, an Austrian catering company cross-listed in Vienna, raised approximately $1 billion.

Figure 2.4 The Sectoral Breakdown of Listed Companies at the ISE



Source: Capital Market Board of Turkey, Annual Report 2009.

ISE is highly concentrated: Sixteen companies represented 64 percent of total market capitalization and 55.1 percent of total trading volume in 2009.

Foreign investors' holdings of free float have been consistently around 65 percent since 2005, and their share of equity turnover around 24 percent, indicating significantly longer holding periods than those of local investors.

The primary market reflects the investments of foreign investors during initial and secondary public offerings, as well as in the block sales market. Foreign investors have always been major participants in public offerings. In the last decade, foreign investment inflows through the equity market have been more than $21 billion, of which 40 percent was realized in 2007 alone (associated with Citibank's acquisition of 20 percent of Akbank shares for $1.4 billion and buying of $1.3 billion out of $1.7 billion offering by Halkbank).

In 2009, all stock markets, especially those in EMs, rose considerably. According to the data from the World Federation of Stock Exchanges, highest returns in dollar terms in 2009 were realized in Brazil's Bovespa (143.1 percent) and in the Colombo Stock Exchange (124.6 percent). ISE with its 101.2 percent rise is the seventh highest returning stock exchange among the members of the World Federation of Exchanges. In TR terms, ISE's return was around 25 percent in 2010.

ISE is highly concentrated: Sixteen companies represented 64 percent of total market capitalization and 55.1 percent of total trading volume in 2009 (WFSE, 2010).

ISE's volatility has been high, and there are indications that the stock market in Turkey is a less than perfect processor of economic information compared with stock markets in more advanced economies. Empirical research suggests that in Turkey a large fraction of stocks move together (Morck, Yeung and Yu, 2000). Using this co-movement measure, stocks listed on the ISE seem to be affected by factors other than firm-specific information. Empirical evidence suggests that stock price movements in emerging economies, due to either politically driven shifts in property rights or noise trading, lead to poor capital allocation and thereby retard economic growth.

"Although privatization in general industry has progressed in recent years, restructuring and improvements in corporate governance and business conduct remain significant challenges in view of the need to raise the productivity and competitiveness of Turkish firms. The banking sector has weathered the crises well but remains concentrated and important banks are still state-owned." *

* EBRD 2010 Recovery and Reform, London, UK.

Banking Industry

Following the crisis in 2001 and the subsequent restructuring process, the banking sector showed rapid growth. Total assets increased from $130 billion to $465 billion, and the ratio of bank total assets to GDP increased from 57 percent to 77 percent. The banking industry dominates the Turkish financial sector in terms of its asset size. Table A2.7 shows that banking assets correspond to 81 percent of total assets in the financial industry in 2010. Despite this growth, the ratio of financial assets to GDP was still only 141 percent for Turkey by the end of 2009. This rate is very low when compared with other developed and BRIC countries and indicates future growth potential.

The financial structure of the banking Industry has shown clear improvements: Shareholders' equity in the sector increased from $16 billion to $54 billion, and the free equity from $3 billion to $40 billion. The capital adequacy ratio, which was 18 percent as of December 2008, continued to grow and reached almost 20 percent in 2009. There are several reasons for these positive developments recorded by the banking system, including the favorable domestic and international economic situation and the change in the risk-management conception underpinned by strong banking regulations.

As of 2009, there were 49 banks operating in the Turkish banking sector, with 32 of them commercial banks, 13 development and investment banks, and 4 participation banks. According to BRSA data, commercial and development and investment banks had a total share of 96 percent in banking sector assets while participation banks had a share of 4 percent in July 2009. The proportion of state ownership in the banking sector was 30 percent.

The size of the domestic debt market is a little over $200 billion in Turkey. The debt securities-to-GDP ratio is 33 percent, while the global average is 109 percent (IMF, 2009). This reveals that the size of debt securities market is still meager.

Bond Market

The size of the Turkish corporate bond market is negligible, as nearly 100 percent of outstanding debt securities are issued by the government (Table A2.8). The debt-equity ratios of listed industrial companies were around 268 percent in 2008 and around 300 percent in 2009, while other large industrial companies had slightly lower debt-equity ratios (94 percent in 2008 and 139 percent in 2009). These figures are substantially higher than the debt-equity ratios of the companies in the United States and the EU and also higher than the ratios reported for China (28 percent) and developing countries (36 percent). The primary Bond and Bills Market, which was launched at the end of 2010, is expected to grow fast in the coming years. Further details are explained in Chapter 3.

The corporate bond market is new in Turkey. Existing regulations were cumbersome and discouraging. ISE has recently launched the Offering Market for Qualified Investors (OFQI). Companies, whose stocks are traded on the ISE, are able to issue borrowing instruments on the ISE Bonds and Bills Market without having to issue a prospectus and a circular. Banks, privately held or listed, can Issue bonds. Only qualified investors can invest in OFQI. In 2010, 10 companies issued bonds in OFQI for a total of TR 650 million. It is expected that the bond market will gain ground as government borrowing will be significantly reduced in the coming years. Market players expect the bond markets to reach 5 percent of GDP in the midterm in line with the ratios observed in other EMs. The market is expected to reach $10 billion in 2011.

Insurance Industry

There were 58 insurance companies and 2 reinsurance companies operating in Turkey by the end of 2009. Twenty-two of the insurance companies were life insurance companies, and 36 were nonlife insurance companies. The total premium income of the insurance industry was close to $8 billion in 2009, down from slightly above $9 billion, which is in part due to the strong TR.

The 2009 investments of insurance and reinsurance companies reached almost TR 18 billion—an increase of 11 percent compared to 2008. Table A2.9 shows that the largest component of the insurers' investment portfolio was treasury bonds and government bills, representing 46.4 percent of insurers' total 2009 investment. Deposit accounts were 26.1 percent, and the proportion of investment in shares represented only 11.4 percent of total investments.

"The consolidation and deepening of liberal democracy in Turkey is likely to contribute to better economic performance by helping to prevent the costly stop-and-go cycles, and endemic feature of Turkey's political economy in the post-war period."

Prof. Dr. Ziya Onis *

* Onis, 2010

E. Implications for SI

Sustainable investments in Turkey have a good prospect due to a strong macroeconomic starting position and the EU accession process. Far-reaching policy reforms of the last decade produced greater political stability, providing a healthy background for further structural reforms. Backed by the government's commitment to fiscal discipline and to EU accession, these reforms are likely to induce changes in the governance agenda of the corporate sector to enable it to compete with foreign companies on an equal footing. Access to external finance will be the key factor in this competitive process.

3 Sustainable Investment Industry

- The SI industry based on explicit use of ESG criteria is yet to emerge in Turkey.
- Long-term investments by foreign institutional investors are expected to play an increasing role in SI in Turkey if and when Turkey achieves investment-grade status.
- Significant regulatory and structural barriers prevent the local fund management industry from growing and play a role in SI, mainly stemming from ownership structures and the dominance of banks.
- DFIs, both through direct funding and funding of PE funds, play an important role in introducing ESG issues into the investment process.
- In contrast to financial disclosure, ESG-related disclosure is far from being satisfactory.
- Pension funds and insurance companies currently have a minor role in promoting sustainable investments with an estimated $2.5 to 3.3 billion equity exposure representing roughly 1 percent of ISE's total market cap.

Sustainable Investments are driven by institutional investors in all markets. Public pension funds, reserve funds, and universities as well as insurance companies are the main institutional investors who are concerned about ESG risks and the broader impact of their investments.

The level and quality of sustainable investments are directly related to the quality of the investment environment and the depth and breadth of the investment management industry. Low saving rates and government borrowing are structural barriers to the development of the investment management industry in Turkey. Local investments in equities are too small to have an impact on investee firms' behavior. Furthermore, the asset management industry has structural and regulatory obstacles to being a driver of SI.

As shown in Table 3.1 below, at the end of 2009, investors had roughly TR 124 billion worth of shares in their account balance. Foreign investors, practically all of which are institutional investors and investment funds, held 67 percent of these shares. Local investors' 33-percent holdings mainly comprised individual investors at 20 percent and institutional investors, together with mutual funds, at 11 percent. These percentages are relatively stable and illustrate the low level of local institutional investments in Turkish equities.

Foreign investors hold 60-70 percent of traded shares. Remaining shares are held mainly by individual investors at 20 percent. Institutional investors, together with mutual funds hold about 10 percent. These percentages illustrate the low level of local institutional investments in Turkish equities.

Table 3.1: Local Investments by Type

Investor Identity	Investor Type	Number of Registered Investors	Ratio of Regis-tered Investors	Account Balance (TR)	Ratio of Account Balance
Local	**FUND**	569	0.00%	1,717,150,625.63	1.38%
Local	**INSTITUTIONAL**	281,315	1.89%	11,469,681,656.89	9.23%
Local	**OTHERS**	38,473	0.26%	2,640,818,832.88	2.12%
Local	**INDIVIDUAL**	14,448,046	97.21%	24,504,644,426.18	19.72%
Local	**INVESTMENT TRUST**	52	0.00%	259,100,026.15	0.21%
LOCAL	**Total**	**14,768,455**	**99.37%**	**40,591,395,567.72**	**32.66%**
Foreign	**FUND**	8,441	0.06%	59,576,148,220.54	47.93%
Foreign	**INSTITUTIONAL**	4,998	0.03%	23,667,259,473.08	19.04%
Foreign	**OTHERS**	123	0.00%	12,387,345.32	0.01%
Foreign	**INDIVIDUAL**	80,000	0.54%	440,567,540.79	0.35%
FOREIGN	**Total**	**93,562**	**0.63%**	**83,696,362,579.72**	**67.34%**
	Total	**14,862,017**	**100.00%**	**124,287,758,147.45**	**100.00%**

Source: CMBT Annual Report, 2009

Regulations restrict the right to set up investment funds to banks, brokerage houses, and pension and insurance firms. In practice, this restriction further strengthens the dominance of consumer banks in the financial sector, creating a potential for moral hazard and a barrier to product innovation and diversification.

The breakdown of foreign institutional investors and funds by type is unknown as custodian banks do not disclose their clients' identities. The general consensus is that 30 to 50 percent of foreign shareholdings were held by hedge funds in 2010, which, together with local individual traders, provide liquidity to the stock market.

Turkish stock markets attract foreign "hot money" through the money markets and through short-term and speculative equity investments. As of November 30, 2010, the average holding period of investment funds was 101 days, compared with 431 days for local pension funds, reaffirming the importance of pension funds in long-term/SIs. Pension funds and insurance firms, which drive sustainable investments in other countries, are very small in Turkey (asset size roughly TR 11 billion and 18 billion, respectively, constituting a total of 4.3 percent of the total assets in the finance sector).

Regulations restrict the right to set up investment funds to banks, brokerage houses, and pension and insurance firms. In practice, this restriction further strengthens the dominance of consumer banks in the financial sector, creating a potential for moral hazard and a barrier to product innovation and diversification.

A. Estimates of Sustainable Investments in Turkey

Our first estimate of SIs in Turkey is based on investments in equities with an explicit use of ESG criteria. This procedure produces an amount of almost nil, with the exception of one isolated investment.[1] Our second estimate is less systematic and broader; it includes equity investments by United Nations Principles of Responsible Investment (UN PRI) signatories, investments by foreign institutional investors that monitor the ESG performance of investee firms during the post investment period, and PE investments funded by International financial institutions with ESG conditionality. This approach results in an estimated TR 4.0 billion (approximately $2.5 billion).

1 F&C's ESG fund has an undisclosed small amount invested in Bank Asya.

> *"One of the pre-conditions for investment fund market to grow is the establishment of a competitive fund market."*
>
> **Prof. Dr. Vedat Akgiray, CMBT ***
>
> * *Kurumsal Yatirimci*, October-December 2010, pp 10-14

> *"It is unrealistic to expect the Fund Committee members to have the authority to prevent conflicts of interest, and give priority to investors' interests, when they have other roles and responsibilities in founding banks and brokarage houses where the main business is not about 'establishing and managing funds'."*
>
> **Taliye Yesilurdu, CMBT ***
>
> * *Kurumsal Yatirimci*, January-March 2010, pp.13-15

Table 3.2 Estimate of Sustainable Investments in Turkey (November 2010)

Source`	Investments in Equity (TR Billions)	Total SI (TR Billions)
Portfolio Investments		
Portfolio Investments of UN PRI Signatories	1.25	1.25
Portfolio Investments of International Institutional Investors	80.00	1.00*
Private Equity		
Actera	0.75	0.75
Turkven	1.00	1.00
Total (incl. PE)		4.00

(*) 2% of (Total Investments by Foreign International Investors – Holdings by Hedge Funds)
Source: Interviews with Fund Managers.

Considering that Ak Portfolio Management became a UN PRI signatory only in November 2010, the estimate in Table 3.2 may be rather optimistic.

The data on impact investments (Fig. 1.1)—that is, investments in microfinance, renewable energy, energy efficiency, social enterprises, and mission-based debt financing by DFIs—are not available in a consistent form suitable for consolidation. We can, however, report that the total amount of microfinance loans extended by the end of 2010 is estimated to be around $200 million and the total investments approved by the Clean Technology Fund[2] amounted to $172 million by the end of 2010. Further details are provided in the rest of this chapter.

B. Domestic Institutional Investments

Institutional stock market investments in Turkey are channeled through pension funds, mutual funds, and investment trusts. A summary of the equity exposures of these investments Is presented in Table 3.3a and a comprehensive breakdown is included as Table A3.3b in the Appendix.

Table 3.3a: Estimate of Local Institutional Investments (November 2010)

Source	Absolute Amount	Fraction of Equity	Total SI
Pension Funds	TR 11.7 Billion	13.4 %	TR 1.5 Billion
Mutual Funds	TR 31.5 Billion	3.85%	TR 1.2 Billion
Investment Trusts	TR 270 Million	100%	TR 270 Million
Total			**TR 2.97 Billion**

Source: CMBT, EGM (Pension Monitoring Center), interviews

The insurance industry has TR 2 billion invested in securities; the proportion of this that is in mutual funds is unknown. An upper estimate of local institutional investors' equity exposure may therefore include an additional TR 2 billion at the extreme. Industry professionals estimate the total equity exposure of local institutional investments to be somewhere between TR 4 and 5 billion (approximately $2.5 to $3.3 billion). This represents a very small amount (roughly 1 percent) of ISE's total market capitalization and an even smaller proportion of financial sector assets.

2 www.climateinvestmentfunds.org

"Turkish mutual fund industry AUM was TR 29.3 billion by the end of 2005, comprising 7.6% of the banking sector assets. However, in just five years the proportion of the mutual fund industry AUM to total banking sector assets has shrunk to 3.6 percent. This outcome was a conclusion of a marginal growth of just TR 1.6 billion in fund industry assets in this period as compared to a staggering growth figure of 124 percent in the banking sector balance sheets. The picture becomes bleaker when we exclude the money market funds from our calculation which shows that the non-money market portion of the industry has actually contracted by 19 percent in TL terms in the same period.

*We may come up with similar conclusions when we compare the five year cumulative growth rates of Turkish mutual fund industry with global and emerging market industry figures. While, between 2005 and 2010, the global and emerging markets fund industry AUM has expanded by 16 percent and 94 percent respectively, the size of Turkish fund market has shrunk by 19 percent in Euro terms in the same period." **

* Institutional Investors Association –Strategy Report (http://2023tim.blogspot.com/2011/02/turkish-mutual-funds-industry.html)

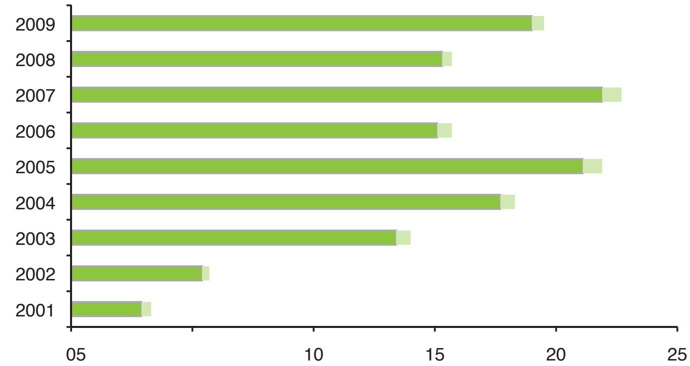
Asset (Portfolio) Management Companies and Mutual Funds

Due to legal restrictions, asset management firms cannot establish investment funds and are limited to investment instruments offered by the banks and the government. The privilege of having the right to establish funds does not provide banks with incentives for protecting investors' interests and fails to establish mechanisms to prevent conflicts of interest. Funds are treated as an asset class and are closed ended. There are no requirements for independent members in fund committees. This structure, whereby the collective investment product development and governance are entrusted to banks, also prevents competition. As a result, management fees have been high, and this forced the regulator to introduce a cap on management fees in 2010. CMBT's draft capital markets law, awaiting the enactment of the new Commercial Code, introduces regulations to align the fund governance systems with EU directives and Undertakings for Collective Investments in Transferable Securities (UCITS) structures, thereby allowing funds to be established as separate legal entities with variable capital structures. In the current system, the custodian's role is limited to the separation of fund assets from fund managers, with no other responsibilities typically included in the EC's UCITS directives.

By the end of 2009, there were 23 portfolio management companies in operation in Turkey. The total value of portfolios managed by these companies was TR 40,098 million. Of the portfolios managed by these firms, 1.8 percent belongs to individuals, 92 percent to institutional investors, and 6.2 percent to corporations (Table A3.4). Four portfolio management firms affiliated with four business groups—namely Is, Ak, Garanti, and Yapı Kredi—have a combined market share of 73 percent.

Two different types of mutual funds, Type A and Type B, exist in the Turkish capital markets. Type A mutual funds are required to invest at least 25 percent of their assets in equities that are issued by Turkish companies. Type B mutual funds have no such obligations. There were 369 mutual funds in Turkey at the end of 2009, of which 238 were Type B. The number of foreign mutual funds whose participation certificates are registered with the CMBT was 77 at the end of 2009. Among these funds, US dollar based funds have a small net asset value of $46 million; Euro based funds have a net asset value of €21 million.

Figure 3.1 Portfolio Value of A and B Type Mutual Funds ($ Billion.)



	2001	2002	2003	2004	2005	2006	2007	2008	2009
B Type	2.9	5.4	13.4	17.7	21.1	15.1	21.9	15.3	19
A Type	0.4	0.3	0.6	0.6	0.8	0.6	0.8	0.4	0.5

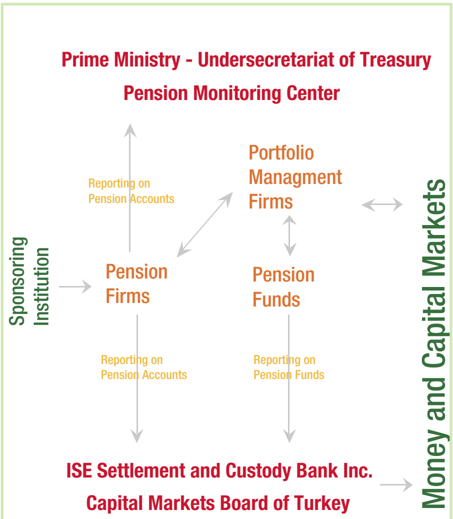
Source: CMBT

Pension Funds

The Turkish private pension system (Individual Retirement Savings and Investment System) is a voluntary, defined contribution system intended to be a complementary scheme to the mandatory social security scheme, which provides retirement earnings to participants on a pay-as-you-go (PAYG) basis. The private pension system was introduced in 2003 and achieved a membership of 2.4 million by the end of 2010. This PAYG system is in deficit on an ongoing basis; the 2011 budget predicts a deficit of TR 30.6 billion (approximately $20 billion).

Pension firms may only invest in pension investment funds set up by them directly. To establish a pension investment fund, a pension company, pension contract in hand, applies to the CMBT. The fund portfolio is managed by independent portfolio managers designated in accordance with capital market regulations and appointed by the pension company. The portfolio management terms require approval from the CMBT. Pension firms are restricted in terms of their investments. Pension funds may invest 10 percent of their assets in mutual funds, with a 2 percent limit per fund. They must invest 30 percent of their assets in government debt instruments, and related party investments are restricted to 20 percent. The total equity investment portion of pension funds has been around 10 to 13 percent over the past five years. Figure 3.2 below illustrates the structure of the pension industry.

Figure 3.2. Pension System



Currently there are 13 pension firms and 133 pension funds. The total amount of money invested in pension funds was TR 11.7 billion as of November 2010. This corresponds to 2.6 percent of total financial sector assets.

The rapid growth of the system since its inception in 2003 is likely to continue over the coming years, and the proportion of total fund value to GDP is expected to rise from 1 percent to 10 percent in the 20th year of the system, that Is, by 2023.[3]

Table 3.5 below illustrates the affiliation between leading pension firms and major Turkish business groups. Four pension firms constitute 73 percent of the total market. The funds collected by these pension firms are managed by asset management firms that are affiliated with the same business group that controls the respective pension firm. These groups have a controlling stake in 45 publicly listed firms. Nine of those firms are constituencies of ISE-30 index, and their total market cap stands at 36 percent of ISE's total market cap.

3 The OECD average is 67.1 percent, indicating the potential for Turkish pension funds to grow.

Investments in Funds per Person

	Investments in Funds per person (USD)	Investments in Funds (excl. liquid funds) per person (USD)
Brazil	4160.62	4004.15
Russia	25.64	25.64
India	96.63	82.30
China	258.02	245.34
Turkey	268.91	60.22

Source: ICI (Quarterly Worldwide Mutual Assets and Flows - 2.quarter), IMF (World Economic Report - 2010)

"In Turkey, population aging is yet to set in. The demographic window of opportunity characterized by the increasing share of working age people in total population is projected to remain open over the next 15 years.

So, the country still has a relatively young population, with about 7 working age individuals (15-60) per elderly (60+) citizen in the general population. The active-passive ratio of the publicly managed pension system, on the other hand, is a mere 1.8. That is, the publicly managed Pay-As-You-Go pension schemes have to rely on contributions paid by 1.8 workers to finance each pensioner that currently collect benefits. Two parametric reform acts in 1999 and 2007 that the Turkish Parliament passed to curb the rapid growth of pension deficits, mainly through gradual increase in entitlement ages, have had only limited success.

Without large budgetary transfers amounting to about 4% of the GDP, financing pension benefits is still impossible, unless labor force participation rates (particularly of women) significantly increase in the years ahead, and unregistered employment rates (close to 50% currently) are reduced. A major reform is needed as the public pension system is not financially sustainable, but does not seem feasible politically."

Prof. Dr. Serdar Sayan, TEPAV *

* Interview

Table 3.5 Ownership Relations among Pension Funds, Asset Managers, and Business Groups

Pension Fund Firm	Market Share	Asset Manager	Business Group	# of Affiliated Firms	# of Listed Firms
Avivasa Emeklilik ve Hayat A.S.	21.88%	Ak Portfolio Mgmt	Sabancı Holding	26	11
Anadolu Hayat Emeklilik A.S.	21.45%	Is Portfolio Mgmt	IS Bank Group	22	15
Yapı Kredi Emeklilik A.S.	15.04%	Yapı Kredi Portfolio Mgmt	Koc Holding	98	14
Garanti Emeklilik ve Hayat A.S.	14.57%	Garanti Portfolio Mgmt	Dogus Holding	124	5
Total	72.94%				

While this picture might lead one to think that substantial improvements in investment strategies could be realized by convincing the leading pension firms to leverage their dominant positions in the market to pioneer SIs, anecdotal evidence reveals that each of those pension firms has exclusive contracts with portfolio management firms affiliated with the same business group and have little influence on the how their assets are invested. This multiple monopoly structure prevents competition and introduces inefficiencies of scale in the pension fund industry.

Our interviews with portfolio managers suggest that pension funds affiliated with a business group would find it extremely difficult to channel their investments independently. Although there is no legal barrier to a pension fund investing in mutual funds founded by an unaffiliated bank, it is considered to be unlikely that the pension fund's management—dominated by the employees of the affiliated bank—would make such a decision in favor of its rival. Allowing independent asset management firms to establish their own funds may be a critical step in pooling a critical mass of SIs in a themed fund.

Other Types of Funds

By the end of 2009, nine exchange-traded funds (ETFs) have been publicly traded on the ISE fund market. The total value of these funds is TR 253 million. Six are based on stock exchange indexes, one on a gold index, and two on notes and bond indexes (Table A3.6). This overview suggests that there is yet no sign of innovation in the ETF market.

In addition to these instruments, the following local funds exist in Turkey: guaranteed funds (8 funds with a total value of TR 170 million at the end of 2009), protected funds (25 funds with a total value of TR 468 million at the end of 2009), hedge funds, which were launched only for qualified investors in 2008 (4 hedge funds with a total value of TR 206 million at the end of 2009), and funds of funds (with a total value of TR 14.7 million at the end of 2009).

There are four investment funds established abroad for investing in Turkish assets;

ii) iShares MSCI Turkey Investable Market Index Fund (TUR) : One of the ways for U.S. investors to invest in Turkey is through the iShares MSCI Turkey Investable Market Index Fund. The fund tracks the MSCI Turkey Investable Market Index, which measures the performance of the Turkish equity market. TUR is

ETFs investing in Turkey

TUR Top Ten Holdings	%
Turkiye Garanti Bankasi (TKGBF.PK)	14.50
Akbank T.A.S. (AKBTY.PK)	9.53
Turkiye Is Bankasi C Share (TYIBF.PK)	8.09
Turkcell Iletisim Hizmetleri AS	6.60
Haci Omer Sabanci Holding A.S. (HOMJF.PK)	4.07
Anadolu Efes Brewery ve Malt Sanayi A.S. (AEBZY.PK)	3.91
Yapi Ve Kredi Bankasi (YVKAF.PK)	3.90
Turkiye Halk Bankasi A.S	3.83
Bim Birlesik Magazalar A.S. (BMBSY.PK)	3.81
Tupras-Turkiye Petrol Rafineleri A.S	3.77

iShares MSCI Turkey Fund Top Ten Holdings	%
TURKIYE GARANTI BANKASI ORD TR1.0	18.20
AKBANK T.A.S. ORD TR1.0	11.72
TURKIYE IS BANKASI-C ORD TR1.0	10.07
TURKCELL ILETISIM HIZMET AS ORD TR1.0	7.97
HACI OMER SABANCI HOLDING ORD TR1.0	5.03
ANADOLU EFES BIRACILIK ORD TR1.0	4.95
YAPI VE KREDI BANKASI ORD TR1.0	4.81
TUPRAS-TURKIYE PETROL RAFINE ORD TR1.0	4.74
BIM BIRLESIK MAGAZALAR AS ORD TR1.0	4.70
TURKIYE HALK BANKASI ORD TR1.0	4.65

Turkishfund Equities Top Ten Holdings	%
Akbank TAS	9.53
Turkiye Garanti Bankasi AS	9.47
Turkcell Iletisim Hizmet AS	5.88
Turkiye Halk Bankasi AS	5.28
Yapi ve Kredi Bankasi AS	5.21
Turk Hava Yollari	4.99
Tupras	4.61
H.O. Sabanci Holding	4.38
TAV Hava Limanlari Holding	4.19
Is Yatirim Ortakligi AS	3.40

heavily focused on financials, which make up 52 percent of total assets. Additionally, the fund makes large allocations toward the industrial materials (13.6 percent) and telecommunications (10.4 percent) sectors.

ii) SPDR S&P Emerging Europe ETF (GUR): The S&P European Emerging BMI Capped Index is a market capitalization weighted index that defines and measures the investable universe of publicly traded companies domiciled in emerging European markets. The fund has 16.49 percent holdings in Turkey.

iii) iShares MSCI Turkey Fund: Listed on the British London Stock Exchange, iShares MSCI Turkey is an ETF that aims to track the performance of the MSCI Turkey Index. The ETF invests in physical index securities. The MSCI Turkey Index offers exposure to Turkish stocks that comply with MSCI's size, liquidity, and free float criteria. The index is free float market capitalization weighted.

iv) **TURKISFUND (SICAV) :** Turkisfund is an umbrella fund established by Is Asset Management in Luxembourg, with the euro as the base currency. The fund comprises three subfunds: equities, bonds, and Eurobonds. Turkishfund Equities invest primarily in the shares of companies registered on the ISE. Turkishfund bonds invest in fixed income instruments issued by the Turkish Treasury, other public authorities, and Turkish companies. Turkishfund Eurobonds invest primarily in EUR-dominated public funds issued by the Republic of Turkey.

Investment Trusts

There are two types of securities investment trusts in Turkey, which are A-Type and B-Type. A-Type are required to invest a minimum of 25 percent of their assets in Turkish equities. B-Type trusts do not have this limitation. By the end of 2009, the total value of 33 investment trusts was TR 712 million. The portfolios of these companies comprise corporate securities (35.17 percent), government bonds and T-Bills (37.61 percent), reverse repos (26.15 percent), and foreign securities and other investment instruments for the remainder. As of the end of 2009, there were 29 A-Type investment trusts with TR 425 million paid in capital, TR 483 million market capitalization, and TR 687 million net asset value.

Real estate investments have been an attractive investment instrument primarily used by business groups to invest free cash into profitable development projects. Fourteen real estate investment trusts were in operation in Turkey at the end of 2009 with a total net asset value of TR 4,346 million and market capitalization of TR 2,853 million. The portfolio of these ISE-listed investment trusts is real estate investments (69.54 percent), real estate projects (17.44 percent), other securities (8.63 percent), and government bonds and Treasury Bills (4.39 percent). Detailed information on real estate investment trusts is included in Table A3.7.

Venture Capital Investment Trusts

There were two venture capital investment trusts in Turkey at the end of 2009 with a total portfolio value of TR 153.3 million ($102 million). The portfolio of the IS Venture Capital Investment Trust, which is about TR 148.9 million, was venture capital investments (42 percent) and securities (58 percent). One hundred percent of the TR 4.4 million portfolio value of Vakif Venture Capital Investment Trust comprises money market instruments.

We conclude that Turkey's fund industry lacks product variety and depth. Whereas low saving rates and high interest rates are the main contributing factors, there are also structural barriers stemming from the ownership structures and dominance of the banks for the market to develop.

C. International Institutional Investments

In the aftermath of the crises, investing in smaller EMs like Turkey is perceived as involving additional exposure to systemic risks; whereas the interest in BRIC countries is bigger, and the risks are better understood. Turkey's bond rating is below investment grade--that is, still not high enough to attract long-term investors. Anecdotal evidence suggests that asset managers typically allocate 10 percent of their investments to EMs, of which Turkey receives 1.5 to 2 percent in line with the allocations of reference indices (See Table A3-8.a for MSCI EM and Table A3-8.b for S&P/IFC EM allocations.).

Although Turkey is expected to reach investment grade during 2011 and is perceived as a potentially attractive market, investors are still nervous about political risks and their effect on macroeconomic stability. A senior analyst we interviewed from an international research firm explained Turkey's recent performance in attracting "hot" money but failing to appeal to strategic investors with the following words: "There is interest, but nobody knows Turkey."

Anecdotal evidence reveals that liquidity is the single most important criteria for stock selection by the majority of international investors. A fund manager who manages pension fund assets in the United Kingdom said that the fund's liquidity criteria were very strict in Turkey. The fund only invests in stocks that can be liquidated within five days and has a trading volume of $2 million a day.

Growing investor interest in Turkey has recently attracted research houses, disclosure platforms, and themed funds to examine Turkish assets more closely. Mainstream investors have the opinion that, despite the rhetoric, asset owners accept sound risk management as being good enough to cover most of the ESG issues. In general, Turkish stocks are considered to be nonproblematic from their perspective. The relative attractiveness of the Turkish financial sector may be attributed to sound risk-management regulations and practices in the Turkish banking sector.

Active funds have a different view. According to F&C Asset Management, which pioneered the industry by setting up an EM ESG-labeled fund, governance and sustainability disclosure in Turkey is often very limited. Currently Turkey is underrepresented in F&C's ESG-labeled fund because most of the companies that are included in F&C's core funds don't meet ESG criteria for the labeled fund. Within F&C's core global emerging markets equity fund, Turkey was overweighed in the fourth quarter of 2010 with approximately 10 Turkish companies held in the portfolio. Although the core fund does consider companies' governance and sustainability practices, unlike the ESG fund, it does not require companies to meet strict ESG criteria. F&C conducts its own research with dedicated equity analysts for Turkey and uses third-party research and local equity research as an input to its own ESG analysis. For example, when F&C considered the inclusion of Ford-Otosan, (a joint venture between Koc Holding and Ford Motor Company), in its ESG fund, it was surprised by how little ESG information was available. The European Bank for Reconstruction and Development's (EBRD) only equity investment in Turkey, however, is in Ford-Otosan, indicating the absence of a standard approach to ESG analysis. F&C's ESG criteria include independence of boards and particularly of audit committees. Turkey lags behind some other satellite markets with respect to these criteria, according to F&C.

For some active investors, ESG assessment is an overlay following the investment decision and provides a basis for engagement. A good example is Hermes, the principal fund manager for the British Telecom Pension Scheme, which is the UK's largest. Hermes' SRI team, Hermes Engagement Overlay Services (HEOS), advises 25 other major pension funds and other long-term

"F&C sees Turkey as an important growth market among EM, and is looking to identify Turkish companies contributing to Sustainable economic development while meeting basic good governance and sustainable operating practices. Among the companies we have researched, Bank Asya stands out as a leader in responsible lending, transparency, and good governance in Turkey. For other companies that fail to meet our ESG indicators, we are in dialogue in management in many cases, explaining where they come up short and why we believe that demonstrating sound good governance and sustainable operating practices are important indicators for driving long-term performance and sustainable economic growth in emerging markets."

Alexis Krajeski, F&C *

* Interview

> *"Progress has been made in recent years, but overall lack of disclosure by Turkish companies remains a major obstacle for foreign investors to assess ESG performance. In terms of governance the highly concentrated ownership of companies and the limited independence of boards is another concern to ensure optimum oversight and respect of minority shareholders. Whilst codes are in place and generally being followed, we find that they are neither observed in the spirit nor far-reaching enough."*
>
> **Brunno Bastit, Hermes ***
>
> * Interview

investors on ESG matters in respect of around £65 billion. HEOS conducts ESG analysis of select companies to engage with and demand improvements in their ESG performance. HEOS covers 10,000 stocks worldwide and engages with more than 450 companies. Reports are provided to pension funds which, at their discretion, may share this information with their fund managers. HEOS' current engagements with Turkish companies are mostly around issues of transparency and governance where HEOS covers 60 Turkish stocks representing over £240 million.

Foreign institutional investors that are more stringent with ESG screening express dissatisfaction with research conducted by local brokerage houses. These brokerage houses apparently "fail to understand what matters" according to an investor. Frequent questions asked by investors are considered to be "inappropriate" or "out of context" by local analysts.

Investors express somewhat better levels of satisfaction with the responsiveness of other EM stock exchanges to investors' demands. For example, Taiwan lowered the threshold above which independent directors are required in response to foreign investors' requests. Chile followed suit, and the Malaysian stock exchange recently made sustainability disclosure mandatory. The Hong Kong stock exchange has started auditing randomly selected "comply or explain" reports published by the listed firms on a regular basis.

Some large international investors have a common strategy of investing in a few selected Turkish companies with an average investment of around $200 million. Investor relations managers that we interviewed suggested that investors who are more concerned about ESG risks represent about 5 to 6 percent of shares held by international investors, representing approximately 1 to 2 percent of the total market cap. This estimate is the basis for our SI estimates mentioned earlier.

Undoubtedly, as the local pension funds and insurance industries grow, they will play a leading role in SIs as regulation improves, but this will take time. Meanwhile, foreign institutional investors will remain as the only source of sustainable investments in Turkey for the midterm.

D. Private Equity

A recent report by Meerkat and Liechtenstein (2010) stated that EMs' share of PE deals increased from 12 to 30 percent between 2005 and 2009 in line with the growth of these EMs' global economic weight. The long-term trends encouraging Investment in EMs include superior GDP growth, significantly higher net returns since 2000, greater resilience to the current financial crisis, and an increasingly attractive socioeconomic environment. The report lists Turkey, together with India, Brazil, Poland, South Africa, and Malaysia, as being equally as attractive as China although China stands out with respect to the amount of PE investments due to the size of the market. A report published in the November 2010 issue of local Para magazine, states that some 40 private equity funds are actively involved in looking for deals with Turkish companies. The reasons behind this interest include excess liquidity in the global markets, Turkey's improved position within the EU, and improved relations with Gulf countries as well as the introduction of regulatory frameworks for new asset classes such as mezzanine, buyout, venture capital, and real estate funds.

Unlike some other emerging markets, PE is a relatively new phenomenon for Turkey. Its emergence is partly attributable to improvements in the investment climate as a part of macroeconomic reforms backed up by the IMF standby agreement after 2002. Despite a significant number of transactions in 2009 and an upsurge of new PE fund initiatives, the PE industry in Turkey is still in its infancy. Quite often, DFIs play an important role in the emergence of the PE industry in EMs by backing first-time funds. This appears to have been the case in Turkey.

The PE capital invested in Turkish equities as of November 2010 is estimated by the market players to be around $5 to $6 billion. The majority of PE investments are managed by international asset managers such as TPG and Black Stone (United States) and KKR and Carlyle Group (United Kingdom).

The oldest and the leading local PE houses are Turkven and Actera. Turkven was established in 2000 and became the first independent PE fund manager in Turkey. It raised its first fund in 2002 (Turkish Private Equity Fund I) and its second fund in 2007 (Turkish Private Equity Fund 2). The first fund was sponsored by IFC, the EIB, the Dutch Development Bank (FMO), and the German Development Bank (DEG). Turkven has so far invested in 13 companies. Their current fund size is €500 million, and current co-investors include BC Partners, Advent International, Providence Private Equity, and Robeco with the shareholding of each investor capped at 10 percent. Turkven only invests if it can acquire a controlling stake with an investment horizon of 10 years. The first five years are the investment period, followed by the expansion phase. According to Turkven, incorporation of ESG risks in estimating potential returns is prudent business practice and reflects the investment strategies of their co-investors. Turkven adopts an ethical screening and sector exclusion strategy, selecting investees in line with the preferences of its co-investors and followed by an environmental impact assessment by third-party experts. Turkven considers the governance of its investee firms to be the foundation of value capture and the basis for managing environmental and social risks or impacts. Following the acquisition of control, Turkven changes the corporate charter to install an efficient board and governance structure in the investee firms.

PE may be a more effective instrument for ensuring compliance with ESG criteria in a manner similar to the minority investments of activist funds in widely held firms in developed markets.

Turkven's investments are predominantly in the services, retail, and technology sectors. The companies In which Turkven has invested are listed in Table 3.9 below:

Table 3.9: PE Invested Companies

Domino's Pizza (Food)	Mavi Jeans Giyim Sanayii (Textile)
Migros Turk (Retail)	Digiturk Iletisim Hizmetleri (Services)
Tekin Acar Buyuk Magazacilik (Retail)	Pronet Guvenlik Hizmetleri (Services)
Provus Bilisim Hizmetleri (Technology)	Uno Unlu Mamuller (Food)
Roma Plastik (Manufacturing)	Ekim Turizm (Services)
Next Generation Media (Media)	United Cellular Group (Technology)

Actera Group is another independent PE firm, a signatory to the UN PRI. It considers itself to be a responsible investor, and the fund size is approximately $500 million. Investors in Actera include global pension funds, international financial institutions, and sovereign wealth funds. Actera has an investment policy that incorporates ESG factors into its portfolio construction and monitoring process. The firm plans to implement "ESG compliance metrics" for the CEOs of its invested companies in 2011. With a target holding period of four to six years, Actera's current fund includes six firms, all with controlling stakes as shown in Table 3.10.

Table 3.10: Actera's Investments

Mey Icki (Alcoholic beverages)	LBT (Financial/NPL)
Spectrum Radio (broadcasting)	Mars Entertainment (Chain of movie theatres, restaurants)
Karma Acikhava (Advertisement)	Guney 2M (Services)

Some of Actera's previous investments include Migros Turk, Digiturk, Medical Park, Biofarma, UN Roro, and Boyner Magazacilik. The sectoral concentration in retail, services, and technology overlaps with that of Turkven.

The PE industry is expected to grow substantially over the coming years. One in every 10 opportunities for PE investment represents a disinvestment or refocusing transaction of a Turkish business group, according to Actera. Traditionally, the controlling shareholders of Turkish companies were reluctant to share control or sell because this could be interpreted as their business group's being in financial distress. Business groups have, however, been encouraged to adopt refocusing strategies and divest noncore assets in response to recent increased competition, together with new opportunities arising from the deregulation of protected industries that present a higher return potential. Other opportunities might stem from succession problems in family controlled firms, privatization of state-owned firms, and significant growth opportunities that require a pool of scarce management talent that PE firms can offer with proper incentives for superior performance.

Industry professionals consider PE investments as a key influence for promoting sustainable business practices in the long term. PE may be a more effective instrument for ensuring compliance with ESG criteria in a manner similar to the minority investments of activist funds in widely held firms in developed markets.

Some of the obstacles to foster growth of the PE Industry, expressed by industry professionals include -

Issues Related to the Provisions of the Old Commercial Code[4]

- Joint stock companies are not allowed to own treasury stocks. This limitation not only prevents a more efficient capital deployment, but also creates costs for investors who would need to use complicated and costly schemes mimicking stock options for setting management incentives aligned with investor interest.
- Commercial law requires a minimum of five shareholders to establish a joint stock company. This requirement sometimes causes problems when shares are disowned by rejection of inheritance by the inheritors.

Issues Related with the Macroeconomic Picture

- High interest rates partly attributable to domestic borrowing are still a barrier to long-term borrowing in local currency. Foreign exchange loans create a risk for companies that generate revenues predominantly in TR.

Human Capital

- The equity research community lacks the incentives and skills required for high quality research output.
- The managerial talent pool is predominantly replenished by executives with experience gained in multinational firms operating in Turkey. Local firms, where owners often occupy executive positions, tend not to cultivate entrepreneurial managers.

4 The New Commercial Code will become effective in July 2012.

Smaller local PE houses include Is Girisim Sermayesi, Standard Unlu PE, and Euraisia Capital Partners. International PE funds that have already invested in Turkish companies or are actively looking for deals are listed in table A3.11 in the Appendix. Only a handful of these funds are minority investors or are interested in listed companies. Most funds are looking for buyout opportunities or controlling stakes. Investments generally target mature companies in the expansion stage. This is likely to be related to weaknesses in the legislative framework (minority shareholder rights, enforcement of contracts, and judicial efficiency).

E. Development Finance

DFIs provide finance to the private sector in developing countries to support their sustainable economic growth.

DFIs provide finance to the private sector in developing countries to support their sustainable economic growth. Five major multilateral and one national DFI have been actively investing in Turkey over the last decade. The development institutions cooperate closely with the Turkish government and its agencies, NGO's, academia in the country, as well with each other.

Despite their diverse organizational and operational differences, there are many commonalities in DFI investors in Turkey. They all choose sustainable and renewable energy, access to finance for SMEs, and infrastructure projects as their investment priorities. Although the specifics of projects differ widely in terms of partners, size, and content, the focus remains the same. All DFIs have their own ESG criteria and use their own guidelines to analyze projects prior to approval and during the monitoring period.

During our interviews, the development institutions mentioned that some of the projects were rejected at the initial stage because they did not meet their ESG criteria although they appeared to be financially profitable. These institutions highlight that many Turkish companies mistakenly believe that compliance with law and regulations is sufficient to meet their ESG standards, which is often not the case. We observed that DFIs differ with respect to the strictness with which they evaluate compliance with ESG criteria. Although some DFIs apply a strict evaluation both at the credit approval stage and later, others are less stringent and can deviate from some of their criteria. Further information about DFIs' activities is provided in the Appendix In the section on "Development Finance".

The availability of global liquidity at low interest rates has been a factor that reduced the credit volume extended by DFIs in Turkey. Larger companies with access to credit did not want to accept the additional ESG criteria required by DFIs. Consequently, most DFIs diluted their ESG requirements, leading to problems for those DFIs that remained stringent—such as, for example, IFC. The monitoring task is usually carried out by specific missions from other countries as local offices, with the exception of IFC, do not have local capacity.

Industrial Development Bank of Turkey (TSKB)

TSKB was founded in 1950 as the first private investment and development bank of Turkey. The main shareholders of the bank are Isbank with 50.1 percent and Vakifbank with 8 percent. The remaining shares are traded on the ISE. The bank is the 16th largest bank in Turkey with an asset size of $4.8 billion.

TSKB is a non-deposit bank. Project and corporate financing are the two main business lines. Project financing activities can be direct or indirect lending to clients ranging from large corporate clients to SMEs.

In recent years, TSKB has focused mainly on energy sector projects. At the end of 2009, the bank had financed 83 renewable energy projects and became the leading institution financing the energy sector in Turkey. TSKB received the "Sustainable Bank of the Year" award in the developing countries category in 2009 by the Financial Times and IFC. The Turkish banking sector's first sustainability report was published by TSKB, and this report was approved by the Global Reporting Initiative (GRI) in 2009. During the same year, the bank introduced innovative products to the market, including the Clean Energy Fund, the Dynamic Commodity Fund, and the Agricultural Products Fund. These funds have no equity exposure.

TSKB's policies require the incorporation of ESG criteria starting from the marketing phase. If a client is capable of improving those areas where deficiencies are observed, projects are undertaken but with close monitoring. Financially attractive projects are declined regularly due to failure in meeting ESG requirements. TSKB requires that investment projects must comply with the local legal requirements. After evaluating the main scope of a project, TSKB stipulates further requirements, including an additional baseline study and a new public consultation and regular monitoring report. Additionally, in some cases, TSKB requires that clients hire an independent environmental consultant for monitoring and documentation.

TSKB has its own environmental management system (EMS) approach, which is used for all projects irrespective of scope, size, loan amount of projects, and even non-recourse projects. TSKB ESG criteria's were established during the implementation of EMS in 2005–2006. TSKB's sustainability check involves 36 attributes. The system allows TSKB to classify the projects according to their ESG performance. TSKB's EMS is audited by TUV Rheinland every year.

To **summarize**, DFIs have been influential in introducing the use of ESG criteria in the investment process in Turkey. Although the volume of their investments is small, compared to the size of total bank credit and equity investments in Turkey, they constitute an important example of best practice and produce a non-negligible amount of positive spillovers in the financial industry in Turkey.

F. Clean Technology Fund

Turkey's CTF Investment Plan estimates a total investment of $2.1 billion where the intended CTF financing is at the level of $250 million, and co-financing at $1.85 billion.

The Climate Investment Fund (CIF) is a financing instrument channeled through DFIs to initiate transformational change toward low emissions and climate-resilient development.

The CIF aims to combine donor funding for climate solutions with other national and private sector development resources, thereby leveraging substantial additional funds.

The two CIF funds are the Clean Technology Fund (CTF), financing low-emissions technologies for significant greenhouse gas (GHG) reductions within country investment plans, and the Strategic Climate Fund (SCF), financing targeted programs in developing countries to pilot new climate or sectoral approaches with scaling-up potential. The contributor countries—Australia, Canada, Denmark, France, Germany, Japan, the Netherlands, Norway, Spain, Sweden, Switzerland, and the United Kingdom—have pledged more than $6.4 billion to the CIF. The allocation for the CTF is $4.5 billion, and SCF funding accounts for $1.9 billion total in grants and concessional financing for targeted programs.

Turkey is one of the pilot countries included in the CTF, together with 11 other developing countries. The CTF trust fund committee approved the investment plan for Turkey on January 31, 2009. The plan was developed by IBRD, IFC, and EBRD in cooperation with the government. Thirteen investment plans have been endorsed for CTF cofinancing to date, and Turkey was successful in gaining funding approval for three of its projects. Turkey obtained substantial financial leverage by using CIF financing to provide the incentives needed to overcome first-mover hurdles and jump-start private markets for energy efficiency and renewal energy. Turkey's CTF Investment Plan estimates a total investment of $2.1 billion where the intended CTF financing is at the level of $250 million, and co-financing at $1.85 billion. Investment levels are expected to increase as Turkey moves to Phase II of its CTF Plan (See Table A3.18).

CTF promotes power sector programs for renewable energy and highly efficient technologies to reduce carbon intensity; transportation sector programs for efficiency and modal shifts; and energy efficiency programs for buildings, industry, and agriculture. In the case of Turkey, the focus is on renewable energy—energy efficiency projects in line with the low carbon objectives set by Turkey's 9th Development Plan (2007–2013).

G. Microfinance and Social Enterprises

Opposition from the banks to a draft law in 2003 prevented earlier attempts to establish a more effective microfinance industry.

Two microfinance programs are in operation in Turkey: the Small Enterprises Loan Programme (SELP II) and the Turkish Grameen Microfinance program. SELP II was initiated by the EU and implemented in cooperation with the Turkish Treasury, the Council of Europe Development Bank (CEB), and the KfW-Entwicklungsbank. Technical assistance services are delivered by the Frankfurt School of Finance and Management.

SELP II[5] builds on the previous SELP I program, which loaned approximately €90 million. Under SELP II, small loans up to €50,000 are extended to small enterprises with fewer than 50 employees through partner banks Akbank, Sekerbank, Garanti Bank, and Is Bank. As of September 2010, more than 12,000 small enterprises received a total of approximately €120 million in loans. The objective of the fund is to attract additional social and private investors and to gradually expand the scope of services to provide for long-term investments.

The Turkish Grameen Microfinance program is administered by Turkish Foundation for Waste Reduction.[6] At the end of 2010, the program had loaned a total of approximately $27 million to 41,000 borrowers. The loan payment rate is reported to be 100 percent.

Anecdotal evidence suggests that the microfinance industry is unlikely to develop without a legal basis. Opposition from the banks to a draft law in 2003 prevented earlier attempts to establish a more effective microfinance industry. The government has attempted to develop a microfinance facility administered local governments, but these have not born tangible results. Local administrations donate to the current Turkish Grameen program.

There is no estimate of levels of investments in social enterprises, but their total volume unlikely to be significant. The Turkish legal system does not enable social enterprises. The terms “public benefit company” or “nonprofit company” are not recognized as forms of legal entity.

Ashoka, the global association of social entrepreneurs, is currently in the process of rebuilding the Turkey chapter. Ashoka-Turkey[7] has 23 members, of which 10 are businesses and cooperatives. There is no estimate of levels of investments in social enterprises, but their total volume unlikely to be significant. The Turkish legal system does not enable social enterprises. The terms “public benefit company” or “nonprofit company” are not recognized as forms of legal entity. Unless a new legal entity model that is consistent with the social enterprise structure is recognized and established in the related legislation, social enterprises that operate as associations, foundations, cooperatives, or companies will continue to encounter problems in implementation.

5 http://www.selp2.com
6 http://www.tgmp.net
7 http://turkey.ashoka.org

4 Key Sustainability Issues

- Turkey's democratic deficits have prevented the achievement of consistently high economic growth. Turkey needs to consolidate and deepen democracy to provide the basis for sustainable development.
- Corporate governance is the most important source of risk for investors. Several governance issues stemming from ownership structures have implications for the sustainability of businesses and their attractiveness for SI.
- Turkey has a carbon-intense economy with an increasing energy shortage and dependence on imports. Turkey's climate change response strategy is vague, and the government is under heavy pressure from the EU.
- Major social issues that also have an impact on sustainable development are human rights, economic and social rights, and unemployment. Unemployment at 14 percent is the most pressing economic and social issue.
- Turkey offers opportunities for sustainable investments. The most attractive investments are in the renewable energy and energy efficiency areas.
- Adjustments to meet the regulatory requirements of the EU will create opportunities for those firms that have been actively managing their ESG risks.

"Turkey has the characteristics of an EM tiger in terms of its young population, geopolitical position, level of entrepreneurship, and the quality of human capital. However, so far it has displayed the characteristics of a temporary star with rapid growth in terms of brief spurts followed by period of deep instability and crises."

Prof. Dr. Ziya Onis, Ismail Emre Bayram *

* Onis, Bayram (2008)

A. Political Context

Political stability in Turkey has always been a key investor concern, given the country's history of frequent military interventions associated with major economic crises. An important feature of various governments' past policies has been inconsistency among their various elements and the consequent uncertainty they introduced into the decision-making process of the private sector. Discretionary government intervention was in general oriented toward short-term measures rather than introducing lasting solutions to the economy's structural problems. As a result, Turkey's growth has been volatile—resembling its major Latin American counterparts with considerable economic and political instability. This irregular and at times erratic attitude has led to an uncertain and severely deficient framework within which businesses had to operate (Bugra, 1994). The failure of various governments to formulate long-term economic policies provided a fertile ground where symbiotic relations between the business and the state led to rent-seeking behavior. Hence, Turkey's development has historically been based on an alliance between the state and national capital. The 1980 coup played a crucial role in Turkey's radical shift to neoliberal policies, similar to Brazil, Argentina, and Chile—leaving a deep imprint on the subsequent periods by imposing an "authoritarian constitutional framework, deinstutionalizing the party system, and presenting a major set-back for Turkey's

"Turkey is a market where foreign direct investments can get emerging market-returns at a developed-market risk. (...) Our European friend should realize that Turkey-EU relations are fast approaching a turning point. In the recent waves of enlargement, the EU smoothly welcomed relatively small countries and weak economies in order to boost their economic growth, consolidate their economies, and provide them with shelter. Not letting them in would have meant leaving those countries at the mercy of political turmoil that might emerge in the region. No such consideration has ever been extended to Turkey. Unlike those states, Turkey is a regional player, an international actor with an expanding range of soft power and a resilient, sizable economy. And yet, the fact that it can withstand being rebuffed should not become reason for Turkey's exclusion. Sometimes I wonder if Turkey's power is an impediment to its accession to the Union. If so, one has to question Europe's strategic calculations."

Recep Tayyip Erdogan, Prime Minister of Turkey *

* "The robust man of Europe". Newsweek, 17 January 2011

quest for EU membership" (Onis, 2010).

The Justice and Development Party's (Adalet ve Kalkınma Partisi–AKP) impressive election victory in 2002 against a background of a series of economic crises (in 1994, 1999, 2000, and 2001) was underpinned by an election manifesto that committed the party to extensive policy reforms that previous weak coalition governments had failed to implement. AKP has been more successful in containing fiscal deficits than its predecessors. During its first term of government, GDP growth was around 7 percent; and inflation, which was a chronic feature of the Turkish economy for three decades, fell from about 30 percent in 2002 to less than 10 percent in 2006. Tight fiscal discipline produced a surplus of almost 6.5 percent, which was prescribed under the IMF conditionality, bringing the ratio of public debt to national income down from almost 80 percent in 2002 to 41 percent in 2007. Investment analysts considered the stability, underpinned by a strong majority government, as a positive development.

The second phase of AKP government since 2002 has, however, been characterized by the struggle for civilian control of the armed forces and has been less impressive in terms of political stability, reform orientation, and economic performance. During this period, Turkey also suffered from the effects of the global financial crises, which helped to expose structural weaknesses in Turkey's growth performance. These weaknesses, including excessive dependence on external financial resources against weak domestic savings and the inability to channel resources to research and development to improve the long-term competitiveness of the real sector, had previously been disguised by the favorable global liquidity surplus.

One of the key lessons drawn from Turkey's growth history is that the country's democratic deficits have prevented the achievement of high economic growth. The consolidation and deepening of liberal democracy in Turkey is likely to contribute to better economic performance (Onis, 2010). The EU has played a crucial role in shifting the power configuration in favor of civilians in Turkey's domestic politics over the past few decades. Despite phases of weakening mutual commitments from time to time, the process of EU accession and the increasing integration of Turkey into international markets have changed both the nature of doing business and the role of the state in Turkey.

Foreign multinational companies have increased their presence in Turkey, competing with incumbent firms that were used to enjoying a home advantage due to their relations with the state. This process has induced Turkish diversified conglomerates to refocus their investment strategies, exiting mature sectors and exploiting new opportunities stemming from deregulation process. Meanwhile the democratization process is expected to provide a more solid base for sustained economic growth by consolidating the rule of law in Turkey, helping build the moral credibility of governments, providing the basis for judicial reforms, and reducing informality and corruption.

B. Global Proxies of Turkey's ESG Performance

Against the political background explained above, Table 4.1 below summarizes eight indicators drawn from a set of globally recognized country surveys, academic research, and official statistics as a proxy for overall country performance to give a broad overview of the corporate sector's ESG performance. Country rankings highlight how firms can stand out by voluntarily adopting policies and strategies that lead to superior performance in the long term. They also help investors and governments engage in improving the deficiencies as highlighted in country rankings. We must note, however, that the quality of economic statistics is often dubious in less developed countries. Rankings based on perceptions are specially problematic as these are context- and culture-dependent. Combined indices can also be oversensitive to updates; marginal revisions can substantially change the rankings. Such rankings should therefore be used as broad guidelines and as sources of additional knowledge, rather than as absolute insight.[1]

Turkey's ESG performance shows no peculiarity when compared to other EMs using global indicators, however, country rankings should be used as broad guidelines and as sources of additional knowledge, rather than as absolute insight.

Table 4.1 Turkey's ESG Performance

Category	Variable	Brazil	China	India	Russia	Turkey
Environmental	Environmental Performance Index 2010	63.4	49	48.3	61.2	60.4
Social	The Global Competitiveness Index - Rank 2010-2011	58	27	51	63	61
Social	The Global Competitiveness Index - Score 2010-2011	4.28	4.84	4.33	4.24	4.25
Social	HDI Rank 2010	73	89	119	65	83
Social	HDI Score 2010	0.699	0.663	0.519	0.719	0.679
Governance	Anti-director Rights Index 1998	5	1	5	4	3
Governance	Anti-self-dealing Index 2008	0.27	0.76	0.58	0.44	0.43
Governance	Ease of Doing Business - Rank 2010	127	79	134	123	65
Governance	Corruption Perceptions Index	3.7	3.3	3.5	2.1	4.4
Governance	Corruption Perceptions Index - Rank 2010	69	87	78	154	56

Source: Websites of relevant indices as of Nov 30th 2010; La Porta, Lopez-de-Silanes, Shleifer, and Vishny (1997, 1998); Djankov, La Porta, Lopez-de-Silanes and Shleifer (2008)

The variables used in Table 4.1 are explained below:

EPI (Environmental Performance Index)[2]

The EPI is developed by Yale University (Yale Center for Environmental Law and Policy) and Columbia University (Center for International Earth Science Information Network) in collaboration with the World Economic Forum and the Joint Research Centre of the European Commission. The 2010 EPI ranks 163 countries on 25 performance indicators tracked across 10 policy categories covering both environmental public health and ecosystem vitality. These indicators provide a

1 For a discussion, see Hendrik Wolff, Howard Chong, and Maximilian Auffhammer (2008). We acknowledge that HDI methodology referred in the paper is no longer in use, however, the general argument is valid for many indices, including the ones we use in this report.
2 http://epi.yale.edu/Countries/Turkey

gauge at a national government scale of how close countries are to established environmental policy goals. The EPI's methodology facilitates cross-country comparisons as well as analysis of how the global community is doing collectively on each particular policy issue. Turkey scored 60.4 out of 100 in 2010. Turkey scores average on environmental health but scores badly on ecosystem vitality, particularly in the subcomponents of biodiversity and habitat (17.1) and air pollution (46.2). It receives a full score for forestry.

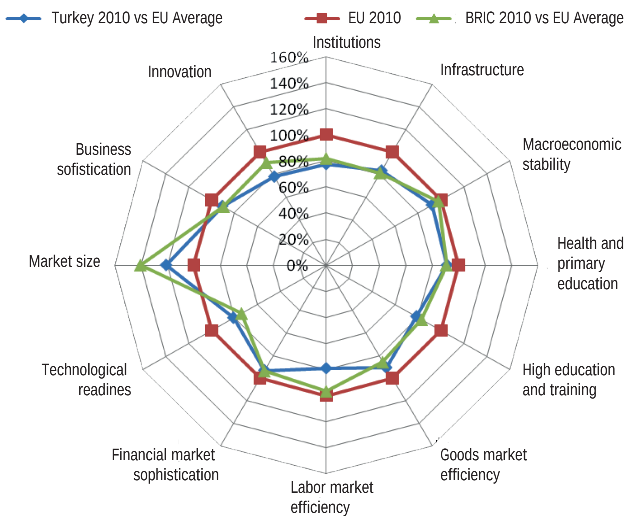
Turkey performs higher in product market efficiency, infrastructure, and business sophistication than the BRIC average. The nation performs significantly worse in innovation.

The Global Competitiveness Index[3]

The World Economic Forum (WEF) defines competitiveness as the set of institutions, policies, and factors that determine the level of productivity of a country. The level of productivity, in turn, sets the sustainable level of prosperity that can be earned by an economy. In other words, more competitive economies tend to be able to produce higher levels of income for their citizens on a sustainable basis. The productivity level also determines the rates of return obtained by investments (physical, human, and technological) in an economy. Because the rates of return are the fundamental drivers of the economy's growth rates, a more competitive economy is one that is likely to sustain its growth in the medium to long run. Turkey scores 4.25 and ranks 61st out of 139 economies. This score lies between Russia and Brazil, is somewhat worse than India, and Is considerably lower than China.

Turkey performs higher in product market efficiency, infrastructure, and business sophistication than the BRIC average as shown in Figure 4.1 below. The nation performs significantly worse in innovation. Turkey is classified in the high achievers group by the WEF, together with the BRIC countries and some of the transition countries.[4]

Figure 4.1 Turkey's Competitiveness in Comparison to BRIC vs. EU



Source: TUSIAD - Sabanci University Competitiveness Forum (REF), Federation of Industrial Associations (SEDEFED) (2010)

3 http://gcr.weforum.org/gcr2010/
4 Although Turkey seems to be performing worse in labor market efficiency, the statistics do not take into consideration the large informal market.

Human Development Index (HDI)[5]

Published by the Human Development Report, HDI is a composite index measuring average achievement in three basic dimensions of human development—a long and healthy life, knowledge, and a decent standard of living. The Human Development Report is an independent publication commissioned by the United Nations Development Programme (UNDP). Contributors to the report include leading development scholars and practitioners, working under the coordination of UNDP's Human Development Office. The HDI represents a push for a broader definition of well-being and provides a composite measure of three basic dimensions of human development: health, education, and income. Between 1980 and 2010, Turkey's HDI rose by 1.2 percent annually from 0.467 to 0.679, which gives the country a rank of 83 out of 169 countries. As per the subcategory of sustainability, which is an adjusted value of net savings as a percentage of GDP, Turkey scores 8.3 percent against 35.2 percent for China, 5.2 percent for Brazil, 24.2 percent for India, and 1.6 percent for Russia.

Anti-Director Rights Index

The anti-director rights index, reported in La Porta, Lopez-de-Silanes, Shleifer, and Vishny (1998), is available for 49 countries and is based on laws in force circa 1993. The index covers the following six areas: (1) vote by mail; (2) obstacles to the actual exercise of the right to vote (i.e., the requirement that shares be deposited before the shareholders' meeting); (3) minority representation on the board of directors through cumulative voting or proportional representation; (4) an oppressed minority mechanism to seek redress in case of expropriation; (5) preemptive rights to subscribe to new securities issued by the company; and (6) the right to call a special shareholder meeting. The general principle behind the construction of the anti-director rights index is to associate better investor protection with laws that explicitly mandate, or set as a default rule, provisions that are favorable to minority shareholders. Higher values indicate better investor protection. Although the index is based on data collected in1993, the Commercial Code has not been changed since 1956. Turkey seems to be less minority-investor friendly than BRIC, except China.

> **Turkey's insiders have more free hands than those in Brazil, India, and Russia but are more restricted than the insiders in Chinese corporations.**

Anti-Self-Dealing Index

The "anti-self-dealing index", developed by Djankov, La Porta, Lopez-de-Silanes and Shleifer (2008), is a new measure of legal protection for minority shareholders against expropriation by corporate insiders and hence a more relevant measurement for countries with insider dominance like Turkey. Assembled with the help of Lex Mundi law firms, the index is calculated for 72 countries based on legal rules prevailing in 2003 and focuses on private enforcement mechanisms, such as disclosure, approval, and litigation, which govern a specific self-dealing transaction. Higher values indicate better investor protection. According to anti-self-dealing index, Turkey's insiders have more fee hands than those in Brazil, India, and Russia but are more restricted than the insiders in Chinese corporations.

Ease of Doing Business (Rank)

Economies are ranked on their ease of doing business, from 1 to 183 by the World Bank Group. A high ranking on the ease of doing business index means the regulatory environment is more conducive to starting and operating a local firm. This index averages the country's percentile rankings on nine topics, made up of a variety of indicators, giving equal weight to each topic. The rankings are

5 http://hdrstats.undp.org/en/countries/profiles/TUR.html

from the *Doing Business* 2011 report, covering the period June 2009 through May 2010.Turkey ranks the 65th, and, as such, it is significantly easier to do business in Turkey than in Brazil (127), India (134), and Russia (123) and somewhat easier than in China (79).

Corruption Perceptions Index

The annual Corruption Perceptions Index (CPI), first released in 1995 by Transparency International (TI), has been widely credited with putting the issue of corruption on the international policy agenda. The CPI ranks more than 150 countries by their perceived levels of corruption, as determined by expert assessments and opinion surveys. TI is a global civil society organization against corruption. The 2010 CPI measures the degree to which public sector corruption is perceived to exist in 178 countries around the world. The index scores countries on a scale from 10 (very clean) to 0 (highly corrupt). The 2010 results are drawn from 13 surveys and assessments published between January 2009 and September 2010. Turkey scored 4.4 in this survey, ranking it as perceived to be less corrupt than any of the BRIC countries. There was, however, no improvement over Turkey's 2009 score.

In summary, Turkey's ESG performance shows no peculiarity when compared to other EMs using global indicators. Based on EPI, Turkey's environmental performance is somewhere in the middle of the remaining EMs listed in Table 4.1. Turkey performs better overall than India and China and somewhat worse than Brazil and Russia. We can also conclude that Turkey occupies an intermediate place in the rankings with other EMs for social performance.

In terms of governance performance based on the anti-self-dealing index (and the anti-director rights index), Turkey again has an average performance, whereas both the Ease of Doing Business Index and the CPI suggest a relatively better governance performance compared with the emerging economies listed in Table 4.1.

Common metrics allow comparability but do not provide much information about specific issues, as summarized in Figure 1.1 in the Introduction, and their implications for sustainability in Turkey.

C. Governance Issues and Implications for Sustainability

An estimated 40 percent of the market capitalization of the ISE is accounted for by 13 holding companies and their 8 affiliated banks. Eleven of these 13 holding companies are controlled by 11 leading families.

Corporate governance is regarded as the most important pillar of sustainability by investors (EIRIS, 2009). Whether a firm manages its environmental and social risks is directly related to the quality of its governance. UN PRI's Clearinghouse, which facilitates investors' collaborative actions against malpractices of investee firms, is reported to gravitate around corporate governance issues by 35 percent, followed by environmental issues by 26 percent and social issues by 17 percent (UNEP FI and UN Global Compact, 2010).

Corporate governance issues are contingent on ownership structures. Controlled firms have different governance issues than dispersedly owned firms (Bebchuk and Hamdani, 2009). The corporate governance landscape in Turkey is characterized by concentrated ownership in the form of family-controlled, diversified business groups. An estimated 40 percent of the market capitalization of the ISE is accounted for by 13 holding companies and their 8 affiliated banks. Eleven of these 13 holding companies are controlled by 11 leading families.
A holding company is generally majority owned by family members directly or indirectly—for example, through an offshore trust—and constitutes the apex of

the group and houses the coordination functions. Some of these apex firms are listed on the national stock exchange alongside the operational firms controlled by that apex firm. The cross shareholdings between those firms affiliated with a business group and a full list of firms affiliated with that group or controlled by the same shareholder are not fully transparent.

Ararat, Orbay and Yurtoglu (2010) reports that holding companies hold majority control of 54 of the 122 companies that constituted the ISE 100 in 2006 and 2008. The mean ownership is equal to 48.34 percent of the outstanding shares. This situation raises concerns about insiders using intragroup transactions to exploit minority shareholders. As is common in many other EMs, such transactions can be used for asset stripping, transfer pricing, and other corporate governance abuses; and most analysts agree that intragroup transactions remain a major corporate governance weakness in Turkey.

Table 4.2 Ownership and Control Structures

Panel A summarizes ownership data from 2006 at the direct level of ownership. We provide the means of the shareholdings of the largest direct shareholder in the full sample and by the identity of the largest shareholder. We also provide information on the concentration of ownership by the three largest direct shareholders (CR3) and on the fraction of shares freely floating on the ISE (Free Float). Panel B summarizes the ultimate ownership structures in 2006. To identify the ultimate shareholders, we follow all ownership chains at the direct level until we determine that the ultimate shareholder is a natural person or the state. Our data sources do not allow us to follow the ultimate owners of foreign entities. Hence, we report them as a separate ultimate owner category.

Panel A: Direct Ownership

		Largest Shareholder	CR3	Free Float
Identity	N	Mean	Mean	Mean
Holding Company	54	48.34	63.03	34.36
Non-financial companies	16	52.32	63.79	31.40
Financial Companies	10	50.37	64.11	34.42
Families	14	34.53	47.85	46.09
Foreign Companies	15	67.06	73.63	26.06
State	3	53.98	61.68	38.25
Miscellaneous	6	52.80	65.35	34.54
Total	122	50.14	62.86	34.38

Panel B: Ultimate Ownership

		Voting Rights	Cash Flow Rights	Wedge
Identity	N	Mean	Mean	Mean
Families	82	55.03	44.06	0.52
Foreign Companies	15	69.28	66.48	0.07
State	3	53.98	53.98	0.00
Miscellaneous	18	53.26	39.65	0.50
Total	122	56.44	46.27	0.45

Direct foreign ownership is present in 15 cases with a mean stake of 67 percent. The first three largest shareholders own together about 63 percent of the equity on average. The fraction of equity held by dispersed shareholders (free float) is about 35 percent. It is usual that the controlling owner has more than a single direct ownership stake. Combining all ownership stakes under the control of the ultimate owner, the true fraction of control rights of families is about 56 percent of the outstanding shares. The cash-flow rights of families however average only 46.27 percent. In more than half of family-controlled companies,

It is usual that the controlling owner has more than a single direct ownership stake. Combining all ownership stakes under the control of the ultimate owner, the true fraction of control rights of families is about 56 percent of the outstanding shares.

there are substantial deviations of cash-flow rights from control rights leading to an average wedge of 0.45 (wedge= cash-flow rights/voting rights). This wedge provides controlling shareholders incentives to make value-reducing decisions from the perspective of outside shareholders. Research shows that such deviations are associated with value discounts and inferior operating performance in Turkish companies, indicating the existence of sizable private benefits of control (Yurtoglu, 2003).

CMBT's Corporate Governance Principles recommend a significant level of independence for boards and their functioning. The only legal requirement on board composition of listed firms is, however, the formation of an audit committee.

External mechanisms of corporate governance, such as the market for corporate control, do not exist at an effective level due to highly concentrated ownership structures. Voluntary actions by individual companies therefore constitute an important mechanism to reduce the extent of agency problems. In 2003, the Capital Markets Board (CMB) of Turkey adopted a set of corporate governance guidelines inspired by OECD's Corporate Governance Principles based on a "comply or explain" approach. The principles recommend a significant level of independence for boards and their functioning. The only legal requirement on board composition of listed firms is, however, the formation of an audit committee. In 2005, listed firms were obliged to issue a corporate governance compliance report, explaining their level of compliance with the guidelines. Although the guidelines contain more than a 100 provisions, reports that typically were issued were only two to three pages and provided very little insight into the governance of firms (Ararat and Yurtoglu, 2006). The boards of banks are subject to separate legislation and stricter monitoring with respect to both the composition and the committee structure of their boards, as well as the qualifications of board members.

A comprehensive assessment of the effectiveness of the corporate governance system in Turkey conducted by OECD (2006), explains some of the contingencies of Turkish boards. The report suggests that controlling shareholders informally select nominees with little or no input from either board members or institutional investors. Controlling shareholders then exercise their decisive voting power to elect those nominees solely selected by them. A survey conducted by Deloitte Turkey (2009) provides some insight into the role of the boards in Turkey. According to the survey, 30 to 40 percent of directors agreed that their boards had no role in CEO succession planning or in their CEO's performance evaluation, while more than 80 percent agreed that their board contributed to the CEO's performance by providing advice, evaluating financial performance, formulating long-term strategies, and identifying potential opportunities and risks. The results suggest that important decisions are made outside of the board by the owners.

Yildirim-Oktem and Usdiken (2010) surveyed boards of 299 listed and unlisted firms affiliated with 10 family-controlled business groups. They reported that family members occupy roughly 20 percent of board positions, and an additional 47 percent of directors are salaried managers employed by the holding firm or in firms controlled by the same family. Thirty-three percent of the remaining board positions are occupied by outsiders. Only 10 percent of outsiders hold external management positions, and 40 percent do not have a full-time occupation. Ararat, Orbay, and Yurtoglu (2010) find a negative relationship between independent board members and firm performance. They argue that this reflects the fact that nomination by controlling shareholders leads to "affiliated" board members, even if they are independent according to CMBT criteria. This weakness has been noticed by international investors, for example, F&C suggests that listed companies should be mandated to have one third independent members, that the independence of audit committees should be regulated, and that independent members should be nominated directly by the boards rather than by controlling shareholders.

Businesses groups remain as important actors in the corporate landscape.

SI in Turkey: Key Sustainability Issues

Measured by existing standards of good corporate governance, it is fair to argue that Turkish companies are run in line with the interests of their insider/owners. Minority shareholders and stakeholders of listed companies do not have much influence in decision-making processes. These issues have the following implications for the sustainability of businesses and their attractiveness for SI:

- Interfamily conflicts frequently place businesses at risk by diverting management attention from business to family matters. These conflicts tend to become more frequent as firms become older, and control is gradually shared between successive generations. Succession issues disrupt businesses as they lead to a reallocation of control within the family.
- The overlap among owners, board members, and executive managers makes it difficult to separate the powers and accountability of management from those of the board and the controlling shareholders. This overlap creates challenges for the engagement activities of minority shareholders.
- Growth opportunities are not fully used if they require external finance because families are reluctant to dilute their shares and forego their private benefits
- The controlling shareholders' desires to maximize profits for the whole business group sometimes conflict with the objective of maximizing the profitability of individual companies.

Although these issues apply to all EMs where family ownership and business group structures are common, these structures are more persistent in Turkey because business groups also include investment banks that facilitate the functioning of internal capital markets through which free cash is allocated according to the priorities of the business group.

Formal and informal norms can promote common business practice. While the power to create formal norms resides in the policy-making institutions, firms can also exert influence on the preferences of the policy makers. They can also take an active role in influencing institutions to adopt a caring agenda. In Turkey, a handful of powerful families have the potential to shape the norms by disseminating best practices, setting examples and supporting civil society organizations embracing the sustainability agenda.

Families

Families as business owners, play an important role in the development of sustainable corporations with long term perspectives. Although a comparable assessment of the sustainability performance of Turkish firms, as previously mentioned, does not exist, powerful families such as Eczacibasi, Kocabiyik, Sabanci, Koc, Yazicilar and Ozilhan stand out in opinion surveys about social responsibility. According to the 2010 social responsibility survey conducted by Capital magazine and the market research firm GSK- Turkey, non-corporate respondents rank Sabanci Holding as first in 11 out of 12 categories in social responsibility, namely: protection of nature and environment, art and culture, education, healthcare, protection of family institution, protection of history, volunteering, community support, business ethics, human rights and consumer protection. The corporate sector respondents have a slightly different perception; Ezcacibasi Holding is ranked second as the leading family owned business in social responsibility after Turkcell (a non-family owned business). Koc Holding follows Turkcell and Sabanci Holding is ranked fifth. Sustainability is a key strategic theme in the corporate communications of all of these groups, but it is more emphasized by Sabanci Holding. The corporate sector however, considers Guler Sabanci as the most successful business leader in social responsibility. The corporate sector representatives that we interviewed noted Borusan Holding (controlled by Kocabiyik family), Coca Cola Icecek (Coca Cola bottler, a joint venture between Coca Cola Company and Yazicilar and Ozilhan families), Ezcacibasi Holding (controlled by Eczacibasi family), and Arcelik (controlled by Koc family) as firms with the best practices in sustainability management. Business groups controlled by families are rivals in multi-point competition, but those families are closely connected through social and business networks. They have the potential to play a leadership role in promoting the sustainability agenda as concerned owners.

Due to the delay in ratifying the UNFCCC, Turkey was unable to participate in the Kyoto Protocol negotiations. Turkey ratified the Kyoto Protocol in 2009 and is not included in the Annex B list of countries that are obliged to have quantified emission limitations or reductions for the first five-year commitment period ending in 2012. Turkey cannot, however, benefit from the flexibility mechanisms of the Kyoto protocol available to other developing countries and can only participate in voluntary carbon markets.

D. Environmental Issues and Implications for Sustainability

International Agreements and Conventions on Climate Change and Turkey

Turkey was included in both the Annex I and Annex II countries when the United Nations Framework Convention on Climate Change (UNFCCC) was adopted in 1992. However, Turkey only ratified the convention in 2004 after reaching an agreement in Marrakesh (2001) to remove itself from the Annex II list and to recognize its unique condition as a developing OECD country.[6] Under the convention, Turkey is committed to implementing climate change mitigation, adaptation, research and education, training, and public awareness measures, as well as to submitting an annual report of inventories of all anthropogenic GHG emissions from sources and removals from sinks; but it has no obligation to provide financial support to developing countries.

Due to the delay in ratifying the UNFCCC, Turkey was unable to participate in the Kyoto Protocol negotiations. Turkey ratified the Kyoto Protocol in 2009 and is not included in the Annex B list of countries that are obliged to have quantified emission limitations or reductions for the first five-year commitment period ending in 2012. Turkey cannot, however, benefit from the flexibility mechanisms of the Kyoto protocol available to other developing countries and can only participate in voluntary carbon markets.

The vagueness in Turkey's position with respect to international climate developments delayed the establishment of the National Climate Change Policy, which was entered into force only in May 2010. Even though the EU accession process has been successful in triggering rapid environmental improvement, the absence of a national policy and its implementation in Turkey's regulatory and financial structure has delayed the establishment of well-formed administrative structures and climate change strategies at various levels, causing confusion in both the private and public sectors.

The inadequacy of the organizational structure and action plans to manage climate change in Turkey is evident from the strategy document, as it specifies the main strategies: (i) initiating organizational restructuring on climate change in concerned institutions, (ii) establishing necessary infrastructure for GHG inventories, (iii) preparing a national climate change action plan, and (iv) developing policies climate change policies in cooperation with all stakeholders.

Currently, Turkey is the only Annex-I country that has not set mitigation targets for the post-2012 period and also the only OECD country that does not have a national emissions reduction target for 2020. Furthermore, Turkey has no national climate change action plan in place; hence the vagueness with respect to climate change strategies remains unresolved while the EU accession process places strong pressure on Turkey to commit to emission reductions.

Turkey maintained its position in the Cancun negotiations, and its unique status was reconfirmed following the agreement in Marrakesh.

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6 Annex I countries: industrialized countries and economies in transition; Annex II countries: a subgroup of Annex I countries that pay for the costs of climate change mitigation and the adaptation strategies of developing countries; Non-Annex I countries: developing and least developed countries.

Increasing Emission Levels and High Energy Demand

The European Economic Area (EEA) provides useful insights in terms of Turkey's emission facts: Between 1990 and 2007, during which emissions doubled among all EEA member countries, Turkey experienced the largest per capita GHG emissions increase with 75 percent. The increase in the total emissions from Turkey is mainly attributable to the country's important demographic growth (+ 25 percent over the period) and economic development. Turkey has, however, the lowest GHG emissions per capita among all EEA member countries. Energy production and its use are the largest contributors to GHG emissions with 77 percent of Turkey's total emissions. Such growth is expected to continue alongside the increase in industrialization and population.

Table 4.3 Indicators for Turkey's Greenhouse Gas Emissions

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Emission Per Capita (tons/person)	2.6	2.6	2.7	2.8	2.7	2.9	3.2	3.3	3.3	3.2	3.5	3.2	3.3	3.5	3.6	3.8	4.0	4.4	4.2
Total Emissions (Mn. Tons)	187.0	199.1	210.2	221.7	217.2	237.5	258.6	271.9	274.0	274.8	297.0	278.1	286.1	302.8	312.3	329.9	349.6	380.0	366.5

Source: TurkStat, Population and Development Indicators

Because Turkey has large coal reserves, the use of coal is expected to multiply over the next decade in order to provide electricity for the growing population and expanding economy. Turkey does not have significant domestic natural gas reserves, and 99 percent of its gas is currently imported. Natural gas consumption has grown rapidly in Turkey over the past two decades (with an average annual growth rate of 24 percent) mainly as a means of reducing growth in the usage of the environmentally unsustainable domestic lignite.

Turkey has an unsustainable car and oil-based transportation system. Improvements in fuel quality, shifts toward new technology vehicle engines, an expansion of the metro and light rail networks, and as extensions and improvements to the railway network are some of the significant measures undertaken in recent years. In addition to ongoing projects, Turkey needs to improve its transportation strategy to reduce transportation-related emissions.

Another important sector where efficiency measures are needed is the building sector. A significant cause of increased electricity demand may be attributed to heating and cooling systems. Improving insulation and introducing more energy-efficient appliances could significantly reduce electricity demand. A recently introduced program involving the energy labeling of buildings in Turkey is an important step toward improving energy efficiency in the building sector (IEA 2009).

Because domestic resources are unable to meet the demand, Turkey remains a net energy importer with a high ratio of import dependency reaching 72 percent--creating additional incentives to favor energy efficiency and renewable energy options. Turkey's low carbon policies are focused primarily on energy efficiency and renewable energy options. Turkey has an abundance of renewable energy resources, including hydroelectric, wind, and geothermal and solar power, but there has been a serious lack of regulatory interventions to promote renewable energy. The long-awaited Renewable Energy Law, eventually enacted on the January 8, 2011, includes an incentive scheme to promote renewable energy use and production. Nuclear power is also expected to become one of the

Because domestic resources are unable to meet the demand, Turkey remains a net energy importer with a high ratio of import dependency reaching 72 percent--creating additional incentives to favor energy efficiency and renewable energy options.

major options for diversifying Turkey's power-generating capacity, but this raises significant controversies. The government has plans to build two nuclear power plants against which the local communities have been campaigning with support from local and international NGOs. The social and environmental impacts of mushrooming hydroelectric power stations have also caused severe opposition in the country and abroad, leading to the postponement of some projects.

Most Turkish companies are not yet fully aware of the consequences of climate change for their businesses for the following reasons:

- Uncertainty regarding Turkey's position with respect to international agreements
- Absence of a national climate change response strategy
- Absence of emissions calculation standards for Turkey, as explained above
- Renewable resources still constituting an insufficient energy resource, considering total energy demand.

Water Scarcity

A large part of Turkey is in danger of desertification due to erosion, diminishing flora, climate change, and, most importantly, improper use of water resources.

The average temperature increase in Turkey between 1941 and 2007 was 0.64C° per 100 years. This may seem low in comparison with the world average of 0.83; however, southern parts of Turkey are considered to be high-risk areas for climate change as temperature increases are significantly higher. A similar trend is observed with regard to the decrease in rainfall intensity in Turkey's southern regions, which has resulted in serious drought periods over the last 20 to 30 years. As a consequence, Turkey's water resources declined from 4,000 cubic meters per person per year in the1960s, to 1,600 cubic meters per person per year in the 2000s. These resources are expected to decrease further to 1,000 cubic meters per person per year by 2030.[7]

A large part of Turkey is in danger of desertification due to erosion, diminishing flora, climate change, and, most importantly, improper use of water resources. Water management is further challenged by the uneven distribution of water resources and topographical barriers within the country. The fight against desertification is covered in the National Environment Action Plan in recognition of the need for improvements with regard to water regulations, technology, and resource use. The Forestation Action Plan for 2008–2012 is expected to be effective in preventing erosion. Furthermore, it is expected that forests will absorb 181.4 million tons of carbon within the first 20 years of the action plan. Turkey is one of the countries which managed to increase its forests as a percentage of the total land.

Responses to the Carbon Disclosure Project (CDP) report reveal that manufacturing companies are aware of the water scarcity risks stemming from climate change.

7 The population of Turkey is expected to reach 100 Mn. by 2030.

Pollution

Water pollution resulting from the dumping of chemicals and detergents and air pollution, particularly in urban areas is a critical issue in Turkey as demonstrated by EPI values for pollution.

The EU accession process has helped Turkey to improve regulations with respect to fuel quality, consumer information, industrial air pollution, and pollution from domestic heating. One hundred sixteen monitoring stations in 81 provinces have been established with a plan to reach 209 by 2014, including the establishment of the Marmara Clean Air Center in 2011. All of these efforts have been successful in improving the air quality in Turkey; however, the institutional and legal framework on water quality remains unsatisfactory. Water management is fragmented and not organized at the river basin level. Transboundary consultations on water issues are in the very early stages.

Waste Management

The regulatory framework (since 2004) regarding waste management is almost fully in line with EU requirements, including the control of hazardous waste; receipt of waste from ships; and control over waste, end-of-life vehicle, and sanitary land filling of waste. Only 43 percent of total waste is being disposed in compliance with the legal framework, however. Recycling workers fill in the gap as high unemployment, internal migration, crime, and other social and economic problems force people to work as recycling workers in Turkey. Recycling workers are organized in an association and have their own periodical magazine. Attempts to formalize the recycling process have met with opposition due to the social impact on this informal part of the recycling business.[8] It has also been argued that recycling workers, through their unofficial institutions, work more efficiently than through any possible municipality-coordinated structure; and the effective recycle rate is relatively high in Turkey.

Nature Protection

The continuing rapid loss of natural habitats calls for urgent solutions in Turkey. However responsibility for nature protection is not clearly allocated among institutions, delaying the implementation of the required legislation and institutional frameworks. Legislation in other policy areas, such as energy, needs to be reassessed with respect to possible links with nature protection. Turkey's biodiversity policies received a very low grade in the EPI assessments. Another issue that requires attention is land degradation due to poor agricultural practices, partly due to the fragmented nature of farming land.

The continuing rapid loss of natural habitats calls for urgent solutions in Turkey. However responsibility for nature protection is not clearly allocated among institutions, delaying the implementation of the required legislation and institutional frameworks.

8 See http://www.sabancivakfi.org/eng/programlar/fark_yaratanlar/bolumler/sezon02/bolum06/bolum06.php

"Almost everywhere across the middle-income landscape, disparities in living standards are enormous. Let me give you an example from Turkey. A recent World Bank study found that a fifteen year-old boy born to an educated mother, in a small family in an urban area in Central Turkey had a 95 percent chance of being enrolled in school. At precisely the same time, a fifteen year-old girl born to a mother with no education, in a household with six or more children in a rural area of Eastern Turkey had an enrollment probability of approximately only 10 percent. Naturally, these boys and girls cannot be held responsible for the families to which they were born, and yet so much of their lives will be pre-determined by the very unequal opportunities they get at the start."

Sri Mulyani Indrawati, World Bank *

* Speech delivered at the Institute for Strategic and International Studies (ISIS), Kuala Lumpur, November 8, 2010

E. Social Issues and Implications for Sustainability

Social issues with an impact on sustainable development can be classified under the following headings: human rights, economic and social rights, and employment.

Turkey has made significant progress in improving the institutional infrastructure for protection of human rights with EU accession as an anchor; however, Turkey's human rights institutions lack resources, independence, and impact (EC, 2010). The key issues related to civic and political rights include freedom from torture, the right to a fair trial, freedom of expression, freedom of speech, freedom of assembly, and freedom of association. Ratification of the Optional Protocol to the UN Convention against Torture (OPCAT) is still pending before Parliament. Turkey has not ratified three additional protocols to the European Convention on Human Rights (ECHR). From October 2009 to November 2010, 5,728 new applications have been filed with the European Court of Human Rights by Turkish citizens.

Issues regarding economic and social rights center on women's rights, children's rights, child labor, socially vulnerable persons and persons with disabilities, labor and union rights, and homophobia. Progress has been made in all of these areas, thanks to the EU accession process. Recent changes in trade union legislation highlight these positive trends, but trade union rights are not yet in line with the EU standards and ILO conventions, as indicated by the fact that the number of workers covered by collective agreements is as low as 3 percent of registered workers. This gap indicates potential for tension between employees and management and the likelihood of disruptions to businesses as these rights are improved and enforced. The Labor Unions Law was changed in 2010 to remove some of the restrictions on unionization; this was partly in response to demand and partly in compliance with the EU directives.

The implications of human rights issues for business manifest themselves in social policy and employment and labor laws. The labor law does not apply to certain sectors of the economy where informality is substantially high. Among all, **health and safety at work** remains a key issue, given the size of the informal market and low level of unionization. For example, 73,000 occupational accidents were reported in official statistics in 2008. Official statistics do not cover the informal sector, which has less stringent health and safety measures. The number of labor inspectors is very low, compared to the size of the economy and the labor market. Fatal accidents in the mining and quarrying sectors are common. Fatal silicosis disease is widespread among workers working in jeans sandblasting workshops. Ship-building yards continue to report fatal accidents regularly. The low rate of unionization and **marginalization of labor unions**, a legacy of past military rule, means that the government has an important role to play in improving working conditions. International initiatives, such as the Clean Cloths Campaign that promotes industry-specific codes of conduct, are also driving improvements in corporate practices (Ararat and Bayazit, 2009).

Unemployment is the most pressing economic and social issue. The employment rate was 44.7 percent in June 2010; whereas the official unemployment rate was 14 percent. Exacerbated by the Kurdish problem, the participation in the work force in the southeast is even lower at 27 percent. The legal framework for unemployment benefits has been improved, but the current rate of coverage is less than 10 percent. At least 44.8% of unemployed people are furthermore unregistered and are therefore unprotected by labor law or pension rights. The implication for business is that dismissals cause severe unrest and protests and

The percentage of the population at risk of poverty remains high, especially in agriculture and the informal sectors. Disabled people and children continue to face a disproportionate risk of poverty. (...) Women's employment and labor force participation remains the lowest in OECD countries. Women are disproportionately affected by informal work conditions.

receive public support.[9] On the other hand, high formal sector labor costs tend to reduce competitiveness and encourage informality. Turkey's severance pay scheme is among the most generous in OECD countries. The minimum wage is higher than in almost all new EU countries and Is binding in lower-income regions of Turkey. To enhance competitiveness and formal-sector employment, reforming minimum wage and severance pay should go hand in hand with measures to shrink the informal economy.[10]

The percentage of the population at risk of **poverty** remains high, especially in agriculture and the informal sectors. Disabled people and children continue to face a disproportionate risk of poverty. In January 2010, the government lifted budget-related staff limitations on the employment of persons with disabilities in public institutions. The official statistics report that the percentage of people below the poverty level remains relatively stable at around 17 to 18 percent, based on a calculation of the income required to raise a family of four above poverty. Turkey no longer has citizens with incomes below $1 per cay, and only 3 percent of the population has an income of $2 per day.

There is no definition of direct and indirect discrimination in Turkish legislation. Labor law is applicable only after the commencement of a labor contract. Progress has been made in the provision of equal opportunities, but the implementation requires substantial resources.

Women's employment and labor force participation (22.3 percent and 26 percent respectively) remains the lowest in OECD countries. Women are disproportionately affected by informal work conditions.

Overall, despite the significant and continuous improvements in social policies and the legal framework, budgetary limitations will continue to represent a barrier to their implementation and enforcement. The EU accession process will continue to be an anchor and set the direction for changes in line with EU policies and frameworks. Meanwhile, health and safety; discrimination in recruitment, employment, and pay; and the threat of poverty and exclusion of the unemployed are items about which investors need to be aware in assessing the ESG risks and policies of firms.

RED FLAGS *

Verité considers the following to be "red flags" or indicators of compromised labor protection in Turkey:

• Suppression of Freedom of Association in Export Processing Zones

• Abuse of Foreign Contract Labor

* Verité (2011), An Assessment of Labor Risks, Country Report: Turkey.

9 Employability is related to the quality of education. Vocational education has long been ignored due to the populist policies, which led to mushrooming local universities with significant deficits in faculty and a high school education system focused on success rates in centrally administered university entrance exams. Philanthropic investments by the corporate sector aim to close the gap; privately funded universities, on the one hand, and vocational training programs, on the other, try to match the skill sets required by the economy with learning outcomes.

10 Turkey—2010 Article IV Consultation and Post-Program Monitoring: Preliminary Conclusions, May 26, 2010.

*"Better access to finance for the agricultural sector could support developing economies of scale and could help adjustment to international (especially EU) quality standards that would improve export market access." **

* EBRD.2010.Recovery and Reform, London, UK.

F. Opportunities for Sustainable Investments

Turkey offers opportunities for SIs. The most attractive investments are in the renewable energy and energy efficiency areas. Improving energy efficiency is in the agenda of every industrial firm. Adjustments to meet the regulatory requirements create market opportunities for those firms that have been proactively managing their ESG risks. The recent enactment of the Renewable Energy Law provides incentives for renewable energy investments.

An easing of the Kurdish problem through the political process will create opportunities for a retail sector that is already buoyant. Discount retail chains have been highly successful in large cities in Turkey. There is an opportunity for expansion to the smaller cities and to the southeast Anatolia with products designed specifically for lower-income customers.

Banking has yet to reach a large part of the lower-income population through innovative strategies and business models. The mortgage sector is in its infancy and is expected to grow as interest rates continue to fall.

Responsible practices in lending can be effective in promoting sustainability in the construction sector by assessing the quality of land development projects and their impact on environment, specifically on water reservoirs.

The bond market, which is expected to grow fast, can be instrumental for issuers to attract sustainable investors through sustainability certified/rated bonds or through better disclosure of environmental and social impacts.

Consulting firms will also have opportunities to help Turkey's corporate sector adapt to growth with constraints. The upsurge of environmental consulting firms in 2010 indicates that such opportunities are not missed by entrepreneurs.

Turkey offers opportunities for SIs. The most attractive investments are in the renewable energy and energy efficiency areas. Improving energy efficiency is in the agenda of every industrial firm. Adjustments to meet the regulatory requirements create market opportunities for those firms that have been proactively managing their ESG risks. The recent enactment of the Renewable Energy Law provides incentives for renewable energy investments.

5 Enabling Environment

- Disclosure of environmental and social performance is not mandatory in Turkey.
- Due to spillover effects of global initiatives, there is an upsurge in voluntary nonfinancial disclosure and sustainability reporting in 2010.
- Effective civil society organizations in Turkey are few and focus on environmental issues.
- Labor unions lack power due to high unemployment rates and the legacies of military interventions.
- Academic institutions play an important role through research and advocacy centers and focus on ESG issues.
- Major influences driving ESG performance are international.

Over the past few decades, significant transformation has occurred in the nature of Turkey's economic system. Turkey has completed its integration with the global economy during the past decade—a process that also exposed Turkish corporations and society to external influences, predominantly from Europe. Turkey has a number of drivers that can support and enable the emergence of SI in Turkey:

- Voluntary Disclosure which accelerated in 2010
- Forthcoming laws and regulations

  - Legal and regulatory improvements in environmental management and social policies driven by EU accession process as a driver and as an anchor.
  - The new Commercial Code, which will introduce a radical change in the way Turkey's joint stock companies are managed and held accountable.
- Civil society, which, with the ongoing democratic consolidation process, is becoming a significant player.
- ISE's Sustainability Index Project and the government's ambitions to make Istanbul a regional financial center

These enablers are explained below.

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A. Voluntary Disclosure

Turkey has taken considerable steps forward in improving the quality of disclosure since 2001, starting with improvements in banking regulation. The current legal and regulatory framework builds on initial reform components, including corporate governance guidelines (CGG) issued in 2003 by the CMBT, directives related to audit and accounting standards and practices issued in and after 2003 by CMBT, the new banking law and directives issued by the Bank-

"As an investor, we feel that sustainability issues are sufficiently material to company performance to warrant disclosure."

Steve Waygood, Aviva*

* Steve Waygood, Head of Sustainability, Research and Engagement at Aviva (Financial Times, November 28, 2010)
Aviva is the 50% partner of AvivaSa, one of the largest pension firms in Turkey

ing Regulatory and Supervisory Agency (BRSA), and adoption of International Financial Reporting Standards (IFRS) in 2005 for listed companies. Although compliance with the CGG is voluntary, reporting on compliance on a comply-or-explain basis is mandatory. CGG covers a wide range of corporate practices in four categories: shareholder rights, financial disclosure, board composition and processes, and stakeholder relations. The last section includes recommendations with respect to companies' environmental and social policies.

A four-year study, starting in 2003, conducted by Sabanci University's Corporate Governance Forum(CGFT) in cooperation with Standard and Poor's, monitored and assessed corporate disclosure trends in response to regulation and market circumstances. The disclosure assessment covered three components of disclosure; ownership structure and shareholder rights, financial information, and board and management structure and processes. The final report, published in 2008, informed that after initial improvements from 2004 to 2005, disclosure converged around IFRS, which became mandatory in 2005. Figure A5.1, presented in the Appendix, shows the disclosure trend following the launch of the CGG in 2003. During the four-year period, the highest disclosure scores were achieved by different companies each year with some overlaps as shown in Table 5.1 below. An interesting result of the survey was the inconsistency of disclosure levels within the same business groups (Balic and Ararat, 2008).

Table 5.1: Top Five Companies for Disclosure in Alphabetical Order (2005–2008)

2005	2006	2007	2008
Akbank	Akbank	Akbank	Anadolu Efes Biracilik ve Malt Sanayi
Anadolu Efes Biracilik ve Malt Sanayi	Anadolu Efes Biracilik ve Malt Sanayi	Anadolu Efes Biracilik ve Malt Sanayi	Aygaz
Dogan Yayin Holding	Koc Holding	Enka Insaat ve Sanayi	Koc Holding
Koc Holding	Petrokimya Holding	Koc Holding	Koc Holding
Turkcell Iletisim Hizmetleri	Turkcell Iletisim Hizmetleri	Turkcell Iletisim Hizmetleri	Turkcell Iletisim Hizmetleri

Source: Ararat, Balic (2008)

Each year's result captures disclosures based on annual reports and websites of the previous year.

During the four years of the study, financial transparency has been improved to a good level, thanks to the adoption of IFRS; however, there has been little improvement in other areas. The most opaque areas remain ownership structures, voting arrangements between shareholders, the relationship between parents and subsidiaries, nomination and remuneration processes, and executive pay. The level of financial disclosure was reported to be close to the European average.

Corporate disclosure in Turkey misses fundamental issues related to human rights in the firms' supply chain—for example, issues such as forced labor, child labor, discrimination, freedom of organization, and human rights abuses.

During the same period in which S&P and CGFT were monitoring the disclosure practices of Turkey's listed firms, a CMBT survey (Ozguc, 2009) investigated the corporate social responsibility related disclosure of firms included in the ISE-30. The study looked at the availability of disclosure in five areas: employee relations, human rights, product/customer/supplier, society, and environment. The analysis of the responses showed that disclosures missed fundamental issues related to human rights in the firms' supply chain—for example, issues such as forced labor, child labor, discrimination, freedom of organization, and human rights abuses. The author notes that environmental disclosures should be detailed to cover the use of natural resources and the effect of activities on ecological balance, emission of greenhouse gases, waste management, recycling ratios, and noise levels. The author further notes the need for disclosure on policies related to bribery, corruption, and fair competition that seem to be missing from the reports.

These two studies suggest that Turkish firms responded to the mandatory disclosure regulations related to financial disclosure but that disclosures by the largest firms did not address environmental and social areas adequately where standards were not mandatory. There are no regulatory requirements for nonfinancial disclosure in Turkey except CG compliance reporting. Since the last survey, improvements in the disclosure infrastructure led to increased transparency of ownership structures and board members' identities and affiliations (www.kap.gov.tr).

Due, in part, to the spillover effect of global initiatives, nonfinancial disclosure and, in particular, sustainability reporting have become more common practices. Larger companies have stronger incentives to disclose due to their international operations and stakeholders; hence, we observe a better performance in their sustainability reports. An analysis of voluntary disclosure reveals irregularity in reporting, which suggests that ad hoc reporting may be related to particular external stimuli, for example, a loan agreement or need to appeal to a particular investor or buyer. Specifically, we observe an improvement in the quality and upsurge of voluntary reporting in 2010. An example is Ezcacibasi, which issued the very first externally assured sustainability report in Turkey in 2010.

Our analysis of voluntary disclosure in Turkey can be summarized as follows:

- A small number of firms with consistent disclosure of ESG information
- Better quality reporting by larger firms; however, some do not show any effort
- Regulatory intervention that does seem to work if coupled with incentives
- Banks likely to take leadership roles both as catalysts and as best practice examples
- As CDP responses demonstrate, an effective combination of external stimulus and incentives with execution capacity
- Evidence of progress and signs of ongoing improvement
- Improvement efforts that may be sustainable if investors respond positively

Some of the international standards/platforms of reporting and further analysis of Turkish disclosure are summarized below:

Carbon Disclosure Project

Carbon Disclosure Project (CDP) is an international initiative advocating that businesses disclose information related to their carbon emissions on behalf of institutional investors. CDP has been collecting emissions data since 2003 and currently holds the largest international database on corporate climate change information. Currently some 3,000 organizations in some 60 countries measure and disclose their GHG emissions data and climate change strategies through CDP.

"Climate change is one of the most urgent and greatest challenges that humankind faces today. We are facing a problem that will ultimately affect everyone and future generations. Combating climate change is a long term responsibility that requires the international community as a whole to take efficient measures to ensure sustainable development and prosperity around the globe.

All activities (of CDP-Turkey) are being closely followed by the Ministry of Environment and Forestry and we would like to express that we are open for any collaboration."

Climate Change Department, Ministry of Environment and Forestry *

* CDP-Turkey 2010 report

"In Turkey, where climate change poses a major threat and new regulations rapidly change the business environment, corporations must integrate sustainable development principles into every one of their business processes, from human resources through to production, marketing and communication, if they are to survive. They must also understand that sustainable development is not the responsibility of a single department or division; it is an approach to doing business that employees throughout the organization must adopt and apply to their work processes.

A company's skill in anticipating, evaluating and responding to threats to its sustainable development will determine its success in achieving and maintaining competitive advantage. This skill has a direct economic value for shareholders because a corporation's ability to understand the issues and come up with solutions increases its market value.

Sustainable development is also a sound growth strategy for business. By focusing innovation on products and services that provide solutions to sustainable development issues, corporations are better prepared to overcome the impact of these threats on their business, differentiate themselves from their competitors, and hence achieve sustainable growth."

Bulent Eczacibasi, Eczacibasi Holding *

* Interview

With the financial support of Akbank, Sabanci University CGFT became the local partner of CDP in Turkey. The first CDP project was launched in January 2010 with Ernst & Young's Turkish office as the reporting partner. Currently, Turkey is implementing the Investor CDP program, which provides climate change data from the world's largest corporations to inform the global market place on investment risks and commercial opportunities. In the first year of the project in Turkey, those companies included in the ISE-50 index, representing 50 of the largest companies by market capitalization, were invited to respond to CDP's information request.

Of the 50 companies contacted, 10 responded to the CDP questionnaire. There was also an additional voluntary disclosure by one firm that is not included in ISE-50. The responding companies are listed in Table 5.2 below. CDP Turkey notes that the banking sector was the most responsive with a 50 percent response rate, probably because the strict risk management regulations applicable to the sector meant that their efforts required less additional preparation.

Table 5.2: CDP Responses 2010

Company	Sector	Scope 1	Scope 2	Scope 3
AKBANK T.A.A.	Financials	Disclosed	Disclosed	Disclosed
T.GARANTI BANKASI A.S.	Financials	Disclosed	Disclosed	Disclosed
KARDEMIR KARABUK DEMIR CELIK SANAYI VE TICARET A.S.	Materials	Disclosed	Disclosed	
PETKIM PETROKIMYA HOLDING A.S.	Materials	Disclosed	Disclosed	
SABANCI HOLDING A.S.	Financials	Disclosed	Disclosed	Disclosed
TAV HAVA LIMANLARI HOLDING A.S.	Industrials	Disclosed	Disclosed	
TURK EKONOMI BANKASI A.S.	Financials	Disclosed	Disclosed	Disclosed
T.SINAI KALKINMA BANKASI A.S.	Financials	Disclosed	Disclosed	Disclosed
YUNSA YUNLU SANAYI VE TICARET A.S.	Consumer Discretionary	Disclosed	Disclosed	Disclosed

Source: CDP Turkey 2010 Report

The CDP-Turkey office notes that coverage has been expanded to ISE-100 in 2011, and the response rate is estimated to increase to 30 percent. CDP signatories in Turkey are growing.

United Nations Global Compact

Launched in 2000, the UN Global Compact seeks to mainstream 10 principles in the areas of human rights, labor, environment, and anticorruption. The UN further invites businesses, labor forces, civil societies, and governments to act in light of these universal principles. With more than 2,500 participating companies and 8,000 signatories in over 90 countries, the UN Global Compact is one of the largest voluntary initiatives in the world. Global Compact members are requested to report annually against the basic principles and social responsibility activities and to provide information regarding their performance within this framework. If signatories fail to develop a communication on progress (CoP) by the relevant deadline, they are marked as nonactive members on the Global Compact website.

The Global Compact Turkey Network was officially launched in October 2001 and is among the 10 largest networks in the world. Table 5.3 presents a comparison of active members from Turkey with other developing countries. According to the UN Global Compact website, 206 Turkish institutions are currently signatories, of which 156 are active. Although the level of interest and participation seems high at first glance, only 14 out of 206 institutions are publicly listed companies, of which 11 are listed as active below. Of the 70 privately held business participants from Turkey in all sectors, 7 are nonactive (See Table 5.3). There are no state-owned business participants from Turkey.

Table 5.3: UN GC Active and Nonactive Members (Listed Companies)

Active Members (Business) of GC	
Bolu Cimento Sanayi A.S.	Koc Holding
Dogus Otomotiv Servis ve Ticaret AS	H.O. Sabanci Holding
Yasar Holding Co.	Akfen Holding Co. Inc.
Turkcell Iletism Hizmetleri A.S.	Aksa Akrilik Kimya Sanayi A.S.
Akkok Sanayi ve Gelistirme A.S.	Coca-Cola Icecek
Eczacibasi Holding Co.	
Nonactive Members (Business) of GC	
Goldas Jewellery Industry Import Export Inc.	Borusan Holding A.S
Sarkuysan Elektrolitik Bakir Sanayi Ve Ticaret A.S.	

Source: UN Global Compact website (as of 15.01.2011)

Even though GRI-based reporting is fairly new in Turkey, 2010 seems to have been a milestone year with nine firms issuing a GRI report.

Global Reporting Initiative

GRI is an international sustainability reporting standard that has been used since 1999 for companies to publicly communicate their ESG performance. GRI has pioneered the development of the world's most widely used sustainability-reporting framework. The GRI G3 Reporting Guidelines and the C-Level Template were translated to Turkish in 2008, and the GRI Indicator Protocols have been available in Turkish since October 2009.

GRI has a total of 208 stakeholders from Turkey, including 56 companies and 88 SMEs. Even though GRI-based reporting is fairly new in Turkey, 2010 seems to have been a milestone year with nine firms issuing a GRI report. It remains to be seen whether those companies that issued a GRI report will institutionalize this practice because those companies that issued GRI reports in previous years did not continue their efforts. Company reports are presented by year below in Table 5.4, together with a comparative picture of Turkey against BRIC countries (Table 5.5)

Table 5.4: Turkish Companies That Published a GRI-Based Report

2010		
Akbank	C	GRI-checked
Anadolu Efes Brewery and Malt Industry	C	GRI-checked
Arcelik	C	GRI-checked
Coca-Cola Icecek Turkey	B	GRI-checked
Dogus Otomotiv Servis ve Tic. A.S.	C	GRI-checked
Milteks	C	Self-declared
SLN Tekstil ve Moda San.Tic.Ltd.Sti.	C	GRI-checked
TSKB – Turkiye Sinai Kalkinma Bankasi	C	GRI-checked
Tubas Textile	C	Self-declared
2009		
6GEN	Undeclared	
Turkcell	C	GRI-checked
2008		
Aksa	Undeclared	-
Coca-Cola Icecek Turkey	C	GRI-checked

2007		
Aksa	Content Index	-
2006		
Aksa	Content Index	-
2005		
Erdemir	Content Index	-

Source: GRI website (as of 15.01.2011)

Table 5.5: Number of GRI Reports in BRIC+T

	2007	2008	2009	2010
Brazil	35	69	67	68
China	8	16	52	51
India	6	20	20	16
Russia	8	11	4	4
Turkey	1	2	2	9

Source: GRI website (as of 15.01.2011)

CSR Reporting & the Corporate Register

The Corporate Register is a reference point for CSR reports and resources worldwide, provided entirely online. This site contains more than 30,000 reports from nearly 7,500 companies around the world. The register aims to include every relevant published corporate report, without any limitations. The reports published are either provided directly by the reporting company or through Corporate Register's active research efforts. There are 35 reports from Turkey from 17 companies within the Corporate Register database. Reporting companies listed in the Corporate Register database are presented below in Table 5.6.

Table 5.6: Turkish Companies Issuing a CSR Report

Reporting Period	2003	2004	2005	2006	2007	2008	2009
Company Name							
Akbank							X
Aksa Akrilik Kimya Sanayii AS		X	X	X	X		
Arcelik AS					X		
ARGE Consulting Inc				X	X	X	
Aygaz Anonim Sirketi			X	X	X		
Beko Elektronik AS (Inactive)				X	X		
Borusan Holding					X	X	
BP Turkey				X			
Coca-Cola Icecek AS					X	X	X
Dogus Grubu Binalari					X	X	
Dogus Otomotiv Servis ve Ticaret AS							X
Eregli Demir ve Celik Fabrikalari TAS			X	X	X		
Koc Holdings AS				X	X	X	X
Sisecam Chemicals Group	X						
SLN Tekstil ve Moda San							X
Turkiye Petrol Rafinerileri AS					X	X	X
Turkiye Sinai Kalkinma Bankasi AS						X	X
Yesim Tekstil				X	X	X	X

Source: Corporate Register website (as of 15.12.2010)

The trend of discontinuous efforts is also observed in the Corporate Register database, suggesting that ESG policies are not rooted in the firms' operations.

Corporate Governance Compliance Reporting

Corporate governance compliance reporting (CGCR) is mandatory; however, the reporting standard issued by the CMBT is limited. The reports issued by the listed firms remained short and uninformative over the past years, but the reports issued in 2009 showed a drastic improvement in their coverage and content (ongoing research by Ararat, Black, and Yurtoglu, 2010). CGCR is undertaken mainly as a compliance activity and is not leveraged by investor relations professionals. The foreign investors interviewed were not aware of its availability as a source of information. In our view, current regulation, which can be improved based on the past experience, provides a solid institutional basis for disseminating ESG disclosure.

B. Forthcoming Laws and Regulations

Turkey's legal and regulatory framework is in continuous improvement, driven by EU accession and democratization processes. Turkey has been a part of the EU's customs union since 1995 and a candidate country since 1999. Accession negotiations with Turkey were opened in October 2005. To-date, negotiations have been opened on thirteen chapters (Science and Research, Enterprise and Industry, Statistics, Financial Control, Trans-European Networks, Consumer and Health Protection, Intellectual Property Law, Commercial Code, Information Society and Media, Free Movement of Capital, Taxation, Environment and Food Safety, Veterinary and Phytosanitary policy). Only one of these negotiations - Science and Research has been provisionally closed. During the process, Turkey has made significant changes to its legal and regulatory framework and continues to do so.

*"Turkey has signed several international protocols regarding the protection of intellectual property rights, and in line with the membership of World Trade Organization, has signed the key Agreement on Trade-Related Aspects of Intellectual Property Rights. However, there are continuing problems over trademark violations and patent infringement, with the result that Turkey remains on the US Government's priority watch list for insufficient protection of Intellectual Property Right" **

* EBRD.2010.Recovery and Reform, London, UK.

Despite the recent weakening of commitments from both the EU and Turkey observed in political discourse, it seems likely that the process will continue. The areas likely to be affected the most are social standards, including employment relations and environmental regulations (a new chapter in negotiations).

Below, we highlight the most important of the forthcoming laws and regulations, namely the new Commercial Code. This law would have the highest impact on the accountability of businesses and would provide the foundations for the new Capital Markets Law and further regulations surrounding business organizations.

New Commercial Code

The Turkish Commercial Code was enacted in 1956 and has French origins. Although the legislation has been amended in response to changed circumstances and urgent needs, it has long become inadequate, given contemporary legal and commercial requirements. Accordingly, the government prepared a draft commercial code for discussion in 2005. Although the draft was accepted by the Justice Commission in November 2009, since then no progress was made toward its adoption until January 2011. Delays in the adoption of the new commercial code had a knock-on effect with respect to other draft legislation that is contingent on the code. The delays are attributed to the political agenda's crowding-out effect as there was no open opposition to the draft. The draft is finally enacted on the 13th of January 2011 in just one day based on government's agreement with the opposition on an accelerated process. The legislature has embraced a reformist approach in the law, departing from conventional approaches and certain historical practices that have been in force for more than 50 years. The law will come to effect in July 2012.

The new law introduces the following changes, which are relevant from an investor's standpoint.

Share Capital and Shareholding Structure

Contrary to the old law calling for a minimum of five shareholders for joint stock companies (JSCs), the new law provides that JSCs may be established with only one shareholder. This change is most likely to ease and accelerate the incorporation procedures of JSCs by diminishing the burden of required documentation, as well as removing the necessity to include nonfunctioning shareholders simply for technical compliance with the law.

Formation and Function of the Board of Directors

Under the new law, the board of directors can now comprise directors who are not required to be a company shareholder. The new law also enables legal entities to become board members. The liability of the board of directors, previously unclear, has been regulated in detail. Limitations are introduced for the nomination of board members by classified shares; according to the Commercial Code, only 50% of the board members can be nominated by the owners of classified shares with nomination privileges. The new law requires at least one fourth of the board members to be university graduates.

Mandatory Web-site and Online Notification

The law brings a statutory obligation for each corporation to maintain a website. Statutory announcements, official corporate announcements, important notices for shareholders, audit reports, and financial statements must all be published on the website for the purposes of transparency and public information. Failure to maintain a website in conformity with statutory obligations is deemed to be a breach of the law and will constitute a failure of the board to perform its statutory duties. Corporations are obliged to keep notarized printout records of the announcements on their websites.

Privileged Shares

Under the new law, voting privileges are limited to 15 votes per share, a number that can be increased only by a court decision. The possibility of privileged shares' blocking a capital increase has been renounced. Privileged votes can also no longer be used for voting on resolutions regarding amendment of a company's articles of association, the appointment of a transaction auditor, or filing discharge or liability suits.

Group of companies

The most innovative changes Introduced by the new law are related to business groups. A group of companies created for the specific purpose of managing more than one JSC within the context of controlling relationships will be regulated for the first time in Turkish law.

The concepts of a controlling (parent) company, which sustains control, and a dependent company (subsidiary), which is under control, have been clearly defined. The legal status of these companies and their relationships also has been specified. The law requires that the board of directors of both controlling and dependent companies is required to report the members' intercompany relations annually. This ensures that the management of such companies will have detailed information regarding the results of intercompany relations.

Turkish Accounting Standards

The new law requires that the financial statements of all JSCs, regardless of whether they are public, be prepared in accordance with Turkish Accounting Standards (TMS). TMS is, in essence, the Turkish translation of IFRS. This change will mean introducing mandatory accounting standards to nonlisted companies. Concepts like materiality, comparability, substance over form, and true and fair view that previously did not have a role will be included in the TMS in conformity with IFRS.

In conclusion, the new law delivers long overdue solutions to the challenges of modern commercial activities in Turkey. Undoubtedly, the draft will require some improvements and periodic updating as conflicts arise. Nevertheless, it provides a vast improvement over the status quo.

"With the new Capital Markets Law, we plan to align our fund management with the UCITS structure in compliance with EU regulations. The most important change will be authorizing portfolio management firms to set up investment funds. These changes will enable separation of firms specialized in fund management from banks, and allow successful portfolio managers to emerge. This alignment with UCITS regulations will allow our fund management sector to reach global markets in the mid-term."

Prof. Dr. Vedat Akgiray, CMBT *

* Kurumsal Yatirimci Dergisi, October-December 2010, pp 10-14

Other Forthcoming Laws

The New Capital Markets Law is one of the new legislations waiting the enactment of the new Commercial Code. The New Capital Markets Law is drafted to bring capital markets regulations into full compliance with EU directives.

The Turkish government is under tremendous pressure from the EU to commit to emission reductions and participate in the EU Emission Trading System (EU ETS) by 2018. The Climate Change Department plans to introduce emission measurement regulations for industrial plants in 2011.

The long-awaited Renewable Energy Law was finally enacted in January 2011. The law introduces subsidies for wind energy production in the order of $7.3 per megawatt and $11 per megawatt if equipment is sourced locally. Solar energy is planned to be connected to the national grid by 2013—a disappointing postponement according to some investors. Although the private sector commended the law, the civil society organizations note the environmental and social risks introduced by the law. The law empowers the government to allocate national parks, protected areas, and forests to renewable energy production. The law is also heavily criticized for allowing the government to outsource to private actors the auditing function of the production and distribution of renewable energy. Currently it is estimated that more than 25,000 companies operate in the energy sector. It is expected that hydroelectric power stations will continue to be at the center of debates with respect to environmental and social Issues unless the procedural laws adequately handle stakeholder concerns.

Government sources report that only 27 percent of licensed investments have achieved a realization rate of more than 34 percent. Fifty-nine percent of all licensed investments achieved less than 10 percent realization.

“Over the past 10 years, civil society and civil society organizations in Turkey have been growing rapidly, joining global networks and, in collaboration with the civil society organiza tions of European and North American origin, expanding their activities into different regions of Turkey. They have the potential, alongside the political parties, to become key actors in the democratic, just and good governance of Turkey. A strong civil society is a precondition for solving all the multi faceted issues Turkey’s citizens have been facing: from human rights to co-existence, from human development to protection of the environment, improving education and healthcare. A strong civil society is also the cornerstone of on- going democratic consolidation and the formation of a confident, forward looking society. We should, therefore encourage civil society organizations to strengthen their organizational capabilities in order to fulfil their potential to contribute to Turkey’s future and at the same time demand that the political parties and the state support their development.”

Prof. Dr. Fuat Keyman, Istanbul Policy Centre. *

* Interview

C. Civil Society and Institutions

After experiencing three military coup d’etats in 20 years (1960, 1970, and 1980), Turkey has been deprived of strong civil society initiatives. Most civil society organizations have been distanced from their original purpose and serve as social clubs. The Associations Act, which was a serious obstacle to freedom of organization, was amended in March 2005 during the EU accession process to meet the Copenhagen criteria after which the European Commission allocated €3.3 million to the Department of Associations. Effective civil society organizations in Turkey are few and focused on environmental issues. They act on a project basis, either to preserve natural habitats or to prevent business or government actions endangering the environment. Labor unions, which are supposed to speak for employees and defend their rights, have limited power due to high unemployment rates and the legacy of military interventions. Academic freedoms have been restored gradually in the democratization process, thanks also to privately funded “foundation universities”. Universities have been playing an important role through research and advocacy centers focused on ESG issues. Civil society is becoming more active and vocal; however, dependency on corporate funding mutes civil society organizations and sets boundaries around subjects that may be conflicting with corporate interests.

In 2010, the Turkish Business Network, which is a part of a Web-based professional network Linked-In, managed 500 registrations to their “CSR in Turkey” group. The group has a large number of European based professionals with Turkish origins and hosts discussions and debates. In the Appendix, we provide a list research institutions, business networks, and civil society organizations that have the potential to play an enabling and supporting role for SI and highlight the key players below. We also touch on the role of media and international initiatives.

Corporate Governance forum of Turkey (CGFT)[1]

The CGFT is an interdisciplinary academic initiative hosted by the Faculty of Management at Sabancı University. CGFT has been a pioneer in corporate governance research and contributed to the development of CMBT’s CGG as an external advisor. CGFT is involved in both empirical research and high-impact active research by participating in ESG-themed projects. Examples include the moderation of the Social Standards Roundtable for the textile industry with the German Society for Technical Cooperation (GTZ), institutional investors voting behavior research in collaboration with Broadridge, the female director index study, the disclosure index study, and board diversity research. Recently CGFT undertook the ownership of launching CDP-Turkey. CGFT works closely with the Global Corporate Governance Forum. CGFT’s activities and research have been funded by TUSIAD, GTZ, IFC, Akbank, CIPE, Turkcell, the European Commission, E&Y-Turkey, and The Scientific and Technological Research Council of Turkey (TUBITAK) over the years. CGFT supports the annual investor relations awards by participating in the jury.

Turkish Association of Institutional Investment Managers (TKYD)[2]

The TKYD is a nonprofit organization founded with the goal of promoting the institutional investment industry. TKYD became the 23rd member of the European Fund and Asset Management Association in 2004. The association is funded through its 28 corporate members, sponsorships, and fees for membership as well as its publications and activities.

1 www.cgft.org
2 www.tkyd.org.tr

"Case: Civil Society is becoming influential; 2000 villagers on guard to protect their water

Turkey's Akfen Holding has backed down from its decision to build a hydro-electric power plant on a river in Mugla due to 'environmentalist reaction,' according to its chief.

Villagers and environmentalists have been demonstrating against the hydroelectric plant project in Yuvarlakcay of the Aegean province's Koycegiz district for four months.

Building a hydroelectric power plant on the Yuvarlakcay River in spite of the reactions of local residents is impossible, said Hamdi Akın, chairman of the holding, expressing his expectation of seeing approval from the Energy Market Regulatory Authority, or EMRA.

'As Akfen Holding, we will apply to the EMRA not to build a hydro-electric power plant [on Yuvarlakcay]. The EMRA follows the licenses given for power plant constructions and imposes penalty if a company obtains a license but does not establish a plant. Therefore, we expect tolerance and understanding from the EMRA for our decision,' he said.

Turkish Business Association for Sustainable Development (TBCSD)[3]

TBCSD represents Turkey at an international level as a member of the World Business Council for Sustainable Development. The association, while executing its activities, also aims to develop close cooperation with the government, official institutions, local administrations, NGOs, and universities, but most of all with corporations. TBCSD has recently partnered with ISE in developing the ISE Sustainability Index.

Turkish Green Building Council (CEDBIK)[4]

CEDBIK was founded in 2007 by leading actors of the construction industry and aims to contribute to the building industry's development by means of the spread of principles of sustainability. CEDBIK organizes educational programs, develops pilot projects with government and universities, and conducts lobbying activities to increase public awareness of the necessity of green building while also encouraging the building industry to develop along principles of sustainability.

CEDBIK was granted EM status with the World Green Building Council (WGBC) on the September 28, 2009, and continues to develop its substructure through an increasing participation with other green building councils in the world and with the local construction sector. CEDBIK is funded by sponsors, corporate members, and through services such as education, certification, and consultancy.

Corporate Governance Association (TKYD)[5]

Founded in 2003, Corporate Governance Association of Turkey (TKYD) is a nonprofit organization aiming to develop and promote adherence to corporate governance standards and guidelines in Turkey. TKYD has more than 400 members and has been a successful organization in advocating good governance. The association has good engagement management capabilities and is funded by its members and international donors.

3 www.tbcsd.org
4 www.cedbik.org
5 www.tkyd.org

'The reaction of environmentalists and villagers in Yuvarlakcay is our main reason in this cancellation decision. We are also environmentalists,' Akın said. 'We had 20 hydroelectric power plant projects, but now it is 19. I also send my respects to people that are on guard for the environment day and night in Yuvarlakcay.'

In Turkey, over 1,600 licenses have been given for hydroelectric power plant construction but protests and objections have emerged against those plants on grounds that they will destroy nature and cut tourism and agricultural revenues The power plant tension started in Yuvarlakcay with the logging of hundreds of trees, some up to 400 years old, in one night on Dec. 3, 2009

The Yuvarlakcay, whose water is drinkable, supplies water to nearby Koycegiz Lake, nourishes five villages in the area and is crucial to the region's agriculture.

The area's contribution to the country's economy with its citrus production is nearly 100 million Turkish Liras. The river also welcomes 200,000 tourists each year."

Daily News, 30 Nisan 2010

Greenpeace Mediterranean[6]

Greenpeace Mediterranean actively campaigns from one of its main offices in Istanbul. Its actions are in line with a global mission to ensure a just, peaceful, and sustainable environment for future generations. Greenpeace believes actions often speak louder than words and takes nonviolent direct action in the heart of its campaigns.

Greenpeace Mediterranean's campaigns in Turkey mainly focus on preserving life in the Mediterranean, climate change, and energy. It have been actively campaigning against nuclear energy production in Turkey. Following is a list of the organization's accomplishments in Turkey:

2000: Turkey's plans to build its first nuclear reactors at Akkuyu as part of a larger project to construct 10 reactors by the year 2020 was cancelled in July after eight years of campaigning by Greenpeace and others.

2004: Greenpeace's efforts to achieve tighter controls on the notorious ship breaking industry result in an international agreement to treat obsolete ships as waste. Treaty commitments by 163 nations can be expected to increase demands for decontamination of ships prior to export to the principal ship breaking countries of India, Bangladesh, and Turkey.

2008: Greenpeace worked with local activists to block the shipment of coal to the Sugozu Coal Plant in Southern Turkey. Greenpeace was successful in making the issue visible in the international press.

2008: Greenpeace Mediterranean brought an antinuclear campaigner on board in Istanbul to expose the true cost, negate the erroneous information released by the government and industry, and have the tendering process cancelled. The energy minister responded to Greenpeace's direct communication by agreeing to an unprecedented visit to the Greenpeace office in Istanbul.

Doga Association[7]

Doga Association is an independent NGO that has been engaged in environmental activities since 2002. The association's campaigns mostly focus on preserving natural habitat in Turkey. The most relevant accomplishments with regard to sustainable investment and Doga's potential power to put pressure on the government can be summarized as follows:

- The establishment of the Doga Fund in collaboration with the MoEF and UNDP.
- Success in winning a lawsuit against Izmir Municipality's Nazim Development Plan for its negative effects on the Gediz Delta.
- Success in making the environmental, cultural and social consequences of Ilisu Dam construction visible through intensive campaign against the construction. "Hands Off Hasankeyf" was the association's call to action.

6 http://www.greenpeace.org/Mediterranean/
7 http://www.dogadernegi.org/

Broadcast Media and the Press

There are numerous daily, weekly, and other publications in Turkey. Broadcast media are well developed, with hundreds of private television channels from the state-run TRT, as well as more than 1,000 commercial radio stations.

Even though the legal framework imposes broadcasting restrictions on media companies and ownership percentage limitations, large conglomerates easily sidestep such regulations to create a monopolistic market. Thus is the case in Turkey where Dogan Group, a diversified conglomerate, owns more than half of the nonstate Turkish media, including major dailies, magazines, printing houses, a distribution network, a news agency, radio stations, and some major television stations. In 2009, shares in Dogan Yayın Holding fell by 20 percent after it was hit with a record fine of $2.53 billion for unpaid taxes. Dogan claims it faces unprecedented tax penalties because of the critical coverage of the government by its newspapers and television stations last year, particularly over corruption allegations. Although on the surface, fines were considered as a punishment for the negative attitudes of Dogan media toward the government, it was also argued that the battle reflected the conflicting economic interests of Dogan Group and businesses interests close to the administration. A number of new media groups emerged during this period, each controlled by the owners of diversified business groups.

The legal framework that stifles freedom of expression is a cause of concern and has repeatedly been mentioned in the international press as well as European Commission progress reports. Although there has been a decreasing trend in the prosecution of journalists, the high number of cases initiated against journalists and frequent website bans are cause for concern. Freedom House reports that 21 journalists were prosecuted due to the contents of their writing.

Media centralization and concentration in the hands of few owners threatens the quality of journalistic output. Furthermore, journalists' limited ability to maintain employment is becoming detrimental. The International Federation of Journalists blamed the Turkish government for allowing a state of media concentration when some 4,000 people in the media lost their positions in 2001.

Less competition and business involvement inevitably cause the reporting accuracy to degrade and increases the likelihood for corruption and use of media as the organ of business interests. Freedom House assesses the quality of Turkish media as poor, with an emphasis on columns and opinion articles rather than pure news.

Anecdotal evidence suggests that reporting on corporate misbehavior is frequently manipulated by the media owners.

International Initiatives: UNEP & UN PRI Membership

UN Environment Program Finance Initiative (UNEP FI) and UN Principles for Responsible Investment (UN PRI) are the major international SI frameworks for the banking and investment industries.

UNEP FI engages with a broad range of financial institutions to promote the integration of environmental considerations into all aspect of the financial sector's operations and services and foster private sector investment in environmentally sound technologies and services. Currently, there are 191 finance institutions signed up to UNEP FI worldwide. The Industrial Development Bank of Turkey (TSKB) is the only Turkish institutions among those members (See Table 5.8).

Table 5.8: UNEP Membership in BRIC+T

	Number of Signatories
Brazil	3
China	4
India	2
Russia	0
Turkey	1

Source: UNEP website (as of 15.01.2011)

The UN PRI were developed when the UN invited the world's largest institutional investors to join the development of such principles in 2005. UN PRI reflects the core values of a group of large investors, and there are currently 835 signatories globally, including 211 asset owners, 437 investment managers, and 168 professional service partners.

UN PRI has six signatories from Turkey: three Investment managers, Actera Group, Ak Asset Management and Logos Asset Management; two professional service partners, Acclaro and Illac, the author of this report. The Istanbul Stock Exchange has become a signatory in 2010. Table 5.9 compares Turkey with BRIC with respect to UN PRI membership. The number of signatories is expected to grow in 2011 alongside the signatories of CDP. Acclaro launched Turkey's first Investor Relations Awards in 2009 with sponsorship of the financial sector. In 2009, no firms received awards in the category of corporate governance disclosure.

ISE's adoption of UN PRI is particularly important as it encouraged ISE's Sustainability Index Project.

Table 5.9 UN PRI Signatories in BRIC+T

	Asset Owners	Investment Managers	Professional Service Partners	Total
Brazil	15	20	10	45
China (Hong Kong)	0	6	3	9
India	0	1	2	3
Russia	0	0	0	0
Turkey	0	3	3	6

Source: UN PRI website (as of 15.01.2011)

6 Coverage of Turkish Companies in Sustainability Research and Indices

"HSBC Global Asset Management has relocated a senior executive to Hong Kong to co-ordinate the integration of environmental, social and governance issues into the firm's investment processes worldwide.The move is only the latest example of an asset manager bolstering its ESG coverage in the Asia-Pacific region, as it grows in importance for global investors.

HSBC's Xavier Desmadryl moved from Paris to Hong Kong in early November as global head of ESG research and PRI, a role that refers to the United Nations Principles for Responsible Investment, which HSBC signed in 2006.

HSBC's embracing of ESG is primarily a function of risk management, says Mr Desmadryl, citing examples of governance risk in India and environmental risk in Indonesia. "We think that adding a more holistic view of a company we're investing in will make us more efficient investors," he says."

Financial Times, 2011 *

* January 16, 2011, by Scott Johnson, Managers respond to demand for Asia ESG focus.

- Availability of third-party ESG research is an important condition for companies from smaller EMs to be considered by international investors for inclusion in investment portfolios or products.
- There are no local ESG research firms in Turkey.
- Turkey has a unique category of CG rating firms for the purpose of rating the compliance of Turkey's listed firms with CGGs.
- The ISE Corporate Governance Index (XKURY) is an index based on voluntary CG ratings. It has not received attention from investors due to methodological shortcomings.
- The ISE launched its Sustainability Index project (ISESI) in 2010, to be completed by December 2011. The Index will face challenges, but will improve ISE's credibility.

Availability of third-party ESG research is an important condition for companies from smaller EMs to be considered for inclusion in investment portfolios or products by international investors. We will first look at the general outlook of the ESG research industry to put in wider context the issues related to ESG research on Turkish companies.

A. General Outlook of the Industry

ESG research with global coverage is primarily conducted by a few international research firms and a handful of local firms in a few large emerging markets. In line with the increased demand for sustainability information, sustainability and ESG research organizations have been consolidating rapidly during the past few years.

The consolidation trend places data providers, such as MCSI, Thompson Reuters, and Bloomberg, in control of ESG research and suggests that ESG research provision can better be positioned within larger companies that offer multiple financial information services to the fund management industry. According to Eurosif (2010), this flux may also represent a transition of ESG research providers from information gatherers to information diggers. Most ESG research providers currently base their evaluations on publicly available information and/or solicit companies to disclose information that is not available in the public domain. This is particularly problematic for EMs where publicly available information is far less than is the case in developed markets. Eurosif predicts that in the future, ESG providers will be increasingly expected to anticipate future risks more actively, incorporating information that may be outside the public domain and employing more advanced means to complement their current processes.

Anecdotal evidence suggests that the recent mergers and acquisitions wave in the ESG research industry did not result in any job cuts. The main driver behind mergers is arguably the need to reach economies of scale in the deployment of information technology infrastructure in order to increase both geographical and thematic coverage to meet investor demand. The growth is expected to be in the direction of EMs.

B. Local ESG/Sustainability Research

There are no local ESG research firms in Turkey. Equity research, carried out by the brokerage houses, is primarily used by international capital management (ICM) departments to promote recommended stocks. This research is offered free of charge and does not cover ESG issues. The few local brokerage houses with ICM departments in Turkey have only a handful of equity analysts. Given the size of the market, employment of ESG specialists is not commercially feasible.

C. Corporate Governance Rating Agencies

Turkey has a unique category of CG rating firms. Regulated by CMBT based on a special directive, CG rating agencies established during the past five years have the purpose of rating the compliance of Turkey's listed firms with CGGs of CMBT. Firms, listed or unlisted, can voluntarily decide to have their CG compliance rated and commission one of the rating firms licensed by CMBT to conduct CG ratings. The rating is paid for by the firm. Unsolicited ratings or ratings by unlicensed firms are not permitted.

Globally recognized rating agencies like Standard and Poor's., Moody's Investor Service Inc., and Fitch Ratings Ltd. are permitted to conduct CG ratings in Turkey, although none of these agencies offers CG rating services.[1] The regulation led to the establishment of a few local rating agencies. RiskMetrics is the only international firm that applied for and obtained a CG rating license. The list of CG agencies licensed by CMBT is given in Table 6.1 below.

Table 6.1: CG Rating Firms Licensed by CMBT

1	RiskMetrics Group Inc
2	TCR Kurumsal Yonetim ve Kredi Derecelendirme A.S.
3	SAHA Kurumsal Yonetim ve Kredi Derecelendirme Hizmetleri A.S.
4	KOBIRATE Uluslararası Kredi Derecelendirme ve Kurumsal Yonetim Hizmetleri A.S)
5	JCR Avrasya Derecelendirme A.S.

The locally established CG rating firms tend to be fairly small. Their main source of revenue is solicited CG ratings. Some of these firms also offer credit rating services, but there remain few projects as the credit rating market is still in its infancy. The total market of CG rating businesses is estimated to be around $500,000. Risk Metrics does not have an office in Turkey and brings in analysts from abroad for rating projects. Each of these firms has a handful of clients except Saha, which dominates the market and, according to anecdotal evidence, built its customer base initially from Koc Holding companies, thanks to the background of its founders as former employees of Koc group. The list is given in Table 6.2 below.

1 For a discussion on the CG rating by international agencies see Ararat and Yurtoglu (2007) , Different Approaches to Differentiating 'Better Governed' Companies - Market Segmentation in BOVESPA and Rating Based Indexing in ISE, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=989806 and Ararat, M. and B. B. Yurtoglu, 2008, Different Approaches to Differentiating "Better Governed" Companies; Market Segmentation in BOVESPA and Rating Based Indexing in ISE, FOCUS (Global Corporate Governance Forum) 5, 57-77.

Table 6.2: CMBT Licensed CG Rating Agencies and Their Clients in Turkey

	FIRM	2006	2007	2008	2009	2010	Rating Agency
1	Dogan Yayın Holding	81.19	85.88	87.64	87.64	87.80	ISS
2	Vestel Elektronik		75.91	82.57	83.38	84.02	ISS
3	Y&Y Yatırım Ortakligi		78.83	81.55	81.55	82.66	Saha
4	Turk Traktor		75.17	78.34	81.21	83.02	Saha
5	Tofas	75.72	77.36	81.59	82.37	84.17	Saha
6	Hurriyet		79.67	83.21	84.31	84.69	ISS
7	Tupras		79.12	82.02	83.41	85.58	Saha
8	Asya Katılım Bankası			75.56	78.24	81.69	Saha
9	Otokar			79.40	81.20	83.18	Saha
11	Sekerbank				81.36	86.64	ISS
12	Dentas			70.75	78.18	80.29	Saha
13	Anadolu Efes Biracilik			80.96	82.71	84.00	Saha
14	Yapı ve Kredi Bankası			80.21	84.38	87.75	Saha
15	Vakıf Yatırım Ortakligi				78.10	82.34	Kobi-Rate
16	Coca Cola Icecek				83.04	84.34	Saha
17	Arcelik				82.09	85.53	Saha
18	TAV				83.34	90.35	ISS
19	TSKB				87.69	89.15	Saha
20	Dogan Holding				82.64	84.20	Saha
21	Petkim				77.13	81.90	Kobi-Rate
22	Logo Software				80.53	81.71	Saha
23	Is Leasing				80.24	83.76	Saha
24	Turk Prysmian Kablo				77.59	80.79	Saha
25	Turk Telecom				80.11	82.66	Saha
26	Turcas					75.20	Kobi Rate
27	Park Elektrik					86.45	Saha
28	Aygaz					84.61	Saha
29	Albaraka Turk					81.38	JCR
30	Yazıcılar Holding					80.44	Saha

Source: TKYD Web Site, accessed at 12.01.2011

The average rating of the companies in 2010 was 81.01. The differences between scores are minimal. Some companies with a reputation for good governance are not included in the index as they have chosen not to be rated. The ratings are not comparable because each firm has Its own methodology. These high scores do not reflect the average ranking of Turkish firms in international research. For example, GMI's average score of 17 Turkish companies is 3.62 out of 10. GMI covers firms with free-float market capitalization of $1 billion or more.

D. International Research

International research houses cover a limited number of Turkish stocks. The list of companies covered by them overlaps with the Turkish constituencies of MSCI and S&P/IFC EM indices (See Table 6.3 below).

Table 6.3: Coverage of Turkish Firms by International Research Houses

Research Firm	Turkey Coverage	Notes
InRate (Broad ESG)	35	From public information
RiskMetrics (Governance)	7	From public information
EIRIS (Governance)	10	From public information
GMI (Governance plus)	17 >$ 1 billion	Research conducted in Turkish from public information
Sustainalytics/Jantzi (Broad ESG)	24	Based on a quarterly analysis of ESG-Related incidents and controversies, does not apply Sustainalytics' broad ESG assessment methodology
RepRisk (Business Activity)	All listed firms in ISE	Web calling
MSCI-ESG (Business Activity)	All listed firms in ISE	Based on public information

Source: Own collection from interviews

MSCI is in the process of consolidating the research methodologies of the merged research firms. MSCI-ESG Research will combine the know-how of KLD and Innovest under this new brand. MSCI's current strategy is to cover EM stocks in two different tracks. Straight Business Research identifies and screens firms within the highest negative impact industries such as alcohol, tobacco, arms, and so on. Minority holdings of less than 50 percent by the covered firms in such industries are signaled. Controversies Research is an event-driven process using MSCI's Web calling capabilities. Controversial events are rated by MSCI according to the intensity of the risks to which the firm is exposed. MSCI uses RepRisk data. MSCI's current effort on formulating the framework for the next generation of research, aims to develop a methodology to measure the firms' ESG performance. The ultimate objective is to create a single platform and a single research process, with multiple outputs serving different needs. The coverage will be gradually expanded from MCSI ACWI IMI large cap to small cap and to Emerging Market Index.

We were given access to RepRisk data derived from media and Internet sources, which RepRisk used to analyze the risk profile of Turkey's firms. The review showed that, out of more than 500 items captured in relation with Turkish businesses from Web sources, the number of news specifically related to ISE firms was a handful. Ilisu/Hasankeyif Dam Project had the highest level of occurrence. Screening the Web sources in the local language might have identified other issues.

During the study, all research companies we interviewed noted a growing interest in EMs from their clients. Notable was the interest from Canadian investors following removal of the restrictions on pension funds to invest in emerging markets. Canadian investors are mainly concerned about governance issues more than social and environmental issues, except when they invest in extractive industries. Jantzi-Sustainalytics, an ESG research firm active in Canada, notes the disclosure in Turkey as being particularly inferior in the category of governance.

Research firms acknowledge the challenges in covering EMs. Most consider EMs as a specialization. Lack of data, reliability of data, and the differences in pressing sustainability issues invalidate the business models that work for research on developed markets and firms. Controlled firms, which are a part of

"The top ESG issues for Turkey:

1. Impact on communities

2. Impact on Ecosystems and Landscapes

3. Freedom of Association and Collective Bargaining

Top projects with ESG issues:

1. Ilisu Dam

2. Baku-Tbilisi-Ceyhan pipeline

3. Yusufeli Dam "

CharlotteMansson, RepRisk *

* Interview

"In response to the question 'How do you tell if a company is doing well (in sustainability)?,' referring to BP's position in Dow Jones Sustainability Index:

'Last place I would look for is the standard indexes (…) You have to dig beneath the surfaces and you have to look at what the company is actually doing. (...) Existing metrics are not consistent and comparable enough to do an index."

Prof. Micheal Porter *

* http://www.sustainableprosperity.ca/event

Brazil's Novo Mercado was introduced by Bovespa because Brazilian companies were finding it difficult to access capital markets. The Novo Mercado demands higher governance standards than the main market. *"Companies voluntarily agreed to higher governance standards to list on a more exclusive exchange on the basis that this would attract more capital,"* Mr Wilcox (John Wilcox, chairman of Sodali, a US-based corporate governance consultancy) says. *"It worked extraordinarily well and it is the best example we have that good governance is equated with better performance – companies listed on the Novo Mercado have tended to outperform their peers."*

Financial Times, 2010 *

* December 19 2010, by Mike Scott, Poor governance now seen linked to inferior returns.

financial conglomerates, pose extra challenges as they can rarely be considered as stand-alone entities. Our discussions with leading professionals in the industry revealed that there is room for innovative approaches to overcome the obstacles in covering EMs in ESG research.

Solaron, as an EM (India)-based ESG research firm, managed to occupy a significant space in the industry as a subcontractor to main research houses. Solaron provides solicited ad hoc research incorporating an understanding of EM issues internationally as well as coverage of Indian companies based on "best in context" methodology. Solaron's international expansion, supported by its local market stronghold, demonstrates that emerging market specialization is valued by the research industry.

E. Indices

The views about the usefulness of local sustainability indices vary. International research firms find them useful as they tend to improve the availability of ESG data, which can be used by international research firms. Asset managers that prefer active strategies consider indices as competition but appreciate their information value in constructing their own portfolios. Some of the industry professionals argue that the local indices help raise the prestige of stock exchanges but do not function as commercial instruments. The indices developed in Brazil, India, Korea, and South Africa have not been instrumental in the development of investment products by institutional investors. There is an ongoing fundamental debate about the usefulness of indices and passive strategies in changing corporate behavior of the firms included in the indices—even when engagement strategies are used.

The index business is a natural monopoly in Turkey. All investable indices are published by ISE, except bond indices issued by TKYD and the Ekonomi indices published by the local Capital magazine in association with a small index modeling firm, GC Capital.

Corporate Governance Index

The ISE Corporate Governance Index (XKURY) is the index in which companies applying CG principles are included. XKURY aims to measure the price-and-return performances of ISE-listed companies (except Watch List Companies Market) with CG ratings of a minimum 6 over 10. The CG rating is determined by CMB-approved rating institutions based on their compliance with CG principles as a whole. Calculation of the XKURY began in August 31, 2007, after the first five companies achieved a qualifying score of 6 over 10. As of December 3, 2010, the value of this index had increased to 57,539, suggesting a (nominal) return of 19.6 percent since its inception. During the same interval, the IMKB 30 Index had a return of 41.3 percent.

The ratings of companies included in XKURY can be found in the explanations on the public disclosure platform, but there is no official source where these data are available collectively. For companies included in XKURY, the annual listing/registration fee is discounted by 50 percent for the first two years. This discount is reduced to 10 percent over the next three years. In November 2010, ISE raised the qualification score from 6 to 7, although it is not expected to make a difference in the composition of the index. So far, no firm has received less than a qualifying score. Table 6.2 shows the index constituents of the in XKURY by years.

According to market players, the scores received by the companies do not have the credibility hoped for. There are several reasons for this:

- Each licensed rating agency has a different methodology.
- Rating companies are commissioned and paid by the issuers.
- Rating is optional. So far, less than 10 percent of companies chose to be rated, and they all received a high score. (See Table 6.2.)
- The reports did not seem to capture the key issues.

In the initial years of the index, a score assigned by Core Ratings was criticized heavily by the market, which led to disqualification of Core Ratings by CMBT.

CG analysts, according to the rating decree, have to be certified by passing an exam or must have three years of CG rating experience in an international rating firm. The experience requirement was deliberate to encourage international firms to set up partnerships with local firms, but this expectation did not materialize. One of the published CG rating reports openly notes that Its score reflects "compliance with the guidelines" and is not to be confused with a CG quality rating. Nevertheless, increasing numbers of firms, which voluntarily choose to be rated, indicate that the index serves some purpose, including reduction in listing fees, which are considerable for large cap firms.

"The Novo Mercado case provides convincing evidence that consultation with major institutional investors on the requirements and soliciting their support for reform, including the CG Index, is a very important step. It is also a step that may be more challenging since Turkey lacks the business and political traditions that Brazil had, which include experience in building consensus. Cultural differences, then, are among the most important determinants of success in ushering in market-led corporate governance reforms. After comparing the similarities and differences between Brazil and Turkey, Brazil's success is linked to the influence of a broader range of investors (incl. pension funds and foreign investors) than is the case in Turkey. Those investors in Brazil participated in a policy-making process that drove corporate governance reforms, including the Novo Mercado."

Ararat and Yurtoglu *

* 2008, Novo Mercado and Its Followers: Case Studies in Corporate Governance Reform, Focus.

Dow Jones Islamic Market Turkey ETF

Dow Jones Islamic Market Turkey ETF

This index was launched by Dow Jones and tracked by BMD Securities, a local brokerage firm. BMD Securities, Inc. Dow Jones DJIM Turkey Exchange-Traded Fund is a Dow Jones Islamic Market Turkey index-based ETF. The fund's shares are traded on the ISE. Investors can buy and sell the ETF shares as they buy and sell other stocks.

The DJIM Turkey Exchange-Traded Fund currently includes 32 stocks that are traded on the ISE. Dow Jones, as with its other indices, determines the companies that will be in the index by considering the floating market capital of the companies. Additionally, Dow Jones takes into account the appropriateness of some financial ratios and operating fields of the companies, based on Dow Jones Islamic Market criteria. The first step is to exclude from the index universe any industry group that represents an incompatible line of business, such as conventional banks.[2] According to the criteria, the following companies are also excluded: those whose total debt, divided by trailing 12-month average market capitalization, is 33 percent or more; those whose cash plus interest-bearing securities, divided by trailing 12-month average market capitalization, is 33 percent or more; and those whose accounts receivable, divided by total assets, are 45 percent or more. As of the end of 2010, the largest fraction of investments of the ETF was concentrated in the telecommunications, retail trade, and energy and cement industries. The ETF had no investments in conventional banks.

The current fund size is as small as TR 2.5 million (approximately $1.7 million). The investors are domestic retail customers of participating banks (interest-free banking institutions).

2 The key concept of Islamic finance is that lenders must participate in the risk of the business in order to earn a reward. Islamic banking has the same purpose as conventional banking, except that it operates in accordance with Islamic rules. Therefore, Islamic finance prefers profit-and-loss sharing arrangements of participating banks. Forms of equity-based financing are in line with the Islamic view on financial transactions that one cannot be entitled to a reward if one has not taken any risk; however, in the current Islamic finance market, debt-based instruments are more widely used than equity-based instruments, and this practice is criticized by the Shari'ah scholars (Hawkamah, 2010, White Paper: Taking stock and moving forward: The State of Islamic Finance and prospects for the future", www.hawkamah.org).

"A sustainability index comprising of the ISE traded companies that have added sustainability criteria into their investment processes and activities will make a tremendous effect."

Huseyin ERKAN, Istanbul Stock Exchange *

* Opening speech at launch of ISE Sustainability index Project, ISE Istanbul, Turkey, 10 August 2010.

Istanbul Stock Exchange's Sustainability Index Project (ISESI)

In August 2010, ISE, together with the Business Council for Sustainable Development, launched the ISE Sustainability Index project to deliver a sustainable index based on ISE-listed companies by December 2011. The ISESI project's goal was "to provide competitive advantage for leading Turkish companies by raising the profile of sustainability leaders." Sustainability indices at a country level have been developed since 2004 in major EMs, using similar but different ESG frameworks based on local requirements: in Brazil (2005), China (2009), Egypt (2010), South Korea (2009), India (2008), and South Africa (2004), many with stock exchanges as strategic partner.

The ISESI project plans to deliver the ISE Sustainability Index by developing a set of Turkey-specific company sustainability criteria covering ESG issues through stakeholder consultations and mapping best practices of global initiatives such as the GRI and the CDP with Turkish business practices and economic development needs. The ISESI advisory board is drawn from stakeholders in Turkey's private and public sectors. Once finalized in mid-2011, the ISESI criteria and ranking methodology will be applied to ISE-listed companies for the selection of the index constituent companies. In 2011, company assessments will be completed by a third-party institution with conceptual input from Sustainable Asset Management, a research provider of the Dow Jones Sustainability Indexes (DJSI).

The ISESI project team has stressed that the ISESI project seeks not only to apply best international practices in Turkey, but also to explore and present unique Turkish business features. The ISESI project has already made progress on the following objectives: raising the profile of sustainability in Turkey, building on previous work of the UN PRI, launching of CDP Turkey through events at the ISE, meetings with companies and investors, media interviews, and online communications through the ISESI website.

The index is welcome as a positive development, although there are concerns that ISESI may face the same destiny as XKURY. Some of the shortcomings of the XKURY have been eliminated in the ISESI project. Research will be conducted by a single firm using a consistent methodology, and all the firms within the selected universe will be covered. There is no information about the intended methodology, but it is expected to be similar to Dow Jones methodology, based on firms disclosing required information voluntarily. The success of the ISEIS project will be contingent on i) the willingness of Turkish firms to disclose the required information and the resulting coverage, ii) the level involvement of the institutional investors in the process. To our knowledge, the project has not yet solicited input from institutional investors.

Our round table with corporate representatives highlighted the concerns of the corporate sector that the criteria for being included in the index may not address issues important for investors. A workshop organized on October 1, 2010, by ISE and the TBCSD to identify current corporate risks and opportunities associated with sustainability highlighted the following key sustainability issues in order of importance: "Energy security, lack of regulation and standards regarding sustainable development, strategic long-term government planning, skill, resource constraints, climate change and material-based consumption, water scarcity, intellectual property, and valuing ESG issues (individual and government)."[3] This list demonstrates the mismatch between the priorities identified in the workshop with respect to sustainability and the priority given to corporate governance issues by international institutional investors. It is yet unclear whether the corporate sector's interest in this project will continue if investors' concerns are not addressed. The index would be considered successful if it can

3 Report issued by the ISESI project team, December 2010.

generate ETFs that would attract investors and if investors deliberately choose to invest in the index firms. However, the impact of the index on stock selection may be limited because institutional investors' current interests gravitate toward roughly 10 companies with the highest liquidity and market cap. Any adjustment of the weighting between these companies or the exclusion of companies that do not meet the criteria will introduce "tracking errors" against benchmark indices that may not be acceptable to investors. Furthermore, any reallocation of capital between 10 and 15 companies will have a limited effect on changing corporate behavior.

The index will undoubtedly enhance the reputation of ISE and also has the potential to help sustainable enterprises that are not currently on the radar screen of portfolio investors to stand out. This potential may be realized if the index expands its coverage to SMEs and GIY members, and is based on metrics that reflect more than just disclosure intensity.

"Stock indices are indicators of price and return performance of companies. Companies included in market indices have a high potential of access to capital, attract investors' attention, and benefit from higher liquidity. Therefore, we believe that the ISE Sustainability Index will prove to be a strong instrument to motivate investors and companies. ISE Sustainability Index will add to the international competitive power of companies, while providing a benchmark for their social, environmental, and corporate governance performance in addition to their financial performance.

The Index will display companies' approach to important sustainability issues including global warming, draining of natural resources, health, security and employment, while allowing the independent assessment and in a sense, registration of their operations and decisions regarding these issues. The Index offers companies the opportunity to compare their sustainability performance on a local and global level. With the Index, the ISE provides companies an instrument for evaluating their performance and consequently adopting new targets or furthering their performance while allowing them to develop their risk management abilities for corporate transparency, accountability and sustainability. This, in turn, lets companies gain competitive edge.

Inclusion in the Index will add to the visibility and prestige of companies. On the other hand, thanks to the Index, efforts on sustainability carried out in Turkey will be publicized on a global level. The Index will allow companies to access global clients, capital, and lower-cost finance more easily.

The project aims to create an instrument which will allow investors to select and invest in companies that adopt principles of sustainability and corporate governance. On the side of asset managers, the Index will provide an indicator that will be the underlying asset for various financial products including sustainability funds, exchange traded funds and structured products.

Today, responsible investment is preferred mainly by institutional investors. The ISE Sustainability Index will encourage the establishment of such funds, while facilitating it for Index-constituent companies to get a larger share from such funds. At the same time, the Index offers a new financial asset category for all investors."

Esin Akbulut, Vice President of ISE *

* Interview.

7 Looking into the Future

"Income inequality, religious fundamentalism and regional volatility are the issues to watch when evaluating investments in Columbia, Indonesia, Vietnam, Egypt, Turkey and South Africa. (...) You have to look at the politics carefully in each of the countries."

Prof. Dr. Franklin Allen*

* "The new BRICS on the Block: Which Emerging markets Are Up an Coming?" Knowledge@Wharton, January 19, 2011 (http://knowledge.wharton.upenn.edu/article.cfm?articleid=2679).

A. Challenges and Opportunities

Our analyses indicate that the SI market in Turkey faces a number of challenges that are country-specific as well as some that are common to all EMs. In this chapter, we will first discuss the challenges that are common to EMs globally, followed by those that are specific to Turkey. A number of concrete recommendations are included. We have treated as out of our scope issues related to the shortcomings of the global financial industry structure and the overgrowth of global markets beyond regulatory capabilities, but note that existing industry structures, incentive systems, and the erosion of confidence in financial markets pose challenges for long-term investors in general, despite the on-going process of improvement.

Although investor surveys conclude that "the biggest challenge to investing in emerging markets is a lack of ESG disclosure" (EIRIS, 2009), it is unlikely that ESG disclosure would be sufficient to stimulate SI in a single country. Large institutional investors cannot reduce their investment universe (that is, decrease the potential for diversification), even in BRIC countries, without a corresponding increase in portfolio risk. Most mainstream institutional investors with long term investment horizons, therefore, focus primarily on active ownership strategies and monitoring. The perception of EMs as fragile and exposed to high political and macroeconomic risks effectively marginalizes ESG risks. Liquidity remains the single most important criterion for investing in EM firms. Satellite markets such as Turkey offer a limited number of investable stocks that meet liquidity criteria, resulting in an overweighting of high liquidity firms that meet market cap requirements in country allocations. The first challenge for SIs in smaller EMs is therefore the size and depth of the market.

The second challenge facing the SI industry in our view, is the limited availability of comparable, context-specific ESG information about EM firms with a sufficiently large coverage of EMs. Index builders and research firms confirm that there is market demand for ESG information about EM firms and that the concept of global or regional EM indices incorporating ESG risks appeals to institutional investors. ESG research in EMs, however, requires a different approach than does ESG research in developed markets. The scope of regulatory disclosure is narrower than for developed markets, and disclosure is unreliable. ESG issues in EMs are also different from those of developed markets and are often country-specific. The trade-off between comparability and relevance is difficult to get right and requires an in-depth understanding of emerging markets. This makes ESG assessment a costlier exercise in EMs, and research firms have difficulty achieving economies of scale. The second challenge is therefore making meaningful, comparable, and reliable ESG information available to investors or data providers. Data providers have been trying to overcome cost issues through industry consolidation, but it is not yet known whether the consolidation process will lead to product innovation and address the issues around the informative value of ESG risk assessments.

"Has Istanbul entered the competition to be the leading exchange in Eastern Europe?"

The Economist, 2010 *

* November 13th, 2010

Challenges specific to Turkey are not insignificant.[1] The precondition for growing SIs is growing the equity market, requiring an increase in new IPOs and floatation ratios. Turkey's regulator appears to be aware of this challenge as illustrated by a recent IPO campaign. Partly due to the efforts around this campaign, 22 IPOs were realized in 2010. Whether the IPO trend will continue is unknown, however.

The second challenge that Turkey faces is growing the pension funds and the funds industry. In the long term, the growth of domestic institutional investments is the only route to financing Turkey's growth sustainably. Domestic institutional investments, however, currently constitute only 10 percent of Turkey's (already small) equity market. The Turkish pension fund firms are well regulated and the pension system has the potential to shape the fund management industry, but it will take time before pension funds reach a size that can influence investment strategies. We emphasize the need for regulatory improvements in the fund management industry to foster specialization and competition.

The stock market in Turkey is perceived to be highly volatile and open to manipulation. Incidents that support this perception will decrease as market control and efficiency are improved, but this process will also require improving the quality and independence of research, which is "long forgotten," according to the head of CMBT (presentation of May 15, 2010). This challenge should not be underestimated as "asset owners and asset managers are not separated in Turkey".[2] This overlap leads to moral hazard. CEOs of portfolio management companies are concerned about possibly disqualifying some of the affiliated companies belonging to the same business group[3] by supporting the use of ESG criteria in investment decisions.

It should be emphasized that Turkey also has many strengths, including a well regulated banking system and pension fund industry, prospects of sustained growth, a competent and independent Central Bank, increasing investor interest in EMs and Turkey, and the EU accession process. Although there has been a slowdown in the EU accession processes and the democratization process is facing risks stemming from the complexity of the process, both continue to act as strong drivers for the normalization of Turkey. Furthermore, the government's ambition to make Turkey a financial center in five years can form a basis on which to build comprehensive strategies and programs to overcome the challenges explained above.

*"Despite an active government policy to increase investments and attract strategic foreign investors, political uncertainty before 2011 elections may yet constrain investment capacity." **

* EBRD.2010.Recovery and Reform, London, UK

1 We note the need for policy interventions to increase savings rates but leave it aside as the subject is complex and beyond our scope. Low savings rates are attributed to a number of macroeconomic (the relatively small fraction of working population, the age structure of the Turkish society, political uncertainty, tax evasion, and the degree of financial development) and behavioral (distrust of the banking system, culture) issues. Savings kept outside the formal system are estimated to be close to 60 percent of registered savings.
2 CEO of a leading portfolio management firm.
3 Further research is needed to understand the implications of business group structures for the fund industry.

Investment instruments based primarily on corporate disclosure on so-called sustainability factors may create noise and cause adverse selection. Another possible risk is inflating the demand for larger companies that already have preferential access to finance and have more resources for disclosure and investor communication.

"The pursuit of ESG performance is a "non-market" strategy which aims to encourage firms to make a positive impact on their environment. In economic terms, sustainable investments are those that encourage firms to create "positive externality". I say "non-market", because ESG performance may not always be reflected in current prices (product price, stock price and so on). Therefore the key question is how can firms "internalize" these "externalities" to improve their profitability. This will require interventions by decision makers/ regulators who can envision the social welfare effect of ESG performance beyond the market indicators. Investors can also play a significant role, but they also need incentives e.g. based on an international convention or global consensus."

Prof. Dr. Hasan Ersel*

* Interview

B. Premises

Our recommendations are prioritized, based on their expected economic impact. They are underpinned by the following premises informed by the opinions and recommendations of our panel of distinguished Turkish economists:

- Bank loans are still the dominant and preferred means of finance for Turkish companies as demonstrated by comparatively high leverages reported by Turkish companies. Larger and more established companies have easy access to low-cost loans from international banks, thanks to the surplus of global money. Banks are well regulated in Turkey, and the banking industry is competitive. Banks play a very significant role as underwriters and creditors in the financial markets in Turkey. Initiatives that involve banks are more likely to be effective. We also acknowledge that sustainable investors have been shifting more weight to EM debt instruments from equity investments. Our recommendations should take this trend into consideration, together with the expected growth of the bonds and bills market in Turkey.

- The Turkish legal system has significant weaknesses in contract enforcement. Improvements to the legal and regulatory framework are hampered by judicial inefficiencies. Controlling shareholders prefer to retain control and occupy management seats partly to protect their investments, limiting the development of managerial expertise and the growth of the managerial labor market. PE investments can exercise direct control and aggregate the scarce human capital and expertise required to support growth strategies that may otherwise be unattainable. We should leverage the current interest and increasing attractiveness of PE investments in EMs in formulating our recommendations for Turkey.

- We accept that investment instruments based primarily on corporate disclosure on so-called sustainability factors may create noise and cause adverse selection. Another possible risk is inflating the demand for larger companies that already have preferential access to finance and have more resources for disclosure and investor communication. We should be careful about those risks.

- Small to medium-sized companies have difficulties in accessing finance, especially if they are not affiliated with the handful of business groups that collectively dominate the economy. Current statistics reveal that SMEs receive a significantly lower share of the credit supply in Turkey, when compared with other markets. Financial difficulties encourage SMEs to opt for informality and tax evasion, thus hindering sustainable economic development. Our recommendations should benefit independent (not belonging to a business group) SMEs in accessing finance.

- The XKURY, launched in 2005, has not been instrumental as an investment vehicle. It has limited (if any) visibility and use in investment decisions. In other EMs, experiences vary with respect to those indices based on ESG criteria. There is no proven model for a commercially feasible

"What doesn't help ESG analysis in emerging markets is that traditional sustainability/ ESG research models created to rate developed world companies can become counterproductive in an emerging market context. These models reward companies that show signs of some activity in the right direction rather than 'on the ground' shifts in business activity. A better approach would be to identify companies that demonstrate that they 'execute' sustainability. This means looking not only at the 'screen' of corporate information available in public media but also on-the ground resources that are much more reliable and real. These include information from non-profit organizations, direct feedback from customers, and consumer groups, details from governments and regulators and input from stakeholders that do not have a voice in the media."

Vipul Arora, Solaron Sustainability Services*

* Sustainable Emerging Markets, Responsible Investor 2010.

approach. Our recommendations should be informed by the experience of the XKURY and the experiences of other EM index initiatives. Commercially feasible solutions should also be economically desirable by offering a solution to the dilemma between international comparability and context relevance. We should be mindful of industry dynamics that may support oligopolistic structures and hinder innovation and product quality.

- Governance is the most important of the ESG factors for international investors in EMs, followed by environmental issues, moderated by the impact of climate change on their globally competitive sectors. We believe the popularity of environmental indices reflects the relative ease of finding proxies for quantifying environmental risks. Existing instruments, such as corporate governance principles and comply-or-explain reporting frameworks, should be leveraged in formulating our recommendations with the objective of improving the informativeness and accessibility of ESG disclosure for investors.

In formulating our recommendations, we limit the scope to strategies that can be implemented by private actors and development agencies. We have omitted public policy recommendations from this report. We must reemphasize, however, that SI can take root in democratic countries with an active and organized civil society, and only if local institutional investors and especially pension funds have the size and capacity to be influential as active investors and monitors.[4]

4 Pension fund reform was a subject of debate in Turkey a few years ago, but the discussions ended due to the complexity of the matter. The proposal made by the pension firms to transfer to the pension funds severance pay reserves, which currently sit in the balance sheets of corporations as a liability, have not been supported by the corporate sector. Another proposal put forward by pension firms is that the tax benefits accrued to the pension contributors are postponed until the age of retirement. There is already some evidence from other EMs that domestic pension funds are important investors. Iglesias-Palau (2000) and Lefort and Walker (2000) document, for example, on the importance of such institutions in Chilean listed companies both as monitors and as a source of debt financing to these companies. Evidence from Chile also shows that pension reform had a positive influence on business conduct. Related research by Khorana, Servaes, and Tufano (2005) looks at the mutual fund industry in 56 countries and documents that the industry is larger in countries in which defined contribution pension plans are more prevalent.

C. Recommendations

RECOMMENDATION 1A:

Operationalizing the integration of ESG criteria in syndicated loans by development banks

DFIs play an important role in EMs by incorporating sustainability criteria in their lending and investment processes. Our research reveals that there is room for improvement in operationalizing the integration of ESG criteria in DFI's lending supply chain, which requires improved and regular monitoring and verification of conditionality requirements.

Current practices rely primarily on reports submitted by the receiving banks and occasional monitoring missions. The effect of conditionality on the borrowers' business conduct and the economic impact of borrowers' compliance with the criteria are not always clear. Anecdotal evidence suggests that development banks mostly concentrate on up-front due diligence while being less diligent in following up on the conditionality after the loan extension. Frequently, the loan goes into the credit pool of the borrowing bank and is not matched with specific credits. In some cases, the assessment is limited to the verification of existence of an environmental impact assessment report with the help of external consultants. Exceptions are sector-specific loans or theme-based loans for which specific conditionality applies as a part of the due diligence of an intermediary.

Local banks often lack the capacity and know-how to be effective monitors of the ESG criteria. We recommend that international development banks can collectively undertake a project with the following aims:

- Develop internal capacity within the local banks (individually or collectively) Developing internal capacity within the local banks (individually or collectively) to assess the materiality of ESG risks and incorporate those risks in the credit rating process; and
- Developing guidelines and processes for effective monitoring of the borrowing firm's compliance with ESG criteria throughout the lending period (without overloading the entire process with bureaucracy).

There are good practices and examples that the development banks can share. We recommend that the development banks active in Turkey collectively undertake a project to share best practices and collaborate in developing the means to improve the integration of ESG criteria in the lending supply chain. Undoubtedly, the project can be successful only if all major development banks are willing to collaborate.

Actors: IFC has strong ESG requirements. IFC has the longest history and experience in Turkey in project finance. Although being new to Turkey, EBRD has demonstrated substantial effort is assessing the governance quality of the markets it covers, including Turkey. AFD has been focusing on SME financing using social standards as the qualification criteria. AFD has also developed training programs on sustainability assessments for local banks' credit departments. Local development banks (Turkiye Sinai Kalkinma Bankasi and Turkiye Kalkinma Bankasi) should also be involved to develop the most effective means of operationalizing ESG integration in the Turkish context. The Banks Association of Turkey can play a facilitation role.

Timeline: The first meeting can be organized with a two- to three-month notice, allowing the banks to assess their current status and prepare for the meeting. Implementation time will depend on the conclusions of the meeting.

RECOMMENDATION 1B:

Product development: ESG/Sustainability rated bonds.

The bond market is by far the largest securities market in the world. Many institutional investors—insurance companies, pension schemes, foundations—have a substantial asset allocation in fixed-income instruments. Many of these investors are also subject to restrictions regarding the type of investments they may acquire. Eurosif (2010), reports that SIs in bonds reached 33 percent in 2009 in Europe, following equities, which constituted 53 percent. The institutional investors we interviewed confirmed their interest in debt instruments issued by Turkish corporations.

Although ESG rating of bonds may be too ambitious, it may be feasible to develop single-theme bonds. Green bonds are issued by a government or corporate entity in order to raise the finance for an environmental project. The idea of a "climate bond" is an extension of the green bond concept. Corporate bonds that are issued to finance projects to combat the effects of climate change can be certified and may be tax-exempted. The construction sector can be a pilot sector with a spillover effect on construction material suppliers, a substantial industry in Turkey. The Turkish Green Building Council is a capable organization that can issue international certificates for construction projects confirming businesses' compliance with sustainability criteria.[5] Climate Bonds Initiative, would serve as a catalyst Climate Bonds would involve large scale issuance of long-term debt to overcome medium term investment barriers preventing the achievement of economies of scale in low-carbon industry sectors. The bonds can finance a global transition at speed and at scale.

Actors: BRSA and the Climate Change Department at the Ministry of Environment can collaborate to develop the concept, together with the Banks Association of Turkey and TSKB.

Time Line: The concept development needs an institution willing to take the lead and has the capacity to develop the concept. It should be possible to develop a product within a year.

5 A special project of the Network for Sustainable Financial Markets and the Carbon Disclosure Project, the http://climatebonds.net/

RECOMMENDATION 2A:

Structural backing of local PE funds which integrate ESG criteria explicitly in their portfolio strategies.

With declining interest rates and a gradual increase in access to debt financing in local currency, PE in Turkey is expected to grow faster. The backing of PE funds by development banks has proved to be the most effective means of operationalizing ESG concerns in financing Turkey's privately held businesses. These firms are also potential IPO prospects. Sustainability-labeled or theme-based PE funds focused on portfolios exploiting opportunities resulting from regulatory changes or changes in consumer preferences may attract SIs. Asset managers from Nordic countries and France have the highest share of SI investments in EMs, yet there is no indication that their portfolios include Turkish companies. PE funds with seed money from development banks may appeal to the asset managers located in those countries.

One of the barriers to PE investments in Turkey is the difficulty of generating a pipeline. Most owners are reluctant to give up or share control. PE managers may accept a minority position, based on ESG compliance of the portfolio companies (with a focus on governance), and that may help encourage the owners who wish to hold on to their majority positions to accept PE investments.

IFC's experience in PE investments shows that smaller companies are not as risky as commonly perceived. Furthermore, first-time funds perform similarly to funds that are not first-time. These findings support the premises that PE investments can be expanded to include first-time theme-based funds. For example, sustainability and SME themes can be combined in one fund, multiplying economic impact. During our research, we have encountered new PE initiatives that intend to use ESG factors explicitly in their portfolio selection process.

Actors: IFC, EBRD, AFD/Proparco, and other development banks; general partners of local PE funds; asset management firms interested in the concept.

Time Line: It would take four to five months to identify local partners that are qualified and willing to launch a sustainability-themed PE fund, formulate the fund strategy, and start fund raising.

RECOMMENDATION 2B:

Structural backing of a mutual fund managed by an independent asset management firm.

Newly established asset management firms are interested in SIs. Under the leadership of UN PRI and its Turkish signatories, and with the involvement of the leading pension firms, a UCITS fund can be established with the objective of investing in sustainable firms. Although investment funds founded outside Turkey needs to be registered with the CMBT to be qualified for pension funds to invest in them, it may be possible to establish the new fund under an existing umbrella fund. It may also be possible to involve the CMBT in finding the best solution that can be implemented sooner rather than later. A sustainability fund that both leading local pension funds and international investors can invest in may be able to achieve the economies of scale that would justify the additional costs needed for ESG monitoring.

We recommend that UN PRI and AvivaSA, the joint venture between UN PRI signatory AVIVA plc. and Sabanci Holding, take the lead to finding the best approach to establishing a sustainability-themed passive fund in collaboration with the pension industry. One possible approach could be inviting independent (not affiliated with the business groups that the leading four pension funds are affiliated with) asset management firms to a competitive bidding process.

Actors: UN PRI, newly established asset management firms, and the four leading portfolio management firms: AvivaSA, Anadolu Emeklilik, Garanti Emeklilik, and Yapi Kredi Emeklilik.

Time Line: A feasibility study will take two to three months. A competitive bidding process will take five to six months.

RECOMMENDATION 3:

Review and revision of CMBT's Corporate Governance Principles and improvement of the CG Compliance Reporting regulation.

CMBT's CGGs are comprehensive; however, the compliance reporting is ineffective. The reporting template (the so-called reporting standard) that covers the minimum reporting requirements is poorly designed, and the reports are not easily accessible. Currently companies are required to include the compliance reports in their annual reports, which lag four to six months behind the operating year, so the reports may be outdated by as much as 18 months at a given time. Moreover, accessing compliance reports involves downloading large "pdf" files, which includes substantial amount of communication with little informativeness. CMBT's website provides a link to CG compliance reports of all the listed companies at (http://www.spk.gov.tr/indexcont.aspx?action=showpage&menuid=10&pid=4&submenuheader=-1), but in many cases either the link to a company report or prompts to the home page of the company website do not work. Anecdotal evidence indicates that investors do not make use of these reports, perhaps because the disclosures are incomparable, sometimes not relevant, and not verified.

We recommend that compliance reports should be explicitly disclosed through the Public Disclosure Platform[6], a regulated medium that provides a single repository of key information about the company, identities of board members, significant direct and indirect shareholdings, and financial reports.

In addition to making compliance reports easily accessible through the Public Disclosure Platform, the reporting template or standard should be redesigned so that the information provided by the firm is consistent, comparable, and relevant. Some of the most commonly searched indicators by investors should be included in the template--for example, the name and independence of audit committee members and the committee's chair, board members' affiliations with controlling shareholders, their education and prior experience, penalties and appeals to the public prosecutors by CMBT about the firm's wrongdoings, etc. Currently, information about lawsuits or penalties about listed companies cannot be accessed by investors except the disclosure made by firms at the time of appeal. The revised template can include a cross referencing table that indicates which information is disclosed elsewhere.

In 2010, CMBT launched a project to revise the CG principles, and it solicited recommendations from domestic market players. We recommend that this process include foreign institutional shareholders and their professional institutions. Revisions should reflect the preferences of institutional investors and empirical research findings on the performance effects of companies' compliance with CMBT's recommendations.

Actors: CMBT, ISE, TKYD, CGFT (who participated in the development of the guidelines). UN PRI can be involved in facilitating investors' input; EBRD and IFC can provide technical assistance.

Time Line: Six to twelve months.

6 The primary purpose is to facilitate timely disclosure of material events through use of a secure digital signature.

RECOMMENDATION 4:

Differentiation of sustainable small and medium size companies listed in the newly established Emerging Companies Market (GIY).

The GIP was established as a distinct market within the ISE to create a trading platform for securities issued in order to raise funds from capital markets by companies that do not fully meet the quantitative listing criteria (age, capital, profit, market capitalization, etc.) but have development potential. A market advisor system is established to help companies to prepare for the GIP application, and the advisor cosigns the application. Shares should be issued by restricting any preemptive rights to ensure that the capital raised goes to the company. IPO or private sales of the existing shares are not allowed for the same purpose. GIP-listed firms are also required to issue a CG compliance report. We recommend that a simplified and relevant version of CMBT's CGG should apply to these firms. This opportunity can be used to determine ESG criteria for SMEs in Turkey and perhaps focused on community impact considering that most of these firms are in smaller cities.

The reporting scheme can be designed to rate compliance with ESG criteria and categorize the GIP firms in a simple social rating. These ratings can be used in developing exchange-traded funds with possibly tax-exempt status, making SME investment more attractive for institutional investors and investors from the local community. An investment protection fund or an insurance scheme guaranteeing initial investment protection can be devised.

Actors: TOBB, KOSGEB, CMBT, ISE, and TEPAV (a research and policy center working closely with TOBB).

Time Line: The project needs further conceptualization by a leader from one of the above-mentioned actors. It is still unknown whether SMEs will be interested in offering their shares in the GIP.

"A new multi-polar world requires multi-polar knowledge. Emerging economies are now key variables in the global growth equation.

(...) Yet for too long prescriptions have flowed one way. A new multi-polar economy requires multi-polar knowledge.

With the end of the outdated concept of a Third World, the First World must open itself to competition in ideas and experience. The flow of knowledge is no longer North to South, West to East, rich to poor.

Rising economies bring new approaches and solutions.

(...) This is no longer about the Washington Consensus. One cannot have a consensus about political economy from one city applying to all. This is about experience regarding what is working - in New Delhi, in Sao Paolo, in Beijing, in Cairo, and Accra. Out of experience may come consensus. But only if it is firmly grounded -- and broadly owned."

Robert B. Zoellick, World Bank*

* Georgetown University, September 29, 2010

RECOMMENDATION 5:

Developing research capacity and an approach to rating/assessing emerging market firms' ESG risks/performances.

As explained in the Research and Indices chapter of this report, indices as sustainable investment instruments face a number of challenges. These challenges are applicable to all EMs, as well as to Turkey. The challenge seems to be getting the right balance between comparability and context relevance and coverage of all important EMs. Research firms and asset managers we have spoken to believe that there is a space for EM specialization in global research, but achieving economies of scale is costly and the entry barrier is high.

We propose that the above-mentioned challenges can be overcome by scaling up proven platforms and innovative business models. We provide some examples below.

Example of a Proven Platform

CDP is a good example of a proven platform. It is the most widely used and recognized global information provider of environmental disclosure; its data are used by research firms and index builders alike. CDP processes are currently being expanded to cover water disclosure, and CDP is positioning itself as a sustainability disclosure platform. CDP has a well-defined process of soliciting information from companies on behalf of investors, its information technology infrastructure is scalable, and its database includes quantitative as well as qualitative disclosures. CDP is working with information technology partners, such as German software firm SAP AG, to make its database a repository from which customized reports for different needs can be pulled out by investors, researchers, and index builders. CDP is a not-for-profit organization but has proved to be professionally run and sustainably funded by the investment community over the past decade.

What CDP lacks is the content knowledge on governance and social disclosure requirements although it has a process to define disclosure standards through stakeholder consultation. Considering that investors are more interested in governance disclosures and there is enough empirical research on CG in EMs (for example, GCGF's EM research network), developing a set of criteria that are relevant to all EMs should be possible. Turkey can be the pilot country to test the idea. If the model works, it can be expanded to other EMs where CDP has local partners. Another route of expansion could be to expand to transition countries with the involvement of EBRD, thereby benefiting from EBRD's expertise and interest in CG in transition countries.

Actors: UN PRI can take the lead to invite interested signatories; global asset managers, and index builders to collaborate in developing the concept. Global asset management firms, index builders (FTSE), EBRD, CDP, CGFG EM Research Network and governance experts on the pilot countries should be invited to get involved. FTSE has a working relation with CDP through their recently launched Carbon Strategy Index.

Time Line: A pilot project is estimated to take eight months; a scoping study would take two to three months.

Expanding the Research Network

Anecdotal evidence suggests that investors and index builders are interested in global investment instruments consisting of EM stocks, adjusted for ESG risks. One of the reasons why previous attempts have been discontinued is the gaps in ESG data on sufficiently large coverage of EMs. Scalability of analytical research into EMs has proven to be difficult and costly. Subcontracting to local firms is one of the strategies used by global research firms, but the challenges explained in Chapter 6 are still valid. Public disclosure in EMs is estimated to cover about 30 percent of the ESG criteria covered in developed markets. Although the cost of screening public information is perhaps lower in EM, the disclosure is generally not reliable. Disclosure needs to be verified by stakeholder consultations and on-site visits where possible. Such detailed assessments are costly and require senior analysts with management consultancy skills who can go beyond disclosure analysis with knowledge of the local language and understanding of the local context. These efforts lead to higher costs for generating reliable ESG data in EMs for which the demand is not high enough to justify the costs.

Solaron's business model explained in chapter 6 can be applied to cover analytical assessments in other EMs to meet the coverage requirements of international institutional investors and index builders. Global research firms may be interested in taking the lead to validate the feasibility of scaling up their business model with Turkey as a pilot. They may consider a seed investment in a startup in Turkey with an option to buy it later. If the model works, further diligence is required to develop the roll-up plan and the profit-revenue model. This phase will require the involvement of the end user (an index builder or a global fund manager). The objective would be to fill in the gaps in EMs coverage by a network of local research houses in a commercially feasible way. Initial pilot project investment needs to be funded. UN PRI can initiate and fund the scoping study.

Actors: UN PRI, global research houses (MSCI, Bloomberg, Reuters, and Jantzi-Sustainalytics), global index builders or fund managers interested in emerging markets.

Time Line: The scoping study would take two to three months to identify the players. The actual project would depend on the objective of final use and the coverage.

We believe the two options explained above can be evaluated in combination.

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Appendix

Chapter 2

Table A2.2 The Sectoral Breakdown of GDP (% of Value Added)

	Agriculture			Industry*			Manufacturing			Services		
	1995	2000	2009	1995	2000	2009	1995	2000	2009	1995	2000	2009
Turkey	16.29	11.31	8.99	33.24	31.48	27.96	23.42	22.50	16.90	50.47	57.21	63.06
Brazil	5.77	5.60	6.61	27.53	27.73	27.19	18.62	17.22	15.54	66.70	66.67	66.20
China	19.96	15.06	10.35	47.18	45.92	46.30	33.65	32.12	33.92	32.86	39.02	43.36
India	26.48	23.35	17.11	27.83	26.19	28.25	17.88	15.60	15.87	45.68	50.45	54.63
Russia	7.16	6.43	5.02	36.96	37.95	37.23	-	-	17.99	55.88	55.62	57.75

Source: World Development Indicators (2009 figures for Russia reflect 2008 data) I *Industry includes Manufacturing

Table A2.3 Composition of Household Financial Assets (TR Billions, %)

	2008		2009		March 2010	
	TL Billions	% Share	TL Billions	% Share	TL Billions	% Share
TL Deposits	188.7	51.2	209.5	50.0	220.3	51.2
FX Deposits	89.0	24.2	97.0	23.1	94.1	21.9
- FX Deposits ($ Billions)	59.1	-	64.5	-	61.7	-
Currency in Circulation	30.6	8.3	35.4	8.4	36.6	8.5
GDDS + Eurobond	19.7	5.3	14.1	3.4	12.5	2.9
Mutual Funds	20.8	5.6	26.1	6.2	26.4	6.1
Stocks	10.6	2.9	24.6	5.9	27.3	6.4
Private Pension Funds	6.4	1.7	9.0	2.1	9.7	2.3
Repos	2.2	0.6	2.3	0.5	1.8	0.4
Precious Metal Deposits	0.3	0.1	1.1	0.3	1.2	0.3
Total Assets	268.3	100.0	419.1	100.0	429.9	100.0

Source: BRSA-CBRT, and FX CMB, CRA: (1) TL and FX deposits include participation funds

Table A2.4 Number of Companies and ETFs Traded on the ISE

	National Market	Second National Market	New Economy Market (**)	Watch List Companies Market	Total	Collective Products (***)	General Total	Other Companies (*)	IPOs
2000	287	13	--	15	315		315		
2001	279	13	--	18	310		310		
2002	262	14	--	12	288		288	13	4
2003	264	16	--	5	285		285	13	2
2004	274	17	1	5	297		297	10	12
2005	282	16	2	4	304		306	12	8
2006	290	15	3	8	316		322	13	14
2007	292	14	3	10	319		327	13	9
2008	284	18	3	12	317		326	6	2
2009	233	20	2	12	267	58	325	7	1
2010	233	22	2	12	269	58	327	7	21

Source: Capital Market Board of Turkey, Annual Report 2009, p.31.

Notes: - 2010 figures are as of April 09, 2010.

(*): Other Companies are the companies that are temporarily de-listed and will be traded off the Exchange under the ISE's Board of Directors' decision.

(**): The New Economy Market was launched on March 03, 2003. Data before March 03, 2003 belong to the New Companies Market.

(***) : Collective Products Market became operational as of November 13, 2009. Exchange Traded Funds, Real Estate Investment Trusts Venture Capital Investment Trusts and Investment Trusts which are previously classified under National Market, classified under Collective Products Market since November 13, 2009.

Table A2.6 Stocks Traded, Total Value (% of GDP)

	Brazil	China	India	Turkey
2000	15,71	60,20	110,78	67,23
2001	11,76	33,89	52,17	39,76
2002	9,56	22,93	38,86	30,39
2003	10,94	29,06	47,51	32,87
2004	14,10	38,74	52,58	37,59
2005	17,48	25,98	51,83	41,67
2006	23,37	60,18	67,27	42,87
2007	42,82	222,27	89,84	46,73
2008	44,42	120,69	86,46	32,82
2009	41,30	179,67	83,11	39,46

Source: Standard & Poor's, Emerging Stock Markets Factbook and supplemental S&P data, and World Bank and OECD GDP estimates.

Table A2.7 Banking Industry

	Assets (TL Billions)	Share in 2010 (%)
Central Bank of the Republic of Turkey (TCMB)	111.4	9.90
Banks	908.6	80.90
Insurance Companies	31	2.80
Financial Leasing Companies	14.2	1.30
Factoring Companies	12.3	1.10
Securities Investment Funds	29.8	2.70
Other Financial Institutions	15.3	1.40
Total	**1122.6**	**100.00**

Source: Annual Report of the Association of the Insurance and Reinsurance Companies of Turkey (TSRSB, 2009, pp. 37)

Table A2.8 Debt Securities

		Domestic Debt Securities ($ Billions)	Domestic Debt Securities/GDP	Government Bonds' Share	Corporate Bonds' Share
1	**U.S.**	23900	173%	27%	73%
2	**Japan**	8707	199%	81%	19%
3	**Italy**	2942	140%	59%	41%
4	**France**	2653	104%	52%	48%
5	**Germany**	2458	74%	53%	47%
6	**Spain**	1532	106%	32%	68%
7	**China**	1529	47%	68%	32%
8	**U.K.**	1354	49%	67%	33%
9	**Canada**	1134	79%	63%	37%
10	**South Korea**	1119	117%	43%	57%
22	**Turkey**	217	33%	100%	0%

Surce: BIS (Bank for International Settlements) Securities statistics and syndicated loans.

Table A2.9 Investments of Insurance and Reinsurance Companies (TL Thousands)

	2005	2006	2007	2008	2009	% of Total (2009)
A. Securities	6.197.955	6.683.403	7.848.883	8.489.564	11.140.504	62,22%
Treasury bonds	444.209	290.592	282.895	534.648	542.326	3,03%
Government Bills	4.688.305	5.368.010	6.147.009	7.042.608	7.773.704	43,42%
Investment Funds	166.186	106.421	134.818	136.469	177.759	0,99%
Private Sector Bonds	2.245	2.537	14.676	6.226	22.223	0,12%
Repurchase Agreement	57.014	44.884	219.601	67.554	19.149	0,11%
Shares	212.929	237.595	273.025	159.107	2.050.699	11,45%
Others	627.281	634.457	507.526	572.898	526.655	2,94%
Financial Assets	-213	-1.093	-667	-29.946	27.898	0,16%
B. Real Estate	445.558	505.434	468.756	602.328	619.944	3,46%
C. Deposit accounts	1.470.870	2.538.199	3.132.804	4.769.346	4.685.971	26,17%
D. Participations	2.168.859	2.454.058	3.013.700	2.047.286	1.403.755	7,84%
E. Loans	66.733	152.873	168.909	221.242	53.622	0,30%

Table A3.3b Local Investment Funds - as of November 15, 2010 (Courtesy of AkPortfolio Management)

Fund Type	Average Holding	Total Value (TR)	Portfolio Value (TR)	Equity (%)	Government Bonds	Reverse Repo (%)	Money Market	Foreign Equity (%)	Others
INVESTMENT FUNDS									
Total	99.51	31,436,407,178.64	31,428,850,950.54	3.85	29.17	55.95	7.86	0.28	2.88
Type A	172.11	1,439,584,585.73	1,440,527,445.40	67.53	21.04	11.01	0.05	0.13	0.25
Type B	96.12	29,996,822,592.91	29,988,323,505.14	0.88	29.55	58.05	8.23	0.28	3.01
Type A Variable	65.87	254,280,632.53	250,293,393.74	65.08	15.29	18.73	0.10	0.18	0.63
Tyoe A Equity	28.55	142,939,494.88	140,119,969.76	80.89	5.88	13.23	0.00	0.00	0.00
Type A Mixed	456.97	360,114,171.16	360,642,222.76	36.23	52.13	11.48	0.00	0.00	0.16
Type A Sector	0	442,992.95	414,630.75	100.00	0.00	0.00	0.00	0.00	0.00
Type A Participation	83.63	181,296,471.84	181,285,412.59	85.16	8.50	6.33	0.00	0.00	0.00
Type A Special	245.52	134,057,005.82	134,241,759.29	51.27	34.03	13.45	0.36	0.00	0.88
Type A Index	39.07	360,411,870.94	367,508,060.35	92.01	1.96	5.73	0.00	0.30	0.00
Type A Foreign Equity	0	921,974.91	852,285.82	31.70	0.00	4.93	0.00	36.93	26.44
Type A Gold									
A Type Fund Basket	0	5,119,970.70	5,169,710.34	80.20	0.00	19.80	0.00	0.00	0.00
B Type Variable	389.86	2,382,490,505.29	2,393,456,028.64	6.77	78.23	9.99	0.69	0.00	4.32
B Type Bond and Bills	354.63	2,348,498,529.24	2,351,447,330.54	0.58	81.73	10.17	3.44	0.00	4.09
B Type Liquid2	0	23,119,210,071.44	23,099,803,771.52	0.00	14.07	74.86	10.56	0.00	0.51
B Type Mixed	158.83	2,398,970.38	2,259,573.06	0.00	8.46	3.94	0.00	87.60	0.00
B Type Foreign Equity	60.41	95,654,282.72	87,139,437.39	0.00	1.70	0.48	0.00	97.60	0.21
B Type Special Fund	1,326.65	147,684,483.09	148,303,183.50	29.67	69.06	0.19	0.00	0.00	1.08
B Type Index	684.13	56,557,194.85	56,567,782.58	0.00	99.93	0.07	0.00	0.00	0.00
B Type Gold	0.18	425,589,683.63	424,316,942.43	0.00	0.00	0.58	0.00	0.00	99.42
B Tipi Fund Basket	0	9,624,979.48	9,337,160.52	28.40	0.00	4.34	0.00	0.00	67.26
B Type Guaranteed	175.59	348,403,586.57	351,791,171.11	0.00	88.22	1.79	0.04	0.00	9.95
B Type Protected	184.55	1,055,532,219.50	1,059,193,306.03	0.28	88.25	3.13	0.00	0.00	8.34
B Type Free	554.99	5,178,086.72	4,707,817.82	20.50	48.67	29.26	0.14	0.00	1.43
PENSION FUNDS									
Total	442.23	11,666,119,526.46	11,671,035,234.08	13.39	60.76	9.47	0.01	0.13	16.24
INVESTMENT TRUSTS									
	256.03	2,615,108,060.79	1,018,319,788.03	24.42	42.7	10.8	0.22	0.2	21.66
Real Estate Investment Trusts	291.66	1,864,095,793.38	282,080,508.96	2.53	45.43	0.32	0.07	0	51.66
Securities Investment Trusts	235.84	751,012,267.41	736,239,279.07	36.82	41.15	16.74	0.31	0.32	4.66

Table A3.4 Portfolio Management Companies (TR Hundreds)

	Portfolio Management Companies	Number of Clients				Assets Under Management (TR Millions)			
		Indiv.	Inst.	Corp.	Total	Indiv.	Inst.	Corp.	Total
1	AK	14	37	12	63	88.1	5,727.4	439.9	6,255.4
2	ASHMORE	0	6	2	8	0	124.6	0.6	125.2
3	ATA	0	7	0	7	0	142.7	-	142.7
4	BENDER	3	0	0	3	4.8	-	4.8	-
5	DENIZ	0	19	0	19	0	565.2	-	565.2
6	ECZACIBASI-UBP	0	13	0	13	0	153.8	-	153.8
7	ERGOISVICRE	146	11	27	184	11.4	35.2	262.1	308.7
8	EURO	0	2	0	2	0	21.1	-	21.1
9	FINANS	101	32	6	139	44	1,022.5	32.7	1,099.2
10	FORTIS	2	18	1	21	3.7	692.9	1.1	697.7
11	GARANTI	36	33	18	87	155.8	5,865.9	300.4	6,322.1
12	GEDIK	0	7	0	7	0	25.2	-	25.2
13	GLOBAL	50	8	2	60	5.9	49.7	2.0	57.6
14	HSBC	0	14	0	14	0	1,684.6	-	1,684.6
15	ING	47	15	3	65	9.2	1,087.3	0.1	1,096.6
16	ISTANBUL	7	1	1	9	11.3	0.6	1.0	12.9
17	IS	3	41	16	60	17.1	8,636.8	965.6	9,619.5
18	STANDARD UNLU	0	4	0	4	0	28.6	-	28.6
19	TEB	108	29	11	148	62	1,208.1	106.3	1,376.4
20	UNICORN	0	4	0	4	0	7.9	-	7.9
21	VAKIF	0	12	0	12	0	600.4	-	600.4
22	YAPI KREDI	229	48	16	293	330.5	7,128.1	318.7	7,777.3
23	ZIRAAT	0	19	2	21	0	2,083.5	32.1	2,115.6
	Total (TR)	**746**	**380**	**117**	**1243**	**743.8**	**36,892.1**	**2,462.5**	**40,098.4**
	(USD)					**497.0**	**24,649.1**	**1,645.3**	**26,791.4**

Source: CMB

Table A3.6 Exchange-Traded Funds in Turkey

	Founder	Name of the Fund	Total Value (TR Thousands)
1	Bizim Menkul Degerler	Dow Jones DJIM Turkiye A Tipi	2,405,900
2	Finansbank	Dow Jones Istanbul 20 A Tipi	32,095,299
3	Finansbank	Mali Sektor Disi NFIST Istanbul 20 A Tipi	1,764,066
4	Finansbank	DJ Banka BYF	1,061,406
5	Finansbank	Istanbul Gold B Tipi Altin	77,460,729
6	Finansbank	FTSE Istanbul Bono FBIST B Tipi	42,860,653
7	Is Yatirim Menkul Degerler	Iboxx Turkiye Gosterge Tahvil B Tipi	12,528,583
8	Is Yatirim Menkul Degerler	Dow Jones Turkiye Esit Agir. 15 A	9,341,765
9	Finansbank	IMKB 30	73,609,867
		Total	**253,128,268**

Source: CMB

Table A3.7 Real Estate Investment Trusts in Turkey

	Real Estate Investment Trusts	Date of Establishment	Registered Capital (TR Thousands)	Paid in Capital (TR Thousands)	Net Asset Value (*) (TR Thousands)	Market Value (TR Thousands)
1	AKMERKEZ	2/15/05	27,400,000	13,700,000	910,043,319	453,607,000
2	ALARKO	7/31/96	20,000,000	10,650,794	254,974,865	146,341,910
3	ATAKULE	8/21/00	200,000,000	84,000,000	189,694,377	113,400,000
4	EGS	10/1/97	75,000,000	50,000,000	20,533,264	21,000,000
5	DOGUS-GE	7/25/97	500,000,000	93,780,000	167,401,691	105,033,600
6	IS	8/6/99	2,000,000,000	450,000,000	1,250,324,802	747,000,000
7	NUROL	12/23/97	40,000,000	10,000,000	57,082,470	33,700,000
8	OZDERICI	8/6/99	100,000,000	7,800,000	17,469,000	13,884,000
9	PERA (*)	9/3/97	250,000,000	96,000,000	100,908,710	53,760,000
10	SAGLAM	9/6/06	500,000,000	56,000,000	71,572,517	48,720,000
11	SINPAS	11/26/96	500,000,000	400,000,000	1,085,503,034	932,000,000
12	VAKIF	12/24/96	100,000,000	20,800,000	100,751,907	88,816,000
13	Y&Y	6/3/05	400,000,000	33,162,530	21,972,432	18,902,642
14	YAPI KREDI KORAY	4/24/07	100,000,000	40,000,000	97,798,033	77,600,000
	Total		4,812,400,000	1,365,893,324	4,346,030,421	2,853,765,152

Source: CMB * Pera

Table A3.8a: MSCI Emerging Markets Index Country Weightings (As of December 31, 2009)

COUNTRY	# COMPANIES	WEIGHT
China	117	17.90%
Brazil	75	16.90%
Korea	96	12.70%
Taiwan	117	11.40%
India	60	7.50%
South Africa	45	6.90%
Russia	28	6.30%
Mexico	23	4.30%
Israel	17	2.80%
Malaysia	42	2.70%
Indonesia	22	1.90%
Turkey	21	1.50%
Chile	16	1.40%
Poland	19	1.30%
Thailand	23	1.30%
Colombia	8	0.60%
Peru	3	0.60%
Egypt	12	0.50%
Hungary	4	0.50%
Czech Republic	3	0.40%
Philippines	12	0.40%
Morocco	4	0.20%
Total	**767**	**100.0%**

Table A3.8b: S&P/IFC EM Index Constituencies

Country	Index Weight	Number of Constituents by Size: SmallCap	MidCap	Adj. Market Cap ($ Millions)
Argentina	0.43%	4	2	8,859.10
Brazil	11.99%	19	29	245,535.20
Chile	1.74%	14	7	35,730.50
China	17.29%	37	53	354,073.10
Czech Republic	0.66%	2	1	13,592.70
Egypt	0.72%	11	8	14,752.50
Hungary	0.50%	2	1	10,237.60
India	7.39%	40	47	151,326.20
Indonesia	1.32%	14	11	27,123.60
Israel	2.97%	6	11	45.00
Malaysia	2.76%	28	20	56,438.40
Mexico	5.01%	11	7	102,699.30
Morocco	0.89%	7	3	18,233.90
Peru	0.60%	5	3	12,318.80
Philippines	0.59%	12	6	12,085.30
Poland	1.52%	13	16	31,154.70
Russia	6.45%	10	10	132,113.60
South Africa	7.70%	25	24	157,761.70
South Korea	14.44%	48	46	295,861.20
Taiwan	12.29%	49	92	251,813.50
Thailand	1.28%	17	12	26,175.30
Turkey	1.44%	14	14	29,406.60
Total	100.00%	388	423	2,048,198.50

Table A3.11 PE Funds Active in Turkey

Abraaj Capital (UAE)	NBK Capital (Kuwait)
TPG Capital (Germany)	Global Investment House (Kuwait)
Swicorp (Saudi Arabia)	Argus Capital (UK)
The Carlyle Group (US)	Pinebridge Capital (US)
Ashmore (UK)	Bridgepoint (UK)
Marfin Investment Group (Greece)	Riverside (Poland)
BC Partners (UK)	Global Finance (Greece)
Colony Capital (US)	Cinven (UK)
TPG (UK)	Investcorp (Bahrain)
KKR (Germany)	Franklin Templeton (US)
HSBC PE (UK)	Qatar First Investment Bank (Qatar)
Abu Dhabi Investment Company (UAE)	Advent (UK)
Citi VC (UK)	

Development Finance

World Bank Group

Throughout the last decade, all of the five main institutions of the World Bank Group have been actively supporting Turkey to reach its development goals. In doing that, sustainable investment criteria are the critical decision factor to assess the feasibility of the projects.

World Bank through its institutions and with the cooperation of Turkish Government and its agencies financed projects with amounts exceeding $ 7.5 billion during the past 5 years.

Table A3.12: World Bank's Lending Summary for Turkey

Year	Number Of Projects	Lending Amounts (USD Millions)
2006	6	1525.61
2007	3	1158.25
2008	3	1203
2009	5	2075.12
2010	2	1550
Total	19	7511.98

Source: World Bank Web site ((www.worldbank.org)

IBRD and IDA

IBRD and IDA have been supporting Turkey through their partnership with Turkish government in projects in the energy, health and infrastructure sectors. In the last decade, Turkey has become one of the fifth largest borrowers from IBRD & IDA. Current projects (Table A4.10) amounts to approximately $ 5 billion.

Table A3.13 Current Projects of IBRD and IDA in Turkey

Project Description	Investment type	Partner	Amount (USD Million)
Electricity Distribution and Rehabilitation Project	Energy	TEDAS	269.4
Energy Community of Southeast Europe	Energy	TEIAS	66
Energy Community of Southeast Europe	Energy	TEIAS	150
Energy Community of Southeast Europe	Energy	TEIAS	241
Gas Sector Development	Energy	BOTAS	325
Private Sector Renewable Energy	Energy	TSKB & TKB	500
Istanbul Municipal Infrastructure Project	Urban Development	Istanbul Metropolitan Municipality	322.2
Istanbul Seismic Risk Mitigation Project	Urban Development	Istanbul's Governor Office	400
Land Registry and Cadastre Project	Urban Development	Turkish Land and Registration Agency (TKGM)	203
Municipal Services Project	Urban Devel-opment	14 Municipalities	275
Access to Finance of SMEs	Private Sector Development	TSKB and Halkbank	696.9
Second Access to Finance for SMEs Project	Private Sector Development	Ziraat Bank, Vakifbank, TKB	500
Export Finance Intermediary Loan	Private Sector Development	TSKB, Turk Eximbank	600
Railways Restructuring Project	Transport	TCDD	184.7
Secondary Education Project	Education	Ministry of Education	104
Health Transformation and Social Security Reform Project	Health	Ministry of Health	75.1
Avian Influenza and Human Pandemic Pre-paredness Project	Agriculture	Ministry of Agriculture and Rural Affairs	34.4
Anatolia Watershed and Rehabilitation Project	Environment	Ministry of Environment and Forestry	15.7
Watershed Rehabilitation Project	Environment	Ministry of Environment and Forestry	7
		Total	**4,969.4**

Source: World bank's Web site (www.worldbank.org)

IFC

Since joining IFC in 1956, Turkey became its fifth largest country exposure with USD 5 Bn. of funds invested and USD 3 Bn. syndications. IFC supported Turkey during its severe economic crisis in 2001 and continued its support since then. The main investment focus of IFC in Turkey is in the financial sector with a special focus on SME's access to finance and in the energy, health, education and manufacturing sectors. A list of IFC projects is provided In Table A4-11).

Table A3.14 IFC's Lending in Turkey

Year	Project	Sector	Project Cost	IFC Financing (USD Millions)
2010	YK Leasing	Finance		45
2010	Akbank	Finance		75
2010	Finans Lease	Finance		40
2010	Eurasia Capital	Finance		13.6
2010	Akbank	Finance		75
2009	Sekerbank	Finance		95.1
2008	Enerjisa	Energy	2,353.00	237.7
2008	Seker Bank	Finance		51.8
2008	YKLEE	Finance		50
2008	Atateks	Manufacturing	74.1	25
2008	Posuda	Construction	80.3	40
2007	Sarten	Manufacturing	41.7	20
2007	Avea Long-term	Telecommunication	1.949	120
2007	TEB	Finance		100
2006	Sanko Cement	Manufacturing	330.5	75
2006	Intercity II	Manufacturing		44.7
2005	Arcelik-Reg. Exp	Manufacturing	282	103.4
2005	Assan IV	Manufacturing	125	30
2005	Intercity	Manufacturing	53.6	20
2005	TEB IV	Finance	50	50
2005	YUCE	Education	9.8	4.5
2004	Acibadem	Health	40.9	20
2004	BTC Pipeline	Energy	3,600.00	76
2004	Borusan Holding	Manufacturing	40	40
2004	Kusadasi Port	Transportation	29.3	10
2004	OPET	Energy	150	25
2004	PALEN	Energy	13.6	2
2004	Palgaz	Energy	47.8	10
2004	TSKB Sub Loan	Finance	50	50
2003	MESA Group	Health	45	11
2003/2001/1996/1995	Arcelik	Manufacturing	1,050.00	201
2003/01/1996/1992	Sise - Cam	Manufacturing	555.8	137.9
2002	Atilim University	Education	15.4	6.5
2002	Beko	Manufacturing	95	24.9
2002	Eczacibasi Tiles	Manufacturing	25	9.9
2002/1997	Soktas	Manufacturing	37	16.9
2002/1998	Modern Karton	Manufacturing	99.3	30
2002/1998	Pasabahce	Manufacturing	71.5	23.6
2002/1993/1990	Conrad	Tourism	116.8	33.1
2001/1997/1994	Assan	Manufacturing	167.5	55.2
2001/1998	Ipek Paper.	Manufacturing	102.3	45
2000	Banvit	Manufacturing	78.4	25
2000	Isiklar Ambalaj	Manufacturing	42	10.3
			Total	**2,184.1**

Source: IFC Website and additional input from IFC

European Investment Bank

EIB has been financing projects in Turkey since 1965 with a total lending of EUR 15 Bn.. To support Turkey's accession to EU, EIB focused its investment mainly on energy efficiency, infrastructure and small and medium-sized enterprises projects with two types of funds. The individual loans are the ones with the total investment cost more than EUR 50 Mn. and are offered to both public authorities such as municipalities and to the private sector. The loans that are less than EUR 25 Mn. are provided to the SME's through EIB partner banks or the intermediaries in Turkey. European investment Fund (EIF) provides financing to SME's in the form of business and venture capital, guarantees and microfinance. The shareholders of the funds are EIB with 61%, EU with 30% and 9% is owned by public and private shareholders. TSKB (The Development Bank of Turkey) has been a shareholder since 2006.

Agence Francaise de Développement (AFD)

AFD has been active in Turkey since 2004. The focus of the AFD in Turkey has been energy related projects to help fight the climate change, SME financial assistance and infrastructure projects to support municipalities and local authorities. AFD has focuses on social standards as the conditionality of their syndicated loans. AFD offered training to local banks' staff on social standards to implement the conditionality of their loans in the lending process.

Table A3.15: Selected Examples of AFD Projects in Turkey

Partner(s)	Project Description	Financial Commitment (EUR Millions)	Duration (years)	Signed
DenizBank	Municipal Environmental Investment	80	12	28.11.2009
TEB-TSKB-Isbank	Climate Change/ Reduction of CO_2	150	12	06.10.2009
Sekerbank	Financing for SME's	10	12	09.07.2009
Nuh Cimento	Recycling the cleaning waste	11	10	11.07.2008
TEB	SME Financing	40	12	16.04.2007
Halkbank	SME Financing	130	12	13.04.2006
TKB	SME Financing	20	12	12.04.2006
TSKB	Renewable Energy	100	12	12.01.2005

Source: AFD Website (as of 15.11.2010)

KfWBankenGruppe

KfWEntwicklungsbank and DEG are the development finance institution for developing and transition countries that have been active in Turkey over 50 years with a portfolio of more than EUR 4.8 Bn.. KfW IPEX is another bank under KFW Bankengruppe with a portfolio of EUR 4.2 Bn. in Turkey is responsible for international projects and export finance.

The current focus of KfW in Turkey is improving the municipal infrastructure mainly in the eastern part of country which is relatively less developed. Water, sanitation and waste management infrastructure of the Turkish municipalities does not meet the EU criteria's and the municipalities need financial, technical and advisory expertise to improve their situation. By supporting such projects KfW is contributing to the regional development of Turkey which is important for the Turkey's accession to the EU going forward.

Another focus area of KfW is enabling access to finance and financial services to the small and medium-sized enterprises (SMEs) and poor people. With a budget over EUR 500 Mn., KfW partnered with local commercial banks in 2700 branches in the eastern part of country. In addition to the low interest loans with long maturities or non-repayable grants, advisory services and training services are also provided.

Table A3.16: KfW's Current Finance Projects in Turkey

Subject	Partner	Amount (EUR Millions)
SME Financing (SELP II)	Akbank, Garanti, Isbank, Sekerbank	40
SME Financing	Akbank, Garanti, Isbank, Sekerbank	77

Microfinance	Sekerbank	15
Renewable Energy	TSKB	41
Energy Efficiency	Yapi Kredi Bank	30
	Total	**203**

Source: Data provided by KfW

KfW is also active in the energy field that includes financing for investments that enhance energy efficiency. Recently EUR 50 Mn. have been invested in projects with TSKB.

European Bank of Reconstruction and Development

EBRD operates in Turkey since 2009 and has 14 projects solely in private sector with a value of EUR 301 Mn.. The sector focus has been mainly sustainable energy, access to finance for MSME, municipal sector infrastructure and agribusiness.

During its first year of operation in 2009, EBRD funded around ten projects which some of the selected project details can be seen in the table below. In its second year of operation, the bank continued to grow its portfolio with projects such as USD 20 Mn. loans to DenizBank for energy efficiency and USD 44 Mn. to Vakifbank for SME financing.

EBRD projects are initiated by sector groups or country teams. Each project that meets bank's sustainability criteria, go through a traditional credit check followed by an economic (transition) impact check. Credit check involves integrity check, in consideration of corruption in the region..

SME finance, Energy Efficiency and credit to women, have been themes that the bank had focused on. EBRD's SME finance is extended through local banks. The banks report on meeting the criteria, but EBRD is not involved in verifying the reports. Governance quality of the partner banks is an important area of focus for EBRD. SElected projects are listed in Table A4.17

Table A3.17 Selected EBRD Projects in Turkey in 2009

Company	Sector	Description	Amount (EUR Millions)
Rotor Elektrik	Energy	Construction and Development of Wind Farms	45
Izgaz	Energy	Natural Gas Grid Expansion	60
Garanti Bank	Finance	MSME Financing	50
Deniz Bank	Finance	MSME Financing	20
Noble Hammadde	Agribusiness	Increase Capacity for Grain and Oilseed supply chain	30
		Total	**205**

Source: EBRD website (as of 15.11.2010)

Table A3.18: Projects Funded by CTF in Turkey

Approved Projects	Involved DFI	CTF Amount	Expected Cofinancing	Cofinancing sources
Extension Sustainable Energy Financing Facility	EBRD	$ 50 Million	$ 330 million	EBRD
Commercializing Sustainable Energy Finance Program	IFC	$ 22 million	$ 120 million	IFC
Private Sector Renewable Energy and Energy Efficiency	IBRD	$ 100 million	$ 1.5 billion	IBRD, private sector, TKB (Turkish Development Bank) and TSKB (Industrial Development Bank Turkey
Projects in the Pipeline	**Involved DFI**	**CTF amount**	**Expected co-financing**	**Co-financing sources**
Renewable Energy and Energy Efficiency Projects	IFC	$ 28 million	$ 120 million	IFC, government, private sector
TEIAS Turkish Electricity Transmission Corporation) Transmission including Smart Grid	IBRD	$ 50 million	$ 400 million	IBRD, TEIAS

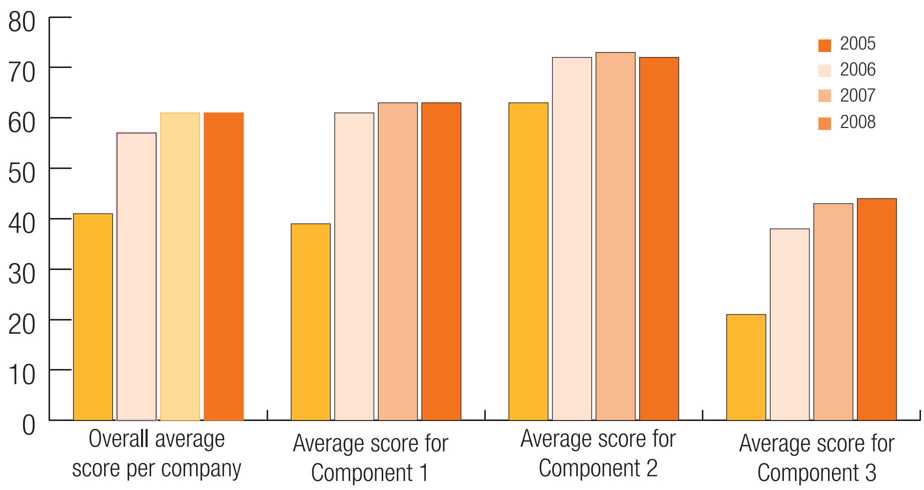
Source: CIF Web site, accessed in January 12th 2010

Chapter 5

Figure A5-1: Disclosure Trends Following the Publication of CMBT's CGG

Turkish Transparency and Disclosure Survey Results (2005-2008) (%)

Note: Components 1-3 cover Ownership Structure and Shareholder Rights, Financial Transparency and Information Disclosure, and Board and Management Structure and Processes, respectively. (Standard & Poors 2008)



Research Institutes, Business Networks and Civil Society Organizations

Eurasia Institute of Earth Sciences Climate Research Group

Istanbul Technical University Eurasia Institute of Earth Sciences Climate Research Group works on the scientific approaches to climate change adaptation. The aim of the research group is to stimulate multi-disciplinary studies in earth sciences including geology, ecology, climatology and oceanography.

The Institute of Environmental Sciences

The Institute of Environmental Sciences at Bogazici University is the first environmental research organization in Turkey to be established by law (Turkish Official Gazette, No:18124, 3 August 1983). The Institute's research areas are not limited to environmental engineering but include pure environmental sciences, ecology, and social environmental sciences.

Sustainable Development and Cleaner Production Cente

Another organization working on environmental issues in Bogazici University is the 'Sustainable Development and Cleaner Production Center'. This Center aims to support research into sustainable development and to provide technical support to the production and service sectors for cleaner and more effective way of production that reduce the amount of waste and mitigate emissions.

The Center for Energy, Environment and Economy

'The Center for Energy, Environment and Economy' (CEEE) was established at Ozyegin University in 2009. The main objective of the Center is to study issues related to energy, the environment and the economy in a coherent way.

The Social Policy Forum

The Social Policy Forum (SPF) is a research and policy center supported by Bogazici University with the objective of generating critical knowledge pertaining to the main issues of social policy. The Forum's research focus mainly on issues of social policy in their social, economic and political significance including poverty and social exclusion; social assistance schemes; social security systems; health, education and other social services; world of labor and changing roles of labor unions.

The research projects receive support from (TUBITAK, Bogazici University Research Fund, Open Society Institute/Foundation, The Turkish Economic and Social Studies Foundation (TESEV), UNDP, European Commission and AFD. Friedrich Ebert Foundation sponsors SPF's workshops. The Advisory Committee of SPF is composed of scholars, Trade Union and NGO representatives, writers, journalists who have done extensive and original thinking on social policy issues as well as on the problems of poverty and social exclusion in Turkey.

TEPAV

TEPAV was founded in 2004 by a group of businessmen, bureaucrats and academics with the mission to conduct research that contributes and improves public policy design. TEPAV conducts studies in three main fields, Economics, Governance and Foreign Policy; and the research focuses on concrete policy matters, which are then presented in the form of feasible policy recommendations. TEPAV sticks to its objective and non-partisan position in its studies without compromising the academic ethics and quality.

PRME – Principles for Responsible Management Education

PRME seeks to inspire and champion responsible management education, research and thought leadership globally. PRME are inspired by internationally accepted values such as the principles of the UN Global Compact. The Six Principles on purpose, values, method, research, partnership, and dialogue serve as a guiding framework to ease the process for academic institutions to integrate corporate responsibility and sustainability in a systemic manner. There currently are 5 Academic institutions signed up to the PRME Initiative, Koc University, Istanbul Bilgi University, Gediz University, Cag University and Sabancı University. Only two, Sabancı and Gediz Universities, are listed as 'Communicating Participants' indicating that they have submitted their information on their progress with regards to PRME principles. Sabancı University is also participating in a new task force set up by UN GC aımıng to implement UN Global Compact in academia.

Women Entrepreneurs Association of Turkey - KAGIDER

KAGIDER (Women Entrepreneurs Association of Turkey) is a nation-wide, non-profit civil society organization, which was founded in Istanbul in September 2002 by 37 successful women entrepreneurs. Their Water Drop Project (2005-2006) received € 175.000 and Women Entrepreneurs Development Centre project (2005) received € 74.500 as a part of the EU Active Labor Force Program.

Transparency International – Turkey Chapter

Transparency International Turkey Chapter was founded in 2008 as a local partner of Transparency It is funded mainly through its members and externally on project basis. The founding corporate members include: PricewaterhouseCoopers Turkey, Ernst&Young Turkey, and KPMG Turkey.

The establishment of 'Transparency Call Center' was funded by European Instrument for Democracy and Human Rights (EIDHR). Establishing Comparative Indicator-based Monitoring of Anti-Corruption Progress (CIMAP) projects was supported by the European Union as part of a broader project involving Albania, Kosovo, Macedonia and Turkey as EU candidate and potential candidate countries

Climate Platform

The Climate Platform was established with the partnership of TUSIAD and REC Turkey to support the activities in the combat against climate change carried out by the business community, and to assist in the transition to a reduced carbon economy. They are funded through their activities and founding members: TUSIAD and REC Turkey. REC Turkey's establishment was ratified by the Grand National Assembly of Turkey in 2004 and financed through a EUR 2.3 Mn. grant from the European Commission, through which most of its activities for the first two years of operation were also financed. Furthermore, the REC collaborates closely with the Japan Special Fund and the Italian Trust Fund.