

Akdeniz University
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Corporate Governance and Transparency in Turkey:
Determinants of Disclosure Practices of the Listed Companies Ahead of the Shareholder
Meetings

Joint Master's Programme European Studies Master Thesis

Antalya / Hamburg, 2011

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Akdeniz Üniversitesi
Sosyal Bilimler Enstitüsü Müdürlüğüne,

Ali DUMAN'ın bu çalışması, jürimiz tarafından Uluslararası İlişkiler Ana Bilim Dalı Avrupa Çalışmaları Ortak Yüksek Lisans Programı tezi olarak kabul edilmiştir.

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CORPORATE GOVERNANCE AND TRANSPARENCY IN TURKEY
DETERMINANTS OF THE DISCLOSURE PRACTICES OF THE LISTED COMPANIES AHEAD
OF THE SHAREHOLDER MEETINGS

Onay: Yukarıdaki imzaların, adı geçen öğretim üyelerine ait olduğunu onaylarım.

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LIST OF ABBREVIATIONS

AGM	Annual General Meeting
BoD	Board of Directors
BRSA	Banking Regulation and Supervision Agency
CEO	Chief Executive Officer
CGP	Corporate Governance Principles
CMB	Capital Markets Board of Turkey
CML	Capital Market Law
DR	Disclosure Rate
EC	European Commission
EGM	Extraordinary General Meeting
EU	European Union
FDI	Foreign Direct Investment
CGP	Corporate Governance Principles
IFRS	International Financial Reporting Standards
GNP	Gross National Product
IMF	International Monetary Fund
IPO	Initial Public Offering
ISE	Istanbul Stock Exchange
PDP	Public Disclosure Platform
M&A	Merger & Acquisition
OECD	Organization for Economic Co-Operation and Development
S&P	Standards and Poors
TCC	Turkish Commercial Code
TESEV	the Turkish Economic and Social Studies Foundation
TKYD	Corporate Governance Association of Turkey
TSPAKB	Association of Capital Market Intermediary Institutions of Turkey
TUSIAD	Turkish Industrialists' and Businessmen's Association
UK	United Kingdom
UNCTAD	United Nations Conference on Trade and Development
US	United States
USD	United States Dollar

ABSTRACT

CORPORATE GOVERNANCE AND TRANSPARENCY IN TURKEY: DETERMINANTS OF DISCLOSURE PRACTICES OF THE LISTED COMPANIES AHEAD OF THE SHAREHOLDER MEETINGS

This study is an attempt to analyze the levels and determinants of disclosure practices of Turkish listed companies ahead of the shareholder meetings.

After touching upon the definitions of corporate governance, transparency, disclosure and assessing the positive and negative consequences of disclosure practices comprehensively, the legal framework for corporate governance and transparency in Turkey are briefly explained. In the empirical part of the study, by means of SPSS statistics program, Kruskal Wallis and Pearson Correlation analysis methods, taking 54 companies, which are listed in Istanbul Stock Exchange ISE30 and Corporate Governance Indexes, disclosure levels of the information related to voting items and the determinants effecting disclosure practices have been investigated. The independent variables are as follows: Being listed in the Corporate Governance Index, Corporate governance overall rating score, transparency and disclosure rating score, free float rates, foreign ownership, and state ownership.

The results indicate that the disclosure practices of the Turkish companies ahead of the shareholder meetings are overwhelmingly based on whether the information is mandatory to disclose. To a large extent the companies do not provide information, unless the information should be legally disclosed. Turkish companies are particularly reluctant to disclose information regarding the names and biographies of the board of directors and internal auditor nominees as well as their remuneration levels ahead of the shareholder meetings. Moreover, it has been found out in the study that the overall disclosure practices ahead of the shareholder meetings are positively correlated with the foreign ownership rate of the companies, whereas the relationship with the remaining factors such as listing in the corporate governance index, overall corporate governance rating scores, transparency and disclosure rating scores, free float rates as well as state ownership are statistically insignificant. The study concludes that Turkish companies should make progress in the disclosure practices in order to attract international investors especially in those abovementioned areas and the lawmaker should develop necessary mechanisms to improve those areas accordingly.

Key Words: Corporate Governance, Transparency, Disclosure, Shareholder Meetings

ÖZET

TÜRKİYE’DE KURUMSAL YÖNETİM VE ŞEFFAFLIK: İMKB’DE İŞLEM GÖREN ŞİRKETLERİN GENEL KURUL TOPLANTILARI ÖNCESİNDE KAMUYU AYDINLATMA ORANLARINI ETKİLEYEN FAKTÖRLER

Bu çalışma ile İstanbul Menkul Kıymetler Borsası’nda işlem gören şirketlerin genel kurul toplantıları öncesinde kamuyu aydınlatma oranlarının ve bu oranları etkileyen faktörlerin analiz edilmesi amaçlanmıştır.

Kurumsal yönetim, şeffaflık ve kamuyu aydınlatma kavramları ve işletme bilgilerinin kamuoyuna açıklanmasının olumlu ve olumsuz tarafları kapsamlı bir şekilde ele alındıktan sonra Türkiye’deki kurumsal yönetim ile ilgili uygulamalar, şeffaflık kavramı, yasal ve kurumsal çerçeve analiz edilmiştir.

Deneysel kısımda ise İMKB30 ve Kurumsal Yönetim Endekslerinde işlem gören şirketlerin genel kurul toplantıları öncesinde, oylamaya tabi olan maddelere ilişkin bilgilerin kamuya açıklanma oranları ve bu oranların kurumsal yönetim endeksinde yer alma, kurumsal yönetim derecelendirme genel notu, kamuyu aydınlatma ve şeffaflık ile ilgili kurumsal yönetim derecelendirme notu, halka açılma oranı, yabancı sahiplik oranı ve devletin sahiplik oranı arasındaki ilişkiler incelenmiştir. Analizlerde SPSS istatistik programı kullanılmış ve Kruskal Wallis ve Pearson Korelasyon analiz yöntemlerinden yararlanılmıştır.

Sonuçlar göstermektedir ki, sözü edilen şirketler bu maddelerle ilgili bilgileri büyük oranda yasal zorunluluk olması itibarıyla kamuoyuna açıklarken, gönüllü olarak yapılan açıklamaların oranı çok düşük kalmaktadır. Diğer taraftan, bu şirketlerin genel kurul toplantıları öncesinde kamuoyunu aydınlatma oranları ile yabancı sahiplik arasındaki ilişki istatistiksel olarak anlamlı iken, kurumsal yönetim endeksinde yer alma, kurumsal yönetim derecelendirme genel notu, kamuyu aydınlatma ve şeffaflık notu, halka açılma oranı ve devletin şirketler içindeki sahiplik oranı ile kamuoyunu aydınlatma oranı istatistiksel olarak anlamlı bulunmamışlardır. Türk şirketleri uluslararası yatırımcıları çekmek için kamuyu aydınlatma uygulamalarını geliştirmeli ve kanun koyucu da gerekli düzenlemeleri hayata geçirmelidir.

Anahtar Kelimeler: Kurumsal Yönetim, Şeffaflık, Kamuyu Aydınlatma, Genel Kurul Toplantıları

INTRODUCTION

Where the divergence of interests arises, especially in the partnerships, whose origin is the source of power, there this differentiation of interests could potentially lead often to conflicts, which *ceteris paribus* reduces to a large extent the firm value when combined with the inability to perfectly write contracts and monitor the controllers. Corporate governance, which is the relationship of different parties in determining policies, strategies, directors as well as performance of the corporation, is one of the most crucial tools to see and solve or foresee and prevent these conflicts when it is adequately and effectively implemented. On the other hand as the history has proved the inefficiency of corporate governance mechanisms might lead to severe global financial crises which result in the negative impacts on whole society beyond solely the relevant parties of the corporations.¹

Even though corporate governance understanding varies from Anglo Saxon to Continental European types of capitalism, depending on whether to consider all stakeholders when designing corporative targets, transparency remains to be the essential element of well functioning corporate governance systems given its role in preventing information asymmetry between the beneficiaries of the corporative information.

It should also be pointed out that transparency has been transforming from its passive definition to active disclosure practices recently, which has become ever more complex, costly and demanding. While transparency is involving a wide range of complex processes, events, institutions, and issues in the contemporary world, the corporations are feeling themselves under ever increasing pressure by the lawmakers and the interest groups affected by the corporative decisions. For this reason, corporations, which interiorize the corporate governance principles, are expected to demonstrate a high level of transparency and disclosure performances.

Furthermore, beside those above mentioned external pressures proactive disclosure practices help the corporations in global competition to be one step ahead in attracting investors. The shareholders should be informed about the corporate decisions, actions and consequences in favor or at the expense of shareholders by means of different media channels such as World Wide Web, public disclosure platforms as well as local and global

¹ Grant Kirkpatrick, *The Corporate Governance Lessons from the Financial Crisis*, Pre-publication version for Vol. 2009, (Paris:OECD Publications, 2009), 1-2.

newspapers, since they need timely, cost efficient, sufficient, true and comparable information for the deliberative decisions. Shareholder meetings in that sense play a fundamental role in corporate governance and transparency since the information about significant development within the company is delivered to the shareholders through shareholder meetings. Furthermore shareholders are involved in the corporative decisions in the strictest sense through informed voting. However, in order to be able to cast informed voting, shareholders should be well informed about the voting items in advance of the meetings.

What about the situation in Turkey? Are shareholders well informed ahead of the shareholder meetings? What are the determinants in the disclosure practices of the listed companies ahead of the shareholder meetings? Corporate governance is a rather new concept of growing importance in Turkey which is a latecomer compared to its counterparts. Capital markets are infantile and macro economic environment is volatile. Whereas concentrated and family ownership corporate structures prevail in listed companies, free float rates and foreign ownership remain low. Therefore it is argued in this thesis that transparency in Turkey is low and disclosure practices of the companies ahead of the shareholder meetings do not go beyond the legal obligations. If so then how are the disclosure performance of the companies related to being listed in the corporate governance index which is deemed to increase the transparency of the companies, corporate governance overall rating score, transparency and disclosure rating scores, free float rates, foreign ownership as well state ownership? This study attempts to find out the answers to these questions and approach in a critical way to transparency and disclosure practices of Turkish corporations ahead of the shareholder meetings. To this end the remainder of this thesis is organized as below.

The first chapter deals with the fundamental definitions of corporate governance, transparency and disclosure. After explaining the importance of shareholder meetings for disclosure practices, corporate governance and disclosure practices and the agenda items in Turkey will be examined.

In the empirical part, firstly the items discussed in the 2010 proxy voting period and their legal status will be analyzed. Based on those findings the determinants such as corporate governance rating scores, free float rates, foreign ownership and state ownership will be tested. In another words it is aimed to find out the disclosure performances ahead of

the shareholder meetings and the factors affecting those disclosure rates. After analyzing the inadequacies, it will be investigated whether the new commercial code is able to cover them and finally some inferences will be made, upon which the study will be concluded.

1. Corporate Governance

Where the divergence of interests arises, especially in the partnerships, whose point of origin is source of the power, there this differentiation of interests could potentially lead often to conflicts, which *ceteris paribus* reduces to a large extent the firm value when combined with the inability to perfectly write contracts and monitor the controllers.² In order to sustain the relations and solve these conflicts, which arise from the eagerness of the control, in the smoothest way, there need to be some predefined roles, liabilities and rights in a way in which all parties should be contented as much as possible.

This claim is primarily based upon the fact that the governance is often described as a system of control or regulation which comprises appointment of regulators and controllers.³ Tannenbaum defines the control⁴ as “*any process in which a person or group of persons determines, intentionally affects, what another person or group or organization will do*”.

The evolutionary progress in managerial sciences and transformation of ownership structures from the block ownership to the dispersed ownership models with the rapid industrialization revealed the importance of separation of ownership and control in 20th century. Berle and Means touched upon the problem by analyzing the different control forces in their book and they came to the conclusion of the need for separation of ownership from control.⁵ It should be born in mind that incapability of owners in the execution of corporations had also become a matter of debate in the academia as well as in the business environment along with the sudden breaking out stock market crises in 1929. The extensive debates took place at the corporate level and had a local character thus far, because of the limited quantity of global business transactions and money flows.

² Dinane K. Denis and John J. Mc Connell, "International Corporate Governance" *Purdue CIBER Working Papers*. Paper 17. (2002). Available at: <http://docs.lib.purdue.edu/ciberwp/17> , Accessed on 26.08.2011

³ Arnold Tannebaum, “Control in Organizations: Individual Adjustment and Organizational Performance” *Administrative Science Quarterly*, Vol. 7, No. 2 (1962), 236-257

⁴ Ibid

⁵ Adolf A. Berle and Gardiner C. Means, *The Modern Corporation and Private Property*, (New York: Harcourt, Brace and World, 1932). Please see a broader explanation by Bob Tricker, *Corporate Governance, Principles, Policies and Practices* (Oxford:Oxford University Press, 2009), 9.

Within the globalization era, the money flows and business conducts have been gaining an ever increasing international character, which has led to ultimately sophisticated and opaque international transactions, hence paved the way for giant size corporate scandals as a consequence of abusive actions. This is emanating from the fact that the capital markets have been undergoing rapid alterations over the last three decades and the capital movements gained a significant momentum triggered by the Reaganist and Thatcherist⁶ liberal approaches.⁷ Privatizations, augmenting pension funds, escalating number of mergers and acquisitions, deregulation of the markets as well as European and International integration may be counted among the driving forces for these ever increasing transformations.⁸ The first well known concrete upshot of these global corporative tribulations is the global banking crises cropped up in 1970s which was followed by saving and loan debacles in 1980s⁹. Roughly 30 years later, in 1998s Asian Crises commenced in East Asia and spread out subsequently the other parts of the globe such as Brazil and Russia. In course of these crises, the significance of substantial investor protection instruments, effective capital market regulations, which is deemed to ensure transparency and establish efficient watchdog mechanisms, were much more appreciated, concerning the fact that the main causes of the Asian crisis laid not so much in the macroeconomic imbalances. It laid out rather in the microeconomic behavior of decision-makers in those economies as well as lack of sufficient corporate governance structures. In other words, the reasons of these crises comprise of particularly inadequate financial disclosure practices, ineffective capital market regulations, absence of minority shareholders protection as well as failure of board and controlling shareholders' accountability.¹⁰ As an imperative retort to several scandals such as BCCI Bank, Maxwell Pension Funds as well as Polly Peck International in the UK in 1991, governmental were obliged to provide adequate remedies at law. As a respond to this need a board was initiated and represented by Adrian Cadbury¹¹

⁶ Ronald Reagan was the president of United States between 1981 and 1989; Margaret Hilda Thatcher was the prime minister of the United Kingdom between 1979 and 1990.

⁷ Bob Tricker, *Corporate Governance, Principles, Policies and Practices* (Oxford:University Press, 2009), 12.

⁸ Marco Becht, "Current Issues in European Corporate Governance" (2003) *European Investment Bank, Background Paper*,2.

⁹ G.L Kaminsky and C.M. Reinhart "The Twin Crises: The Causes of Banking and Balance of Payments Problems" *AER*, Vol. 89 (1999), 473-500.

¹⁰ Fiemetta Borgia, "Corporate Governance & Transparency, Role of Disclosure: How Prevent New Financial Scandals and Crime, American University" (2005) *Transnational Crime and Corruption Center Research Papers*, 4-5. ; Melsa Ararat and B. Burcin Yurtoglu, "Corporate Governance in Turkey: An Introduction to the Special Issue", *Corporate Governance; An International Review*, Vol. 14, Iss. 4, (2006), 201–206.

¹¹ Adrian Cadbury, "Report of the Committee on the Financial Aspects of the Corporate Governance", *Cadbury Report*, (London: Burgess Science Press,1992). Available at <http://www.ecgi.org/codes/documents/cadbury.pdf> Accessed on 20.08.2011.

in 1992 to depict certain principles which address the corporate governance concerns such as CEO - chairman relations, board structures, board training, committees, reporting and control of the corporations. Subsequently, Greenbury treated the issues such as particularly director remuneration, disclosure, significance of the independent members in the audit committees and provided a best practice code on the directors' remuneration. Emergence of this report can be justified by the excessive director remuneration levels in the US and the UK¹² as the remuneration levels of the directors were particularly problematic in those economies.

OECD presented a set of guidelines in 1998 (revised in 2004),¹³ which emphasizes the vital elements of corporate governance notion such as shareholder rights, equitable treatment to shareholders, and the role of stakeholders in corporate governance practices, disclosure and transparency as well as the responsibilities of the board. Some dismiss the principles as of little use and other perceive as merit in terms of setting common new rules and regulations for better governance worldwide.¹⁴

Despite the above mentioned endeavors against corporate failures, the corporate governance questions of the impacts of corporate governance on the financial crises in 2008, including risk management systems and executive salaries came to the forefront. Because, the crises can be attributed to a large extent to corporate governance practices, which was insufficient to protect against excessive risk taking in a number of financial services companies. Accounting standards and regulatory requirements appear to be inadequate in some areas as well.¹⁵

1.1 Definitions of Corporate Governance

A consensus for the universally accepted definition of corporate governance has not been found yet, since scholars with different backgrounds and point of views interpret it in various ways. The scholars are dissenting from the corporate governance idea in the corporation at the points as:

- To what extent and which rights the shareholders have in the corporation,
- To what extent the directors have liabilities vis-à-vis stakeholders,

¹² Bob Tricker, 14,147.

¹³ OECD, *OECD Principles of Corporate Governance* (Paris: OECD Publications, 1999).

¹⁴ Bob Tricker, 14.

¹⁵ Grant Kirkpatrick, 1-2.

- To what extent the external and internal factors such as society, suppliers, clients as well as employees should intervene to the corporate governance practices, and
- To what extent these social actors should be taken into account when designing the corporative targets.

For a broader definition of corporate governance the stakeholders, who have a material or/and legitimating relation with the company or at least have a direct or indirect influence on the company, are taken into account as well, meaning that the moral integrity is of the paramount importance in business doing practices. In this approach, stakeholders such as employees, clients, suppliers, creditors, society and the state comprise the significant elements of corporate governance. However, because of the involvement of many parties and topics, stakeholder theory is criticized as being very difficult to find out the exact definition of the relevant parties.¹⁶ From the stakeholders perspective corporate governance is defined as *“It is the relationship amongst various participants in determining the direction and performance of corporations.”*¹⁷ OECD defined corporate governance as:

“...corporate governance ... involves a set of relationships between a company’s management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined.”

Corporate Governance, however, in its narrow definition¹⁸ is the set of rules describing the relations between different control factors such as management, majority and minority shareholders. This point of view refers merely to a profit maximization standpoint with protection and improvement of the nature of the relations between management and shareholder groups. In particular this is the case in the Anglo Saxon Capitalist systems¹⁹. In other words when private or institutional persons have shares in a corporation, they need to make sure that they have the maximum value return on their investments. This is only

¹⁶ A.C. Fernando, *Corporate Governance, Practices Policies and Principles* (New Delhi: Dorling Kindersley Pvt. Ltd , 2009), 51.

¹⁷ Shann Turnbull, 180-205.

¹⁸ It should be underlined at the outset of the study that this study does not focus on the other corporate governance approaches such as transactions cost economic theory, managerial hegemony, and class hegemony theory. The arguments will be mainly based on shareholder theory by virtue of the fact that the disclosure practices of the listed companies ahead of the shareholders meetings constitutes the core of the study and are closely related to the shareholder perspective.

¹⁹ See the section “Models of Corporate Governance” for further explanation.

possible in a way in which effective framework of rules, efficient institutions, and monitoring systems are established.

Schleifer and Vishny (1997)²⁰ contribute to the corporate governance literature with a definition which suits slightly to the narrow definition of basic financial point of view: “*Corporate Governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment.*”

In the simple finance model, where the ownership is dispersed to many minority shareholders, the line between management and owners is a clear cut as the owners of the company so-called principles need to delegate the power to some agents who has "know – how" about how to run a company professionally by using the state of the art management techniques. Thus, the role of the initiation and implementation of the decisions are split from the ratification and monitoring roles.²¹

The gravity point of the definition however might differ in the block ownership models such as in the continental Europe, Turkey and Japan where the conflicts occur chiefly between minority and majority shareholders that determine also the governance structures of the corporations. The delegation of power besides its benefits contains some risks and harms which is called agency problem and will be explained in the next step.

1.2 Agency Problem

Smith hint at the corporate governance matter among others first with his theory advocating that the managers are in most typical cases not willing to watch over the money of the owner as much as does the owner for him or herself²². In this way, Smith addresses the problem between owners and managers and urges the idea against separation of ownership from control. He emphasized the magnitude of efficiency of owner-manager models, due to the fact that the managers, in a manner of speaking, are selfish human being and prioritize their own interest over the corporative ones. As an outcome of delegation of

²⁰ Andrea Schleifer and Robert W. Vishny, “A Survey of Corporate Governance” *Journal of Finance*, Vol. 52, No.2 (1997), 737-783.

²¹ Eugene F. Fama and Michael C. Jensen, “Separation of Ownership and Control”, *Journal of Law and Economics* Vol. 26, No. 2. (1983), 301-325.

²² “*The directors of such [joint-stock] companies, however, being the managers rather of other people’s money than of their own, it cannot well be expected, that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own.... Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company.*” Adam Smith, *An Inquiry into the nature and the cause of Wealth of Nations*, (London: Wardlock, 1838), 586.

power corporations might inherently incur losses of the principles through the activities of their agents. Jensen and Meckling in their article²³ define the agency relation as:

"a contract under which one or more persons (the principles(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making the authority to the agent."

Another basis for those losses might be the information asymmetry, meaning that the agent can abuse the information accessible for his own interests and not for the principles, or again might be reluctant to take risk in order to secure their positions. The costs arising from the managers' misusing of the power delegated to them as well as the cost for monitor and discipline the agents are called agency costs.²⁴ In some instances these costs occur as monitoring expenditures in order to examine the activities of the agents as to whether they behave in line with the interests of the principles or the bonding expenditures to pay incentives to the executives that they don't take harmful actions. The residual losses arising from the divergence of the decisions of the agents might also reduce the welfare of the principles.²⁵

As solution against agency problem ‘Principles’ in some instances by means of regulations develop some mechanisms. Fama and Jensen²⁶ in their article touched upon some mechanisms for the control of the agency problems arising from the separation of initiation from implementation of decisions and supervising them. These mechanisms are intended to defend the interests of residual claims. Among others, the fluctuant stock price is a significant indicator regarding the decisions and implementations undertaken by the agents. On account of the fact that the residual claims (principles) are free from the decision making process and their stocks are alienable, they can alternatively attack the managers either by offering to buy more stocks (tender offers) or recommend to stockholders for a vote (proxy fights).

Owners of the corporations can also develop a monitoring system through the directors appointed to the board by themselves. Board of directors play in this sense a significant role in appointing the internal controllers, hiring, and compensation, monitoring

²³ Michael C. Jensen and William H. Meckling, "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structures", *Journal of Financial Economics*, V.3, No. 4 (1976), 305-360.

²⁴ Margaret M. Blair, *Ownership and Control*, (Virginia:R.R Donneley and Sons Co., 1995), 97.

²⁵ Michael C. Jensen and William H. Meckling, 305-360.

²⁶ Eugene F. Fama and Michael C. Jensen, 175-201.

and firing the top executives provided board of directors essentially composes of mostly independent and expert directors. Board of directors ideally sets the company's goals, leads and motivates the top management in order to achieve these goals and these directors are appointed by the shareholders to represent them.

1.3 Corporate Governance Models

Since the definition of corporate governance varies from one country to another, it would be senseless to claim that there is one universally accepted corporate governance model which fits all and is exercised in the entire world. Although the countries show some common characteristics, each country model should be perceived as unique in itself. The factors, which affect corporate governance practices in a country, are the legal framework, business doing culture and customs, regime of the country, development level of the financial markets as well as the practices of the companies. In addition, the structure of the country's banking system, protection of property rights and financial system as a whole take place among the determinants.²⁷ On the other hand composition of board of directors, stakeholders' participation in the decisions, transparency and disclosure levels, voting rights, ownership structures are also identification factors of these discrepancies. There are two well known, distinctive, and generally acknowledged typologies of the corporate governance concept which are called by Frank and Mayer²⁸ as outsider and insider models.

1.3.1 Outsider Models

Outsider model, also known as shareholder model or Anglo Saxon model prevails rather in the English speaking capitalist countries such as the US, the UK, Australia and Ireland. In this mode of capitalist states it is fairly rare to see the concentrated ownership structures in the corporations. The aim of the outnumbering shareholders is to get maximum value in the shortest time frame rather than considering long term sustainable development and stakeholder participation. Likewise, the equity financing is the dominant financing model as it can be well understood from the magnitude, strong and liquid capital markets. The same, lower debt/equity ratios in those countries are signal for developed

²⁷ Mutlu Basaran Öztürk and Kartal Demirgüneş, "Kurumsal Yönetim Bakış Açısıyla Entellektüel Sermaye" *IV. Orta Anadolu İşletmecilik Kongresi, Ankara* (2005), 118–133.

²⁸ Julian Franks and Colin Mayer, "Ownership, Control and the Performance of German Corporations" *The Review of Financial Studies*, Vol. 14, No.4 (2001), 943-977.

capital markets as Clark and Dela Rama claims that there is a true correlation between the level of equity financing and the size of the capital markets.²⁹

The key players in this system as often mentioned above are management, directors and the shareholders. This relation appears to be quite simple compared to other models; however the financial markets as a whole is remarkably sophisticated in terms of policies, laws, practices as well as financial products. The owners do not take over liability arising from the managerial actions; they rather appoint managers to do this for them, assign the tasks and merely monitor the management policies and activities. The distinction of management and ownership in this model is clear cut and the managers are in most cases professionals.

However, given this complexity, the disclosure and transparency systems have been developed accordingly, which is one of the fundamental characteristics of this system. The corporations are required to disclose wide range of information regarding the board nominees, some significant corporate actions, amendments in corporate bylaws etc. due to the fact that law regarding disclosure is tight.³⁰ The importance of disclosure and transparency is undeniable for a proper monitoring, so the disclosure practices have been well developed upon ever increasing demand of shareholders in order to reduce the agent costs.³¹

1.3.2 Insider Models

This model is called insider model for the reason that a large proportion of ownership is concentrated in the hand of certain parties which are closely involved in the decision making process of the corporations and are well aware of the company's actions and know all the governance process *inside* out. This model is encountered in most of continental European Countries and Japan. However, it would not be wrong to argue that the corporate governance practices in the rest of the world with the exception of English speaking countries have dominantly the characteristics of insider models. In this model opacity of the corporations are quite common, particularly in less developed capital markets with small number of listed companies. The companies base on the long term value creation in corporative actions by involving also certain stakeholders such as employees,

²⁹ Thomas Clarke and Marie Dela Rama, *Corporate Governance and Globalization*, 1-3 Volume Set, eds., (London:SAGE Publications,2006), 25-40.

³⁰ A.C. Fernando, 55.

³¹ Thomas Clarke and Marie Dela Rama, 25-40.

creditors or banks in the board. In this mode of governance mostly minority shareholders bear the agency costs to monitor the majority shareholders. These typical characteristics can be seen in two models such as German and Japanese models.

German model is also known as two tiers corporate governance model, because of the existence of two boards in the corporations. One board is the management board which fulfills the executive roles and the second one is the supervisory board which hire, monitor evaluate and fire the members of the executive board. One half of the supervisory board is elected by the labor and the other half is elected by the shareholders of the company. Involvement of the labor indicates how stakeholder approach is dominant in the German corporations.

Different than the German model the boards are usually large in the Japanese model and “relation based governance” is dominant which is also called “keiretsu”. The board is overwhelmingly executive and often ritualistic.³² The banks and financial institutions are influential at the boards. The main bank and the shareholders appoint the president and board members and the president is involved both in the management board and board of directors.

In both German and Japanese systems the role of the banks is undeniable. On account of the fact that in Japanese and German models long term value of the corporations and interest of the stakeholders are of great importance, short term money flows, hostile takeovers, proxy fighting are seen seldom. As such, the liquidity in the markets is relatively low compared to the Anglo American Model. Another outstanding characteristic of these markets is the lower level of transparency and weaker disclosure practices.

1.4 Corporate Governance and Transparency

"The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company."³³

³² A.C. Fernando, 51.

³³ OECD, *OECD Principles of Corporate Governance* (Paris: OECD Publications, 1999)

Transparency is the essential element of a well functioning corporate governance system.³⁴ For this reason corporations, which interiorize the corporate governance principles, are expected to demonstrate a high level of transparency and disclosure performance. The shareholders³⁵ should be informed about the corporate decisions, actions and consequences in favor or at the expense of shareholders by means of different media channels such as World Wide Web, public disclosure platforms as well as local and global newspapers, since they need timely, relevant, cost efficient, sufficient, true and comparable information for the deliberative decisions. As a respond to this need the corporations should provide the information regarding the company's operational objectives, strategies, financial information, foreseeable risk factors, related party transactions as well as board members' classifications and remuneration. The principle of transparency is applicable beside the corporation to the auditors as well. The auditors should be independent and make their reports ready for the review of the shareholders in an objectively and timely manner.

Transparency with its simple definition is *"letting the truth be available for the others to see if they so choose or perhaps think to look or have the time, means, and skills to look."*³⁶ Coming to the definition of corporate transparency, Bushman and Smith interpret it as follows:

*"Widespread availability of relevant, reliable information about the periodic performance, financial position, investment opportunities, governance, value, and risk of publicly traded companies".*³⁷

These definitions however reflect merely a passive and moderate meaning of transparency and assign the major role to the recipient of this information. In the simplest terms, the demand for information occurs, however, if the users of this information have necessary elements such as time, means and skills then the ideal conditions for transparency would be in place. If not, then transparency would be meaningless. From the definitions one can deduce that three elements form a basis for the transparency concept. These elements are observer, subject to be observed, and means and methods of observation.³⁸

³⁴ Jill Solomon, *"Corporate Governance and Accountability"* 2nd Ed., (West Sussex: John Wiley & Sons Ltd.,2007),143.

³⁵ As a reminder, stakeholders point of view is not exclusively emphasized in this study.

³⁶ Richard W. Oliver, *What is Transparency*, (Newyork:The McGraw-Hill Com., 2007), 1-30.

³⁷ Robert M. Bushman and Abbie J. Smith, "Transparency, Financial Accounting Information and Corporate Governance", *FRBNY Economic Policy Review*, (2003), 66.

³⁸ Richard W. Oliver, 1-30.

In the classical economy it is often argued that the market already provides the observer with the sufficient information to be able to render reasonable decisions.³⁹ However as mentioned afore, the giant global (and) corporate crises have witnessed that the passive meaning of transparency or the approach of classical economy to the transparency phenomena does not appear to be adequate. Beside these crises, which became a *debate du jour*, the other sources of the change in the transparency perception such as interdependence between countries, cultures, and markets, evolving information technologies and demand and supply of ever increasing information are also worthy of consideration.

According to these sources and developments, the characteristics of transparency have also been changing and it is likely to be changed in the following decades. At the time observer, subject to be observed and the means and methods of transparency tend to increase, diversify and *complexify*. The new characteristics of new transparency in that sense appear to be:

- More transparency rather than less,
- More intense scrutiny from the individuals and institutions,
- More comprehensive demand for new kinds of information,
- More complex structures to gather the information,
- More proactive attention by both observer and observed,
- More debates about which information should be made public.⁴⁰

In parallel with and respond to these evolving nature and volume of transparency, the nature and volume of information, flowing from subject to observer, shows some specific dynamic characteristics as well. While it is expanding its scope, it will also increase its accuracy and quality in more complex systems and institutions. As a respond to the need, the use of information would increase too. Hence the information would become more costly to obtain.⁴¹

As frankly seen, transparency has been transforming from its passive definition to active disclosure practices which become ever more complex and costly. While transparency is involving a wide range of complex processes, events, institutions, and

³⁹ Archon Fung, Mary Graham, and David Weil, 31-33.

⁴⁰ Ibid 33, Fiemetta Borgia 20, and Richard W. Oliver, 1-30.

⁴¹ Archon Fung, Mary Graham, and David Weil, 33.

issues in the contemporary world, the subject to be observed is feeling more pressure by the lawmakers, by the interest groups affected by the corporative decisions.

Transparency is also closely related with the accountability of the board of directors. As it is mentioned in OECD Principles;

*“The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board’s accountability to the company and the shareholders”*⁴²

In parallel to this statement, the company should describe the framework of the liabilities and the rights of the board and its committees either in the company bylaws or annual reports or in the corporate governance compliance reports. These documents should also include wide range information from remuneration levels of directors to minimum required qualifications. This information should be able to be accessed in the easiest and most economical way and be reliable, which prevents the potential conflicts and decrease eventually the agency costs.

2. Disclosure

The disclosure phenomenon is the main component and dynamic element of transparency and critical for well functioning capital markets.⁴³ Disclosure, in its more concrete meaning is publishing financial and nonfinancial, voluntary or mandatory information and presents them to the attention of associates of the company in line with the existing general accepted laws, principles and corporate strategies.⁴⁴ Solomon,⁴⁵ however, excludes the voluntariness principle of disclosure and defines it as:

“The whole array of different forms of information produced by companies such as annual report, which includes the director’s statement, the operation and financial review, the profit and loss account, balance sheet, cash flow statements and other mandatory items.”

⁴² OECD, *OECD Principles of Corporate Governance*, 24.

⁴³ Jill Solomon, 143.

⁴⁴ Aylin Poroy Arsoy, “Kurumsal Seffaflik ve Muhasebe Standartları”, *Afyon Kocatepe Üniversitesi, İ.İ.B.F. Dergisi (C.X,S II, 2008)*, 17 – 35.

⁴⁵ Jill Solomon, 144.

Healy and Palepu⁴⁶ argue that the information asymmetry and agency conflicts between managers and outside investors constitute the main factors for financial reporting and disclosure. In the insider models those conflicts occur to a large extent between majority and minority shareholders. Contrary to the classical economic point of view, advocating the market perfection or better to say ability of the market to run smoothly without any external prevention, they argue that the reliability in the short run and credibility in the long run of the management disclosure are enhanced by the regulators, standard setters, auditors as well as other capital market intermediaries.⁴⁷ The lawmakers regulate essentially this cycle to ensure the full and unproblematic flow of information through information intermediaries, the observers invest in the companies through financial intermediaries in the exchange of the information.⁴⁸ Internet and the other means of communication have been increasing the quantity and quality of the information. Contrary to the obsolescent practices, the corporations in the contemporary world are expected to deliver more information regarding the company's situation. Whereas traditional boards used to disclose only financial statements to indicate the performance of the corporation, the modern corporations should disclose the information far more than only financial statements to tell the story behind this performance as well as anticipate the future⁴⁹ in order to remain competitive and benefit from the capital markets.

Due to the fact that financial statements with their foot notes have become very complex and because of the time constraints, relevant parties are interested in clearer interpretations within the narratives such as chairman's statement, which contains ideally a summary and a general picture of company's past, present and future, the board of directors' report or corporate governance compliance reports.⁵⁰ For shareholders to be able to review the company's current and potential future situation these narratives should include at least some well informative indicators which give an overview of the business practices of the company and the outcomes as a result of those practices. Company management is expected to provide a comprehensive analysis of financial and operational statements, and detailed proactive information about the risks that the company might potentially encounter.

⁴⁶ Paul M. Healy, Krishna G. Palepu, "Information asymmetry, corporate disclosure, and the capital markets, A review of the empirical disclosure literature", *Journal of Accounting and Economics* 31, (2001), 405–440.

⁴⁷ Ibid

⁴⁸ Please See the Figure 2.1

⁴⁹ Bob Tricker, 132.

⁵⁰ Ibid, 132-133.

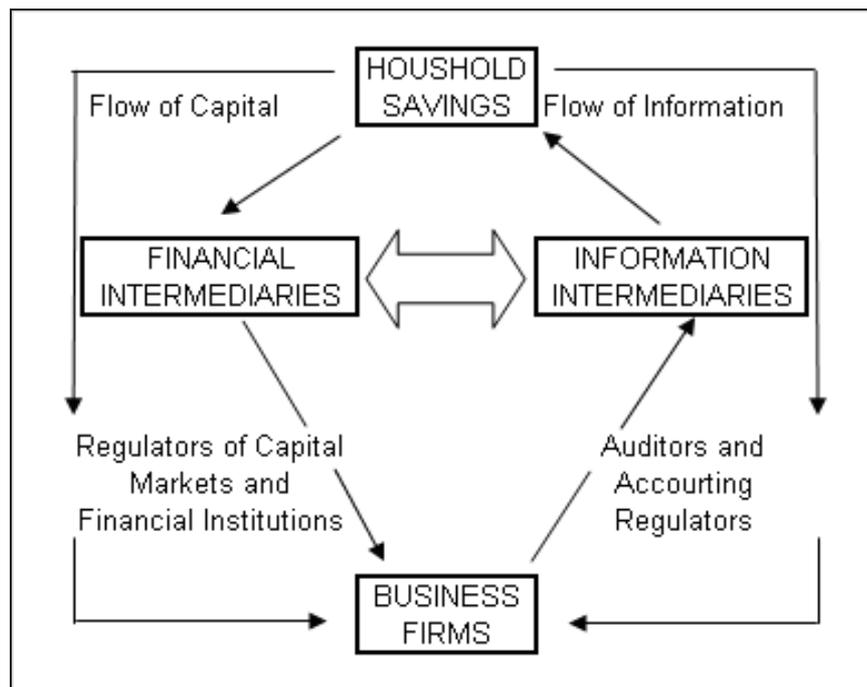


Figure 2.1 Financial and Information Flows in Capital Markets (Quoted from Healy und Palepu, 2001, 408)

Furthermore, noteworthy developments or changes that the company has undergone during the previous financial periods, planned future developments, relations with shareholders as well as a report on the company's sustainability are *sin qua non* in the disclosure activities. The interested parties should basically find the answer in the narratives to the questions of factors, elements and strengths which create value in the company as well as risks and factors to be taken into account in the future.

Whereas some stock exchanges are providing as to what kind of information these narratives should include, International Accounting Standards Board calls the companies to disclose the forward looking information that focuses on generating value for shareholders.⁵¹

2.1 Information Asymmetry

The imperfections of the market and the malfunctions in the flow of information result in the fact that the agent – or the majority shareholders in block ownership models – receive more information and use this information in favor of itself. Thus, outsider shareholders are put in a disadvantaged position. This situation is called information

⁵¹ Ibid

asymmetry and has two significant consequences such as adverse selection and moral hazard.

2.1.1 Adverse Selection

In the commercial transactions one party might have more information than the other party about the certain invisible characteristics of the financial and nonfinancial products, services such as risk, quality, or productivity than the visible ones such as price and quantity. This leads to the hardness to determine a price as one party has more information about the subject to be exchanged.⁵² The study of Hefflin et al⁵³ suggests that the firms with high disclosure quality have lower bid-ask spreads and lower adverse selection components. Furthermore the study emphasizes that publicly available accounting information rather than management's private communications with analysts drives relations between information quality and market liquidity, hence the publicly available accounting information reduces the information asymmetry.

2.1.2 Moral Hazard

The second detrimental effect of the information asymmetry is the moral hazard which occurs in case the agents do not behave in favor of the shareholders' interests or the employees may nap the work or executives abuse the corporative resources. In the assumption of the market perfection and the stewardship theory it is expected that the managers serve the company in the best manner. However, the current crises particularly within the US have provided a clear evidence that the contracts may not able to ensure to hinder those abusive actions. The anxiety and fear are underlying elements behind the compensation and remunerations discussions. Fung et al⁵⁴, come out with three main judgments concerning the information asymmetry. They claim that information tends to be

⁵² A classical example, which would help to grasp the concept, is the lemon (the word lemon is used for the second car in the US) problem of George Akerlof. He argues that the second hand car owners are much more aware of the characteristics of their cars whose real value should be guessed by the buyers. The perception of the buyer about the second hand car's value tends to lower the real value of the car. The second hand cars would be valued less than it should be because of the fact that the owner has few deformations and hide them from the potential buyer. No matter the grade of these deformations the value of the car would be lower than its real value due to the difficulties of valuation of these cars arising from the insufficient and inaccurate information.

George A. Akerlof, "The Market for Lemons: Quality Uncertainty and the Market Mechanism" *The Quarterly Journal of Economics*, Vol. 84, No. 3 (1970), 488-500.

⁵³ Frank Hefflin, Kenneth W. Shaw, John J. Wild, "Disclosure Quality and Market Liquidity" (2000), Available at SSRN: <http://ssrn.com/abstract=251849> or doi:10.2139/ssrn.251849

⁵⁴ Archon Fung, Mary Graham and David Weil, 33.

under produced in the markets because real world transactions would always differ than the markets where information is costless to obtain.

The individuals, firms, companies would have diverse incentives to resolve these information asymmetries such as concluding optimal contracts between agents and principles⁵⁵, regulations that managers disclose their private information and lastly analysts or rating agencies engagement with the company to get more information.

As a conclusion more developed disclosure practices is counter poison and play an essential role to protect outsider shareholder rights, creditors and the stakeholders as a whole by preventing adverse selections and moral hazards. However, the companies should assess the positive and negative consequences of disclosure and decide for optimal disclosure practices. In this term advantages and disadvantages will be discussed in the next section.

2.2 Why (not) Disclosure?

Corporate disclosure and transparency are not only critical for well functioning of capital markets,⁵⁶ but also key elements of corporate governance and important indicator for corporate governance quality in a certain country.⁵⁷ The weak disclosure practices can result in unethical behaviors by the companies, loss of market integrity and hampering not only performance of the company, also the whole economic system. On the other hand transparency and disclosure reduces the potential of fraud and corruption in a country. However, developing and maintaining a sophisticated financial regime at the macro level might be neither easy nor cheap for a country particularly for the countries in emerging economies.⁵⁸ That is because of the fact that reforms for governance and financial transparency require intellectual capital, workforce as well as certain vision and competences as the countries with developed capital markets are dealing with huge resources in order to produce and regulate financial accounting systems and disclosure rules.⁵⁹ It should be pointed out that the financial transparency factor is primarily related to political economy whereas the governance transparency factor is primarily related to a

⁵⁵ David Kreps, *A Course in Micro Economic Theory* (Princeton:Princeton University Press, 1990), 17th and 18th Chapters in Paul M. Healy, Krishna G. Palepu, 405–440.

⁵⁶ Paul M. Healy and Krishna G. Palepu, 405–440.

⁵⁷ Mine H Aksu and Armagan Kosedag, “Transparency and Disclosure Scores and their Determinants in the Istanbul Stock Exchange”, *Corporate Governance: An International Review*, Vol. 14, Iss. 4 (2006), 277–296.

⁵⁸ Robert M. Bushman, Abbie J. Smith, 237–333.

⁵⁹ Ibid

country's legal judicial regime.⁶⁰ Therefore, major changes in the practices might not be possible in the short run.

Along with the global crises throughout the world in the last two decades, increasing demand for transparency has been leading to minimum information asymmetry, low capital cost and higher firm value.⁶¹ Because of the information transparency cycle⁶², more disclosure creates more need for transparency and eliminating opacity is becoming a strategic objective for the companies. In some instances managers and corporations as a whole are discharged from their accountability duties by providing timely information to interested parties.⁶³ This provides an exit option for the corporations in order to be relieved to a certain extent from their actions as well. However, rather than disclosing the information without discriminating is not acknowledged as the ideal way. The ideal way is rather disclosing the optimal information whose presence can ensure inflow of capital to the company and country; hence confidence of the market can be preserved.

*'The lifeblood of markets is information and barriers to the flow of relevant information represent imperfections in the market... The more the activities of companies are transparent, the more accurately will their securities be valued.'*⁶⁴

As quoted above from Sir Cadbury Statement, reliable and timely information boosts confidence and enables decision-makers them to make good business decisions directly affecting growth and profitability. Whereas the firms with better corporate governance quality disclose in more informative ways, the poor disclosure practices do not only strain the markets practices, it does also prevent the managers from making optimal

⁶⁰ Robert Bushman, Joseph Piotroski, Abbie Smith, What Determines Corporate Transparency? (2003) Available at SSRN: <http://ssrn.com/abstract=428601> or doi:10.2139/ssrn.428601, Accessed on 21.08.2011

⁶¹ Archon Fung, Mary Graham, David Weil, 30.

⁶² Disclosure of information results in information transparency cycle, meaning that the more information companies disclose, the more shareholder and stakeholders demand and receive information. Then as a consequence of this pressure the corporations might have less privacy. This situation is called the information transparency cycle.

⁶³ Laura F. Spira, "Enterprise and accountability: striking a balance", *Management Decision*, Vol. 39 Iss. 9, (2001), 739 – 748.

⁶⁴ Adrian Cadbury, 32

strategic decisions as⁶⁵ they need to gather financial and non financial information in order to foresee the potential risk factors and take the measures accordingly.

Shareholders alike need this information to check and balance the managers in their decisions putting forwards logical reasons and reduce the agency costs. From the economical point of view, disclosed information helps observers outside the entity-shareholders, investors and lenders about where to put their money as well as what risk entails such an investment. From the legal point of view, the disclosed information indicates the observers as to whether and to what extent corporations comply with the legal obligations. In terms of business ethics, disclosure helps stakeholders to gain a deep understanding of the company's policies and practices with regard to environmental and ethical standards, as well as its relationship with the communities in which the company operates.

The disclosure of accurate, comprehensive and timely information about the companies' structures and operations builds long lasting investor confidence and enables an informed valuation of their business performance and assets.⁶⁶ In another words high quantity and quality of disclosure of information ensure better reputation and impression to potential and exiting shareholders and creditors, hence more external financing possibilities for the companies.⁶⁷ More disclosure paves the way for more analyst coverage and more institutional investors following⁶⁸ and low cost financing⁶⁹ than the other companies which do not have good disclosure practices. Larger market capitalization through lower cost of equity can be realized in the optimum disclosure regime and absence of information

⁶⁵ Ian Linnell, Fitch IBCA, "A critical review of the new capital adequacy framework paper issued by the Basel Committee on Banking Supervision and its implications for the rating agency industry", *Journal of Banking and Finance* 25 (2001), 187-196.

⁶⁶ EC Directive 2004/109/EC on the "Harmonization of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC", 2004

⁶⁷ Markus Stiglbauer, "Transparency & disclosure on corporate governance as a key factor of companies' success: a simultaneous equations analysis for Germany", *Problems and Perspectives in Management*, Vol. 8, Iss. 1 (2010), 161-173.

⁶⁸ Millicent Chang, Gino D'Anna, Iain Watson and Marvin Wee, "Does Disclosure Quality via Investor Relations Affect Information Asymmetry?" *Australian Journal of Management*, Vol. 33, Iss. 2 (2008), 375-390.

⁶⁹ Edwige Cheynel, "A Theory of Voluntary Disclosure and Cost of Capital", *Kellogg Northwestern University Accounting Papers*, Available at: <http://www.kellogg.northwestern.edu/accounting/papers/cheynel.pdf>, Accessed on 21.08.2011.

asymmetry so there is a positive correlation between of a country's disclosure regime and economic performance.⁷⁰

Transparency might not assure the excellence in an economy but opacity ensures the eventual failure of the companies as they are not explicit and hard to understand.⁷¹

One of the most remarkable aspects in corporate disclosure is that new information has one of the central characteristics of a so called public good; its consumption is non-rival, meaning that new information can be consumed by one party without diminishing its value to another party. Consequently the economic parties would produce less than optimal level of information and attempt to access to more information.⁷² Therefore the companies might be reluctant to produce information for the public interest.

2.3 Disclosure and Shareholder Meetings

Since the investors gain certain rights in exchange of each share in return for their investment, they expect fair tread beside the high value creation for the shares they own. This might be equal voting rights, eliminating the privileged voting practices as well as establishing cumulative voting applications. With respect to this topic, in the section of "The Rights of Shareholders and Key Ownership Functions" of the OECD Principles, it is stated that shareholders shall be able to participate and vote in the shareholder meetings, appoint and remove the members of the board of directors, share the income of the company as well as obtain the relevant and material information in a timely and regularly manner. Moreover the significant changes and transactions should be made public by the company such as amendments in the articles of association, authorization of additional shares, extra ordinary transactions, including fully or partially share or asset transfers, related party transactions, extra ordinary transfers of the company's assets such as mergers & acquisitions or spin offs, names of the proposed directors, internal and external auditors as well as their remuneration. However, in order for shareholders to make reasonable decisions this kind of information should be provided before the shareholder meetings because of the fact that the time given during the shareholder meetings after disclosing the proposals might not be sufficient to research and asses the proposals. In this sense shareholder meetings provide an essential platform which serves to perform the votes in a

⁷⁰ Robert M. Bushman and Abbie J. Smith, "Financial accounting information and corporate governance", *Journal of Accounting and Economics*, 32, (2001), 237–333.

⁷¹ Fiemetta Borgia, 21.

⁷² Ibid

democratic manner regarding important decisions or fulfill the formal procedures. Because of the significance of the general meetings, the procedures and details such as meeting items, location, time and blocking, registration, submission dates of this event should be clarified in advance and should be disclosed by means of certain communication channels. The substructures to perform votes in the light of disclosed information should be set up, the impediments for distance voting should be eliminated, and shareholders should be able to vote at the general meetings personally or via a representative.

Only legislative measures to establish a platform for disclosure of information might not be truly sufficient in the corporations.⁷³ Beyond the legislative actions, a reciprocal communication process between corporations and shareholders seems necessary. In the communication process undue optimism, public relations spin as well as over bombarding the observers with the information should be avoided, which would not only be unnecessary and costly but also it can distract the observers to pick the essential information among all⁷⁴. On the other hand Ararat and Dallas⁷⁵ argue convincingly that investors can and should play a role in shaping corporate governance practices in emerging markets through informed voting and, perhaps more importantly, ongoing engagement with companies and regulators. As the information is difficult to get and the transparency levels are relatively low in those markets compared to outsider models, the mission falls to a large extent to shareholders.

The disclosure practices ahead of the shareholder meetings should well serve to inform the market, both existing and potential shareholders about the risks, potentials as well as trends to be faced by the company in the upcoming year. The information should be balanced and objective, precise and integrate, unbiased, easy to reach, and comprehensive. While discussing future situation of the company the definitive statements should be avoided and more general prospects should be used.⁷⁶

The information disclosed ahead of the shareholder meetings should be material in order for shareholders to be able to cast the votes at the shareholder meetings. The information without any prejudice and with taking into account the principles of equality

⁷³ Archon Fung, Mary Graham, and David Weil, 33.

⁷⁴ Fiemetta Borgia, 20-33.

⁷⁵ Melsa Ararat and George Dallas, "Corporate Governance in Emerging Markets: Why It Matters to Investors—and What They Can Do About It." *GCGF and IFC Publication, Private Sector Opinion*, Iss. 22, (2011), 3.

⁷⁶ Bob Tricker, 133.

should be disclosed to all relevant capital market parties but the confidential information such as trade secrets can be exceptional.

The information that the company discloses should be clear and easily interpretable to all shareholders. All the material relating to corporate governance should be disclosed in a non technical⁷⁷, clear, concise, precise language while considering substance over⁷⁸, easy and comprehensible⁷⁹ form. Insufficient or unclear information hamper the ability of the markets to function, increase the cost of capital and result in a poor allocation of resources.⁸⁰ In the corporate governance principles disclosed by CMB⁸¹ it is also stipulated that:

"While disclosing information, the company is recommended to use the most basic concepts and terminology and avoid using vague or indefinite expressions that would result in confusion. In cases when it may become absolutely essential to use these terms, relevant explanations are to be provided in order to make such information comprehensible to everyone".

The information that the company discloses ahead of the shareholder meetings should be up to date. The shareholders should also be informed in any significant developments that the company has done any changes in the shareholder rights, company objectives, structure, and company bylaws.⁸² The rapid developments in the communication technologies and internet paves the way the companies to transmit the information to observers in a less costly, more speedy and timely manner. To ensure the transparency the accurate, reliable, timely and up to date information should be disclosed to the associates by the company for shareholder to be able to cast informed votes at the shareholder meetings.⁸³

In order shareholders to make decisions the information should be in a standard format and easily comparable. Therefore, the companies should follow a standard format to

⁷⁷ The EC Directive, No:2003/71 on "The prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC", 2003.

⁷⁸ United Nations Conference on Trade and Development, *Guidance on Good Practices Corporate Governance Disclosure*, (Geneva: United Nations Publications, 2006), 29.

⁷⁹ The EC Directive, No:2001/34/ on the admission of securities to official stock exchange listing and on information to be published on those securities, 2001.

⁸⁰ OECD, *Corporate Governance in Turkey: A Pilot Study* (Paris:OECD Publications, 2006), 68.

⁸¹ Capital Markets Board of Turkey, *Corporate Governance Principles* (Istanbul, 2003; Amended in 2005). 23.

⁸² Ibid

⁸³ Süleyman Uyar, Muhsin Çelik, "Sürekli Kamuyu Aydınlatma ve İnternet Ortamında Finansal Raporlama Sürecinde Kullanılan Diller", *Ege Üniversitesi Akademik Bakış Dergisi*, Vol.6, No.2 (2006), 93-103.

facilitate obtaining information for the shareholders. It is evidently clear that international regulations such as International Financial Reporting Standards ensure a convergence in financial statements of companies.⁸⁴ Shareholders are interested in comparing the information of different companies as well as the information of a certain company historically as the principle of standardization is applicable to the process of evaluating the companies past and current year operational and financial results.

The nature of the information flows in the capital markets can be evaluated as forward looking information as the shareholders take usually decisions consistent with the previous year results. However it is also expected that companies disclose also the foreseeable risks, strategic targets, expectations for the following terms in their annual reports. Given the dynamism of the markets these information should be revised and the reasons, if there is any, for the fail of the expected results should be disclosed as well. To the principles of CMB, the forward looking information with underlying statistical data and evidence should be made public and the information should not consist of any exaggerated provisions and misleading information and should not pave the way to interpret false the companies' operational and financial results.

Regardless the quantity of share they have, all the shareholders should have access to the information equally, pursuant to the relevant law, via different means of communications channels. Insiders should be disclosed and any insider trading activities should be avoided.⁸⁵ Whereas an investor group is able to gain insight of the company over the others, then the conditions for information asymmetry occur.⁸⁶

After gaining remarkable insight about the theoretical foundations of corporate governance, transparency and disclosure respectively, even after the following parts will deal with corporate governance and transparency in Turkey and their practical implications at the shareholder meetings.

⁸⁴ Paul Pacter, "What exactly is convergence?", *Int. J. Accounting, Auditing and Performance Evaluation*, Vol. 2, No: 1/2 (2005), 67-83.

⁸⁵ Provisions in the most countries mandate to disclose the information regarding managers or directors who have access to the strategic and financial information and prohibit that they communicate this information to a certain group which bases on this information when investing in the securities. Those who have the permission to this information are called insiders and the action is called insider trading.

⁸⁶ Please see the section "Information Asymmetry"

3. Corporate Governance and Transparency in Turkey

Corporate Governance is a rather new concept of growing importance in Turkey which is latecomer compared to its counterparts with developed stock markets, strong equity culture and more transparent practices. One can confess that there have been momentous developments in recent years in the shade of structural reforms laid down by IMF subsequent to the financial crises in 2001 and the motivation as well as endeavors for becoming a member of the European Union. However, despite these developments transparency continues to be a major problem for the shareholders with which lawmakers should closely deal and in which the corporations should make progress. In this respect this chapter deals with the general framework of underlying problems of the opacity in Turkey, and the remedies developed against these opaque structures. Before making an assessment of the corporate governance and transparency culture it would be wise to gain a brief understanding of the Turkish economy after its establishment in 1923 as it is closely related to the development of capital markets in Turkey.

3.1 Macroeconomic Environment

Though the Turkish Economy is described as a state dependent economy by some scholars,⁸⁷ Turkey is still the country of duality⁸⁸ which has been revealing itself in Turkish economic policies, in its financial markets as well as in its institutions. From the foundation of Turkish Republic (1923) on, in the first phase namely till late 1950s state played a key role in many industries by establishing and controlling state economic enterprises in order to benefit from integrate to and participate in the capitalist world economy and advantage of market-based development⁸⁹ against to the inefficiency of central planned economy. However, this participation was refrained by the import substitution approach, persistently existence of big state corporations and the preventive actions of the state to the companies that want to enter into the market. These were the impediments to the development of the private sector, investment projects and competitive market environment contrary to the initial intentions for integration to the international markets. Furthermore, in the wake of the defensive import substitution rather than offensive export oriented policies let Turkey

⁸⁷ Richard Whitley “Dominant forms of economic organization in market economies”, *Organization Studies*, Vol.15, No:2 (1994), 153-182.

⁸⁸ Melsa Ararat, Ceyhun Göcenoğlu, “Drivers for Sustainable Corporate Responsibility, Case of Turkey” *Sabancı University Working Papers* (2005), 3.

⁸⁹ Ziya Onis, Fikret Senses, Global Dynamics, Domestic Coalitions and a Reactive State: Major Policy Shifts in Post War Turkish Economic Developments, *METU Studies in Development*, Vol. 34, No:2 (2007), Available also at: Available at SSRN: <http://ssrn.com/abstract=1019997>, Accessed on 20.08.2011

fall behind the countries which have fairly advanced capital markets. This approach led to two major consequences. Firstly, the state functioned as the distributor of the *rents* rather than providing public goods such as stable macro economic environment, transparent regulatory system, and social conflict mechanisms; secondly, it increased private risks due to the private economic agents that the state established to compensate at least partial risks, regardless those risks emanate from the state or private sector activities. From 1980s on, with the 24 January reforms these policies have transformed to export, private sector and competition oriented, open and generous for the incentives to the foreign capital.⁹⁰ Thereby, export oriented big business has become increasingly transnational in its operations as well as in ownership structures in this interval. The year 1980 was unsurprisingly a turning point for the capital markets of Turkey in line with the neoliberal developments in the world economy. The institutions CMB and ISE, which have vital importance for the development of Turkish Capital Markets, were established in 1982 and 1985 respectively. However, the overall macro economic situation was not very brilliant given slightly limited private investments and persistent government deficits financed through central bank lending. That resulted in high inflation rates with an average of 50 percent, unstable governments, military intervention, high interest rates as result of political uncertainties.⁹¹

One of the remarkable developments in those unsteady years is that CMB has removed the restrictions on foreign portfolio investors trading in the Turkish capital markets with the Decree No. 32 passed in August 1989⁹², which increased the inflow of portfolio investments. According to data released by World Bank the FDI inflows were around 354 million USD in 1988; whereas it increased to 684 million in 1989.⁹³

On a different track, low level of transparency⁹⁴ and shareholder rights protection thus the lack of investor confidence, political and macro economic volatility resulted in

⁹⁰Melsa Ararat and Mehmet Ugur, "Corporate Governance in Turkey: An Overview and Some Policy Recommendations", *Corporate Governance: International Journal of Business in Society*, Vol.3, No:1 (2003), 58-75.

⁹¹ Institute of International Finance Equity Advisory Group. "Corporate Governance in Turkey – An Investor Perspective" *Task Force Report*, (Washington DC:2005), 6.

⁹² Official Web Site of CMB <http://www.cmb.gov.tr>, Accessed on 15.03.2011.

⁹³ The World Bank Indicators, <http://data.worldbank.org/indicator/BX.KLT.DINV.CD.WD?page=4> Accessed on 15.07.2011. Please note that foreign direct investments are the net inflows of investment to acquire a lasting management interest (10 percent or more of voting stock) in an enterprise operating in an economy other than that of the investor. It is the sum of equity capital, reinvestment of earnings, other long-term capital, and short-term capital as shown in the balance of payments. So the amount does not reflect the exact amount of portfolio investments but it also includes them.

⁹⁴ Joel Kurtzman and Glenn Yago, *Opacity Index: Measuring Global Risks*, (Santa Monika:Milken Institute, 2009).

very low FDI inflows in the decade of 1990 until Turkey faced severe crises in 2001. According to Ararat and Gocenoğlu the grounds of low level of FDI in 1990s were the analyst perceptions of Turkey's governance and non-confidence to the country's wider political environment⁹⁵.

In 2001 Turkish economy was plunged into the deepest economic crises in its history. Turkish Lira was devaluated by around 26 percent and GNP per capital fell down to 2,160 USD which is below per capita income in 1990s.⁹⁶ Following the crises in line or as a requirement of IMF structural reform programs Turkey's agenda was embracing the items which predict reducing the role of state in the economy, reforming the problematic sectors, amendment of the public procurement law, make central bank utterly independent, restructuring the banking system, fostering transparency and establishing new and efficient risk management techniques.⁹⁷ Most noteworthy outcomes of these policies were the increase in the market capitalization, growth of volume of trading in capital markets and increasing flow of foreign direct investments. As Chart 3.1 indicates, FDI inflows were recorded as 2.9 billion USD in 2004 and 22 billion USD in 2007 and decreased to the levels 8.4 billion in 2009.

The investments flew into the Turkish borders was obviously the consequence of the stable economic policies owing to the new single party government, independency of central bank, privatization process, in particular with the accession talks with the EU as well as new law for protecting foreign direct investors⁹⁸ and supporting tax incentives. FDIs boomed especially after 2004 which is the starting year of EU negotiations. The time period between 2001 and 2004 can also be assessed as testing period of stability of the Turkish economy by foreign investors.

In parallel to the rising FDIs, Turkish Economy has also grown since 2001. In 2006 the economic indicators show that the Turkish economy grew 6 percent. In 2007 this growth proportion was 6.7 percent. These growth rates can be evaluated as a magnificent development in Turkish economy when compared to 2001 crisis times. Halicioğlu⁹⁹ argues

⁹⁵ Melsa Ararat and Ceyhun Göcenoğlu, 3.

⁹⁶ Melsa Ararat and Mehmet Ugur, 58-75.

⁹⁷ Ibid

⁹⁸ Official Web Site of The Republic of Turkey Prime Ministry Investment Support and Promotion Agency (ISPAT), [http://www.invest.gov.tr/en-US/infocenter/publications/Documents/FDI percent20Law percent20in percent20Turkey.pdf](http://www.invest.gov.tr/en-US/infocenter/publications/Documents/FDI%20Law%20in%20Turkey.pdf), Accessed on 15.02.2010

⁹⁹ Ferda Halicioğlu, "Foreign Direct Investments and Turkey", *University Library of Munich MPRA Papers*, No. 10404, (2008), 2-3. Available at <http://mpra.ub.uni-muenchen.de/10404/>, Accessed on 24.08.2011

that this growth is the consequence of political stability, which came with the elections in 2002, cohesion to the economic policies supported by IMF after the crisis in 2001 and the process of the EU candidacy. However Yeldan¹⁰⁰ states that the growth was not realized on the account of government economic stability policies (coordinated with IMF), rather this significant growth was emanated from the decrease of import products' prices, low labor costs and as well as inventories. On the other hand, whilst achieving that much growth, sufficient workplace could not be created. Growth is actually a result of private consumption and labor productivity. While labor productivity 37.8 percent increases, labor unit cost has decreased 38.8 percent.¹⁰¹

Due to the high appreciated exchange rate policy, Turkish economy has been dependent on the import products and the growth is based on the import rather than export which resulted in huge current account balance deficits. The deficit reached from -7.5 Billion USD in 2003 to -41.5 Billion USD in 2008 which is of course to be evaluated as fragility of the economy. Considering that the Turkish economy grows incredibly with a population of 73 million, high consumption and high interest rates it stands out with its attractive market for the foreign direct investors, particularly in the financial sectors.

On the other hand, the sustainability and share of FDI incomes should also be investigated in order to understand the real contribution of foreign capital to the Turkish economy. The increase of FDIs was also a common phenomenon between 2004 and 2006 in the other new European Union market economies such as Poland, Czech Republic and Hungary. Nevertheless, the characteristics of the FDIs in these states differ than the ones in Turkey. As it can be observed in Table 3.1, the capital and reinvested earnings are almost equal to each other in the above mentioned countries. But in Turkey reinvested earnings account only 5 percent in total FDI amount. It is obvious that the FDI policy of Turkey is only the privatization of productive sectors at the expense of labor wages, despite risky current account deficits. FDIs in that sense, contribute hardly to the employment creation and poverty reduction in Turkey.

¹⁰⁰Erinc Yeldan, *Büyümenin Kaynakları Üzerine*, (2004), Available at www.sendika.org, Accessed on, 24.08.2011 in Esra Talaşlı, "Doğrudan yabancı yatırımların Türkiye'nin ekonomik büyümesi üzerindeki etkilerinin analizi" (2000- 2007), (Master Thesis:Selcuk University, 2008), 44.

¹⁰¹ Ibid

Table 3.1 Components of FDI (Percent), Country Comparison (2004 – 2006)

Country	Capital	Reinvested Earnings	Other Capital
Turkey	88.3	5.0	6.7
Poland	39.5	42.0	18.5
Czech Republic	42.7	49.4	7.9
Hungary	40.9	36.0	23.1

Source: Turkish Treasury, Bulletin of FDI Data, cited form Esra Talaşlı, 2008, 55.

Moreover, another concern element is the characteristics of FDI inflows. The FDIs in Turkey are rather based on privatizations and M&A in service sector in general, in finance sector in particular. As it can be seen on the Chart 3.2, the amount of the privatization in 2006 and 2007 was recorded more than 8 billion Lira each year. In M&A, the financial sector has a share of 44 percent and telecommunication sector with 41 percent. In addition, Talasli claims that another important reason why the foreign direct investors are investing more through M&A is that Turkey has still some institutional and cultural risks.¹⁰² It means that Turkey still keeps its socioeconomic and political volatility. Whereas share of services accounts around 70 – 75 percent, agriculture accounts around 0.2 – 0.6 percent and the rest is industry total FDIs in Turkey after 2004. This was contrarily 61 percent industry and 38 percent service and the rest of the agricultural sectors between 2000 and 2004¹⁰³.

Right after the crises in Turkey in 2001 the markets capitalization was round about 34 billion USD and this number appears to be 307 billion USD in 2010 which reflects a 1000 percent overall growth in eight years time.¹⁰⁴

The neo liberal single party government followed the program of IMF after the crises attached a special importance to the fiscal discipline and privatization of most of state owned enterprises. Although the privatization process was considerably controversial in Turkey, many state enterprises were liberalized especially in the years 2005 and 2006. As it is indicated on the Chart 3.2 whereas the total amount of the assets privatized in 2001 was 120 million USD, it was recorded in 2005 as 8.22 billion USD.

¹⁰² Ibid.

¹⁰³ YASED, *Foreign Direct Investment Report* in (2007), 4.

¹⁰⁴ Official Web Site of CMB, <http://www.spk.gov.tr/apps/aylikbulten/index.aspx?submenuheader=0> Accessed on 24.08.2011.

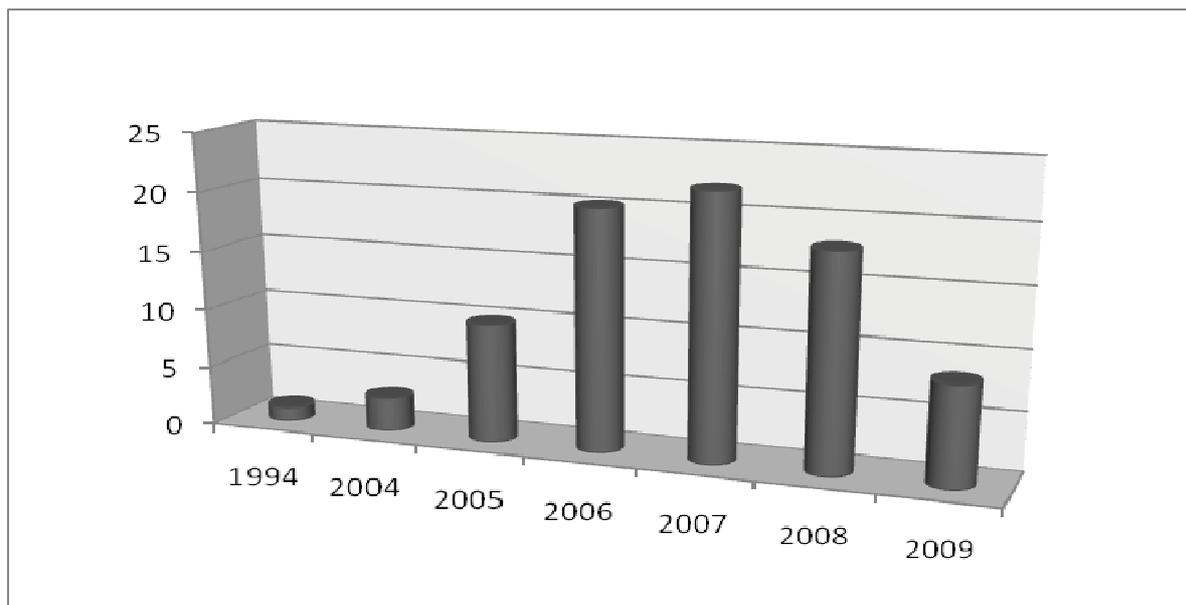


Chart 3.1 FDI Inflows into Turkey between 1994 and 2009
Source: Central Bank of Turkey, 2009

As it can be observed on the Chart 3.1, the outcome of the privatization programs of the governments in recent years has been high level of increase in the foreign investors and market capitalization hence attracting FDI and portfolio investments into the country. However, despite those investments, the volatility of the economy because of high unemployment rate, high current account deficits and political instability remains the major problems that the government should solve to create a confident investment atmosphere.

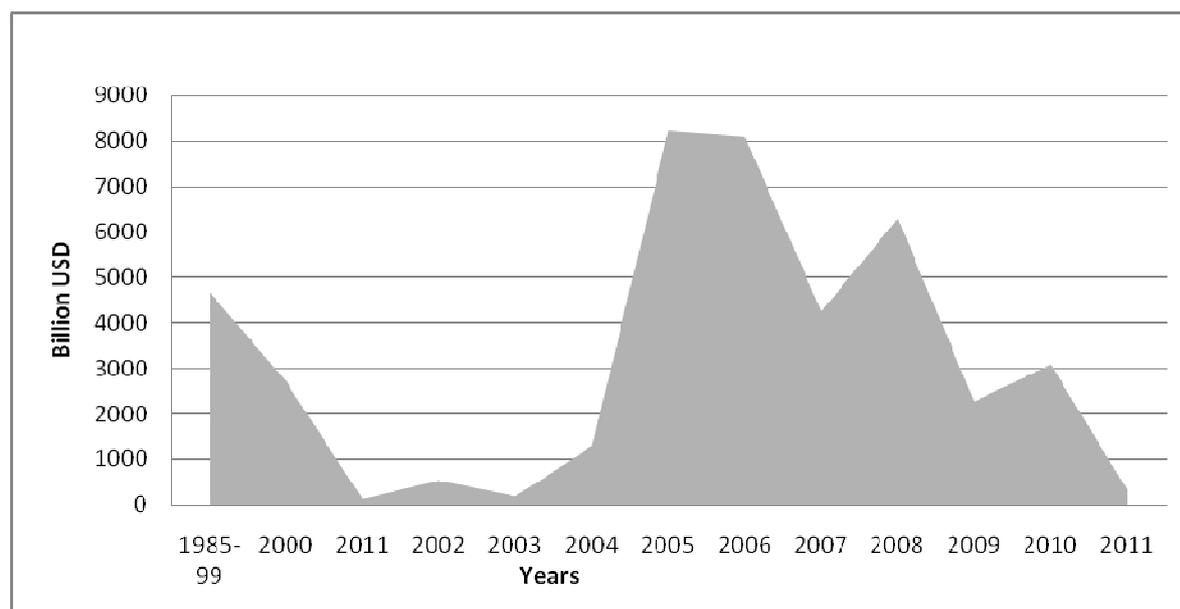


Chart 3.2 Privatization Process in Turkey between 1985 and 2011,
Source: Republic of Turkey, Prime Ministry Privatization Administration, 2011

3.2 Ownership Structures

As it was mentioned above, transparency and disclosure levels remains low in the insider corporate governance models because of the family owned companies and concentrated ownership structures in Turkey. With respect to classification of Turkey's Corporate Governance system it is tough to fit it to any of these above mentioned outsider or insider models given the different ownership structures and free float rates. However, it has overwhelming similarities to the insider models as the ownership in Turkey is also concentrated in the hands of a small number of holding companies, which are mostly belong to the most wealthy families and conglomerates through pyramid structures, cross-shareholdings, as interlocking boards.¹⁰⁵ Yurtoglu in his study found out that 45 of the total number of companies are held by major families which make more than 50 percent of the total market capital.¹⁰⁶ Although this study is not up to date, the ownership structures in Turkey do not seem to have changed significantly in one decade. Given the concentrated ownership structures, the free float rates remain relatively low, around about 20-25 percent,¹⁰⁷ which leads to an underdeveloped capital markets. Shareholder value is rarely mentioned like in the other emerging economies.¹⁰⁸ In this sense it can be argued Turkish Corporate Governance has similar patterns to the insider models. Nonetheless, Turkish companies are not owned by banks as in German and Japanese systems. On the contrary, almost every private bank is under the control of large conglomerates¹⁰⁹ and the stakeholder approach is not as prevalent as in the other insider models.

¹⁰⁵ It is common to see in Turkey that where as non executive board member in a subsidiary serves in an executive or non executive position in another subsidiary or partner company.

Burcin Yurtoglu, "Ownership, Control and Performance of Turkish Listed Firms", *Empirica* Vol. 27 No:2, (2000), 193-222.

Burcin Yurtoglu, "Corpora Governance and Implications for Minority Shareholders in Turkey", *Journal of Corporate Ownership & Control*, Vol.1, No.1 (2003),72-86.

Yunus Emre Akdogan and Melek Acar Boyacioglu, "Corporate Governance In Turkey: An Overview", *Selçuk Üniversitesi Sosyal Bilimler Enstitüsü Dergisi* , Vol: 24, (2010), 11-30.

Istemi Demirag and Mehmet Serter, "Ownership Patterns and Control in Turkish Listed Companies", *Corporate Governance: An International Review*, Vol. 11 (2003), 40-51.

Guner Gursoy, "Changing Corporate Ownership in the Turkish Market", *Journal of Transnational Management*, Vol. 10, Iss. 2 (2005), 33-48.

¹⁰⁶ Institute of International Finance Equity Advisory Group, Task Report, 5.

¹⁰⁷ Ibid

¹⁰⁸ Ibid

¹⁰⁹ Burcin Yurtoglu, Ownership, "Control and Performance of Turkish Listed Firms", 193-222. Institute of International Finance Equity Advisory Group, *Task Report*, 8,9.

Shareholders, that own big stakes in the company, can be classified in Turkey as families and big holdings, state, and foreign investors. Aktug¹¹⁰ classified the investors in Turkey as institutional investors, corporate investors and individual investors. Some of the most prominent conglomerates to be given as example of holdings or family enterprises are Koc Holding, Dogus Holding, Sabancı Holding. Beside banking services these conglomerates are pretty influential in the other industries such as finance, automotives, durable goods, food as well as media for the reason of the fragile economy of Turkey. Turkish companies have been expanding and still expand their business scopes to various sectors on account of the volatility and ambiguity of the macro economic situation, in order to reduce those risks.¹¹¹ Because of the collectivist, traditional and cultural patterns as well as concerns for ensuring effectual control in the group companies, family members and relatives are widespread in the boards of directors.¹¹² From these findings it can be concluded that the separation of ownership and management is not very common and intensified and the boards remain ineffective governance mechanisms in Turkey.¹¹³ On the other hand the concentrated ownership structures provide fortunately tight monitoring systems against agents. Large stakeholders have greater incentives to benefit from the control of the management. Nevertheless, the performance of the companies is likely negatively affected unless they attach a special importance to the performance of the company rather than trying to pursue the dominance through voting rights or ownership structures.¹¹⁴

As a summary the main characteristics of ownership structures of Turkish companies are that few companies are traded in the markets which is a reason of low level of market capitalization compared to the other countries, highly centralized and concentrated, the separation of ownership and management is blur due to the pyramidal, cross and complicated ownership structures.¹¹⁵

¹¹⁰Gokhan Aktug, "Corporate Governance Practices in Turkey During the European Union Harmonization Process, Voting Results in General Meetings", (Unpublished Master Thesis:Akdeniz and Hamburg Universities, 2010), 13.

¹¹¹ Yunus Emre Akdogan and Melek Acar Boyacioglu, 11-30.

¹¹² Ayse Gul Ozbebek and Esra Kilicarslan Toplu, "Does Culture Matter for Corporate Governance, A Case Study of Turkey", *International Journal of Business and Management Studies*, Vol. 3 No: 1, (2011), 31-38.

¹¹³ Melsa Ararat, and Hakan Orbay, "Corporate Governance in Turkey, Implications for Investments and Growth", *Background Paper, 2* Available at: <https://research.sabanciuniv.edu/801/1/stvkaf07a67.pdf> Accessed on 31.03.2011

¹¹⁴ Burcin Yurtoglu, "Ownership, Control and Performance of Turkish Listed Firms" 193-222.

Institute of International Finance Equity Advisory Group, Task Force Report, 8

¹¹⁵ Please see the example of Dogan Holding in Annex 1.

Despite recent intensive privatization endeavors, state still continues to enjoy being boss in a number of major companies. The presence of the state can be seen in various forms in the Turkish Companies. One is that they directly have shares in the companies such as in Turkish Airlines (49 percent) and Turk Telekom (30 percent). The second option is that the state may have golden or privileged shares in the companies which are active in some strategic sectors such as energy, airlines as well as defense industries.

Given the inexperience of the equity culture in Turkey and import substitution oriented and closed economy, institutional investors have not been very active. Especially after the privatization operations, the foreign ownership as well as institutional ownership rates in the companies has increased significantly¹¹⁶. Along with the liberalization and privatization period many foreign institutional investors due to their advanced capital markets, shifted their investments recently to Turkey as TSPAKB reported¹¹⁷ that the foreign capital inflows between 2001 and 2010 have reached to 25 billion USD. The share of the foreign capital because of the recent global crises remained around 66 percent in Turkish capital markets whereas it was 72 percent in 2007. The loyalty level of foreign investors to the securities they hold seem to be higher as well as they have the tendency to hold their securities for one year which is longer than the domestic investor with only one month.

3.3 Institutional and Legal Framework

Institutions: When looking at the institutions regarding corporate governance and transparency in Turkey the CMB distinguishes itself as the first and foremost institution. The CMB is equipped by the CML with broad authority when licensing, monitoring and supervising the financial intermediaries and institutional investors operating in the market as well as protection of the rights and interests of the investors.¹¹⁸ It means that the source of power and liabilities of the CMB basically stems from the CML. The CMB draws statutory laws that are submitted to parliament for approval, thereupon it is allowed to issue regulations. These regulations are known as communiqués and are published in the official gazette after receiving clearance from the relevant authorities. The CMB decelerates that the corporate governance is one of its most important objectives by referring to the improvement of the framework of shareholder protection, enhance transparency in the

¹¹⁶ Ibid

¹¹⁷ TSPAKB, “Capital Market Factsheet”, Available at: www.tspakb.org.tr Accessed on 06.06.2011

¹¹⁸ Official Web Site of CMB <http://www.cmb.gov.tr> , Accessed on 15.03.2011.

capital markets¹¹⁹ the CMB published a guideline for corporate governance principles in 2003 and revised in 2005 in order to bring Turkish corporate governance standards in line with the international standards defined by OECD.

The other fundamental institution, which is the only securities exchange in Turkey, is the ISE. The ISE was established in 1986 to provide trading in equities, bonds and bills, revenue sharing certificates, private sector bonds, foreign securities, real estates certificates, as well as international securities. At the time the ISE was founded the first IPOs were opportunistic and characterized with the high level of market abuses. Related lending and transfer pricing were common and unregulated.¹²⁰ The ISE is supervised by the CMB¹²¹, the main regulatory and supervisory authority for the Turkish capital markets. As of July 2011, 387 companies are included in the National Market and fulfill the listing requirements of the ISE. Currently 100 companies selected from the National Market make up the ISE National 100 Index, the main index of the ISE Stock Market. Settlement of trades is realized through the ISE settlement and Custodian Bank Inc. (Takasbank). Takasbank is Turkey's central securities depository, ISE's clearing and settlement center, and Turkey's numbering agency.

The "Watch List Companies Market" is made up of companies that are under special surveillance and investigation due to the extraordinary situations with respect to stock transactions. Companies may be moved to this market if they fail to provide complete, consistent, and timely disclosure or fail to comply with regulations.

The two organizations have been striving to impose stricter disclosure requirements for publicly listed companies as well as to introduce regulations to empower shareholders rights. The other institutions relevant to corporate governance in Turkey are TUSIAD¹²² an interest group, and the TESEV¹²³ a prominent think tank which have also been active in conducting studies regarding the improvement corporate governance in Turkey. TKYD¹²⁴, which was founded in January 2003, has been cooperating with various organizations to

¹¹⁹ Ibid

¹²⁰ Melsa Ararat, Hakan Orbay, 2.

¹²¹ Official Web Site of ISE, www.ise.org , Accessed on 02.04.2011.

¹²² Official Web Site of TUSIAD, <http://www.tusiad.org> , Accessed on 15.03.2011.

¹²³ Official Web Site of TESEV, <http://www.tesev.org.tr> , Accessed on 15.03.2011.

¹²⁴ Official Web Site of TKYD, <http://www.tkyd.org/en/default.asp> , Accessed on 02.04.2011.

carry out studies for Corporate Governance in Turkey as well as to raise awareness of the concept among Turkish Companies and shareholders.¹²⁵

Regulations: Turkish Corporate Governance interacts with a wide range of laws, regulations, and communiqués. Main source of the law designed for the capital markets is stemming from the TCC and the CML which were enacted in 1957 and 1981 respectively. The CML authorizes the CMB to regulate certain issues and determine the legislative framework. Current TCC was originally taken from French Commercial Code in 1850 and modernized in 1926, and 1956 with the provision of Swiss and Italian Law, but mainly influenced by the French tradition. The commercial code does not seem adequate for minority shareholders protection in Turkey¹²⁶ as La Porte et al. also indicated that French civil law countries are least protective of minority shareholders.¹²⁷ The provisions of the CML are mostly taken from the Anglo Saxon countries but it has still patterns from the civil law. Despite these common points there are some ambiguities and inconsistencies to be mentioned about. Whereas TCC is more static in nature, the CMB Communiqués provide a more dynamic legal framework with a detailed and binding character in order to be able to harmonize Turkish Corporate Governance structures in the listed companies with the latest international developments. For instance, the CMB may issue communiqués in order to regulate, among others, the procedures of public offers, the issuing and listing of securities, disclosure and audit. In case of breach of law and non compliance with these communiqués it imposes administrative fines and is authorized to ask companies for the correction of irregularities, suspend the sale of securities in the stock exchange, even suspending the activities of the company. To investigate the companies' activities it is granted the right to demand the relevant information, books and accounting records from the companies.¹²⁸

The Corporate Governance Principles: Capital Markets Board in line with the OECD Principles released its corporate governance principles in 2003. These principles were revised in 2005 again parallel to up to date principles of OECD. The principles are not mandatory (apart from the clauses which take part in the TCC and CML) in nature but

¹²⁵ Ibid

¹²⁶ Melsa Ararat, Hakan Orbay, 2.

¹²⁷ Rafael La Porta, Florencio Lopez de Silanes, Andrei Schleifer, Robert W. Vishny, "Investor Protection and Corporate Valuation", *The Journal of Finance*, Vol. 57, Iss: 3 (2002) 1147-1170.

¹²⁸ Gul Nilson Okutan, "Corporate Governance in Turkey", *European Business Organization Law Review* 8, (2007), 195-236.

subject to “comply and explain” principle¹²⁹. In case of non compliance the companies should state the reasons of non compliance in their corporate governance compliance reports and this report should be included in their annual reports. Besides, there were some legally binding clauses introduced such as adoption of IFRS. Nevertheless, in that point the question of how efficient the CMB occurs in mind. Because a monitoring mechanism would be quite sophisticated and costly when scrutinizing the companies whether they comply with the disclosure practices or explain if they do not comply. However, it can still be said that the principles of the CMB were one of the mile stones in corporate governance developments, which initiated extensive debates in the corporate sector.¹³⁰ The principles of CMB comprise four main components which are namely shareholder rights, transparency and disclosure, stakeholders and board of directors. Whereas transparency and disclosure field describes the form and content of the information that the companies should disclose, there are many other clauses regarding disclosure and transparency included in the other chapters as well. The principles are one of the concrete outcomes of the CMB to improve the corporate governance quality in Turkey and upgrade the scale in the international arena.

3.4 Transparency and Disclosure

Today transparency has exceeded beyond the luxury rather it has become a corporative necessity.¹³¹ Along with the corporative necessity national and international systems have also been designed to protect investors, minimize corruption, and improve public services.¹³² In case of Turkey, although it is willing to harmonize its regulations with the international standards rapidly, it is still early to argue that it is the country of transparency, as it was for instance ranked 56th in the Transparency International Corruption Perception Index in 2010¹³³ whereas 65th in 2005 and 54th in 2001. This overall transparency performance is clearly very poor compared to other countries. Sometimes it has recorded little improvement or the situation even worsened. Although, these kinds of indexes are controversial¹³⁴ they have the potential to influence the relevant parties which

¹²⁹ The corporations should comply with the principles; otherwise they are obliged to explain the reasoning for non compliance in their annual corporate governance compliance reports.

¹³⁰ Standards & Poors, *Corporate Governance: Turkish Transparency And Disclosure Survey* (2005), 3.

¹³¹ Fiemetta Borgia, 20-25.

¹³² Archon Fung, David Weil, Mary Graham, and Elena Fagotto. *The Political Economy of Transparency: What Makes Disclosure Policies Effective* (2004), Available at SSRN: <http://ssrn.com/abstract=766287>, Accessed on 23.08.2011

¹³³ Transparency International, *Corruption Perception Index*, (Berlin:2010), Available at: http://www.transparency.org/policy_research/surveys_indices/cpi/2010/results, Accessed on 30.04.2011

¹³⁴ Although referring to this index it should be noted that there are some questions for the reliability of these indicators. Please see the article of Theresa Thompson and Anwar Shah1 for a further discussion:

include also the foreign investors. As Aktug¹³⁵ argues, opacity and corruption level in a country are highly related with the role of the state in economy and its interaction with business, the state's involvement in the economy as economic actor fostered opacity, corrupt practices. There are several reasons for opaque corporate governance practices in Turkey such as novelty of capital markets, weak equity culture and dominance of the controlling shareholders along with the block and cross ownership structures, blurred separation of management and ownership, abusive and manipulative actions in the market, weak civil society culture as well as shortcomings in the enforcement of law.

In the corporate level, it is evident from the existing literature, even though it is possible that Turkish companies are improving quite well, there is still a large room for companies to improve those practices. According to the survey series conducted among around 52 Turkish companies by S&P and Sabanci University in 2005, 2006, 2007 and 2008¹³⁶ the disclosure practices were slightly poor in 2005 and the companies were reluctant to disclose the information unless they are obliged by the lawmaker. Aksu and Kosedag¹³⁷ have also stated in their study, collaborated with S&P, the disclosure practices level of Turkish companies seemed to be at the modest levels in 2005 and this weakness was particularly remarkable in the voluntary disclosure practices in the financial statements and board of directors. Bozcuk et al¹³⁸ verify the finding of Aksu and Kosedag as well. They found out that the companies are reluctant to disclose the financial information unless they are mandatory.

Coming back to the studies by S&P, the companies were the best at disclosing the mandatory financial statements and statutory reports and worst at the director elections and article of associations. Whereas the average disclosure level per company was 41 percent in 2005, it increased to 57 percent in 2006 and to 61 percent in 2007. In spite of the improvements in overall disclosure practices and disclosure in financial statements, disclosure of the information regarding board of directors remained still to be a problem. It should be highlighted with bold letters that only one company disclosed the board of director nominees

“Transparency International’s Corruption Perceptions Index, Whose Perceptions Are They Anyway” Discussion Draft 2005 at <http://siteresources.worldbank.org/PSGLP/Resources/ShahThompsonTransparencyinternationalCPI.pdf> Accessed on 31.04.2011

¹³⁵ Gokhan Aktug, 13.

¹³⁶ Standards & Poors, “Corporate Governance: Turkish Transparency And Disclosure Surveys”, (London:2005,2006,2007,2008).

¹³⁷ Mine Aksu and Arman Kosedag, 277-296.

¹³⁸ Aslihan Bozcuk, Sabri Burak Arzova, and Sinan Aslan, “Internet Financial Reporting: The Case of Turkey“ *2nd EUROMED Conference of the EUROMED Academy of Business*. (2009). Available at SSRN: <http://ssrn.com/abstract=149052> Accessed on 24.08.2011

ahead of the shareholder meetings in 2007 and 2008. Moreover, 2008 has witnessed very little progress in overall transparency practices. In 2008, although there were some but very marginal improvements in the overall disclosure practices, the disclosure rate for financial statements slipped away contrary to previous year results.¹³⁹

The study of Ararat and Tansel¹⁴⁰ reveals that the banking and financial sector is more transparent compared to the other sectors in Turkey, nevertheless more opaque vis-à-vis European counterparts. The superlative disclosure performance of the banking sector can be attributed to the stricter rules of BRSA. Other reasons of the lack of the general voluntary disclosure performance are the concentrated ownership structures, low proportion of the independent director existence in the boards.¹⁴¹ Agca and Onder¹⁴² investigated the determinants of disclosure practices of Turkish companies in 2003. They found out that the voluntary disclosure overall in Turkish companies is closely related to the auditors, firm size and profitability.

To sum up, disclosure practices have been improving especially with the IMF reforms and EU membership process but it should be criticized that Turkish Companies make little progress in the disclosure practices given the concentrated ownership structures and relatively weak corporate governance practices overall. So the reforms are likely to be in a top down manner as it can be understood for instance from the fact almost all Turkish companies failed to provide information director and internal auditor nominees ahead of the shareholder meetings.

Listing in the Corporate Governance Index: Corporate Governance Index started to be calculated in August 2007.¹⁴³ The companies, which are able to receive ratings (min six point out of ten)¹⁴⁴ from independent rating agencies verifying their strong compliance with the Corporate Governance Principles as outlined by the CMB, may be listed in the

¹³⁹ Standards & Poors,

¹⁴⁰ Melsa Ararat, and Ayse Tansel Cetin, "İMKB'de İşlem Gören Bankaların Kamuya Açıklama Yoğunlukları ve Yönetişim Özellikleri" 6th Annual International Accounting Conference, MODAV(Istanbul:2009). Available at http://cgft.sabanciuniv.edu/sites/cgft.sabanciuniv.edu/files/BANKALAR_RAPOR.pdf Accessed on 21.04.2011

¹⁴¹ Arman Aziz Karagül and Nazlı Kepçe Yönet , "Impact of Board Characteristics and Ownership Structure on Voluntary Disclosure: An Evidence From Turkey", *Eurasia Business and Economic Society 2011 – Zagreb, EBES 2011* (ZAGREB:2011).

¹⁴² Ahmet Agca and Serife Önder, "Voluntary Disclosure in Turkey: A Study on Firms Listed in Istanbul Stock Exchange" *Problems and Perspectives in Management*, Vol. 5, Iss. 3 (2007), 241-251.

¹⁴³ Official Web Site of ISE, www.ise.org , Accessed on 02.04.2011.

¹⁴⁴ This information is based on the Güçlü's book. However, according TKYD Web site (www.tkyd.org) minimum rating score to be able to listed in ISE Corporate Governance Index was upgraded from 6 to 7 out of 10. The upto date information is also available in ISE Official Web Site.[ww.ise.org](http://www.ise.org), Accessed on 24.08.2011.

Corporate Governance Index¹⁴⁵ provided they are not listed in the “Watch List Companies Market“. The companies in the corporate governance index are offered 50 percent discount for the quotation tariffs to be quoted in the ISE. Those companies listed in CG Index are assumed to benefit from the performance in return of positive reputation. However, according to Guclu¹⁴⁶ there are not many studies yet, hence there is no clear evidence on the positive correlation between performance and corporate governance ratings. Ararat also criticizes the rating facilities as they are subjective and depending on the analyst values and opinion, second there are no universally accepted criteria for corporate rating.¹⁴⁷ Therefore the scores can vary from one rating agency to another. There are also some concerns expressed by the IIF Equity Advisory Group that the cost of the rating done by an independent rating agency might exceed the 50 percent reduction from the listing prices offered to the qualifying companies. It is also possible that the companies might be worried about the corporate governance deficiencies addressed by the rating agencies. Furthermore, there are also some concerns about the comparability of the ratings conducted by these rating agencies.¹⁴⁸

However one thing is applicable in all corporate governance scores is that a special importance is attached to disclosure in rating facilities given the fact that the disclosure component has 35 percent weight in total rating methodology. These rating components in some instances are overlapped. For instance in the principles of CMB, the shareholders clauses include among others some requirements regarding disclosure practices as well.

3.5 Shareholder Meetings and Items Discussed in Turkey

Turkish companies shall discuss and propose to vote some items at the shareholder meetings pursuant to the Turkish Commercial Code and the regulations on the “General Assembly Meetings of Capital Companies and the Commissioner of the Ministry of Industry and Commerce at these Meetings“. The items that the shareholders face at shareholders meetings may be classified as non-routine voting items, routine voting items, and nonvoting items. The TCC regulates the shareholder meetings through its articles numbered between 367 and 389, which include more specifically the clauses regarding

¹⁴⁵ Information regarding the companies listed in the indexes can be obtained from the Public Disclosure Platform www.kap.gov.tr

¹⁴⁶ Hakan Güçlü, “Kurumsal Yönetim Uyum Derecelendirmesi” (Istanbul:IMKB Publications, 2010), 119 – 122.

¹⁴⁷ Melsa Ararat, “Avrupa Birliği Kurumsal Yönetim Standartları Konferansı”, *TKYD Journal*, (April 2008), 8.

¹⁴⁸ Institute of International Finance Equity Advisory Group, Task Report, 4.

form and content of the invitation, agenda, location, quorum, legitimacy of decisions, voting rights, limitations, article amendments, cancellations and some other formalities required for the meetings to take place.

Non-Routine Voting Items: Non routine voting items are election of directors and approve their remuneration, appointment of internal and external auditors and approve internal auditor remuneration, approval of financial statements and statutory reports provided by the auditors, article amendments, income allocation proposal, items related capital matters, and M&As. Avoiding from the duplication it should be stressed that the non-routine voting items will be discussed in a detailed manner in the empirical part of the study.

Routine Voting Items: Routine voting items to be proposed at the shareholders meetings in Turkey are usually opening the meeting, election of presiding council and chairman of the meeting, closing the meetings. These routine procedural items, which are necessary for the meeting to take place, have a non controversial character in nature and do not constitute any corporate governance concerns. Nevertheless, one item which is mandatory pursuant to the Articles 334-335 of the TCC is authorization of the board of directors to carry out businesses directly or on behalf of others within or outside of the company's fields of activity or to participate in companies engaged in such businesses and to perform other acts. This item is usually unproblematic in the Turkish market and does not confront much opposition by the shareholders. In the study of Aktug¹⁴⁹, in which he collected and assessed the voting results of the Turkish meetings in the proxy voting period of 2009, this item was accepted 100 percent in 14 meetings out of 22. At the rest of the meetings it was accepted with an average between 99 and 100 percent.

Non Voting Items: In addition to that shareholders meetings play a significant role in providing a disclosure platform by the majority shareholders and company management. During these meetings shareholders shall be informed about the significant transactions took place during the financial year or policies of the companies such as related party transactions as per Article 5 of the Communiqué Serial IV No. 41 of the CMB and about the implementation of IFRIC. Even though related party transactions are unproblematic because of their nature and volume in Turkey, it appears that shareholder have no opportunity to vote against or give abstention in case of doubts or uncertainties. Given the

¹⁴⁹ Gokhan Aktug, Annex 2.

sensitiveness and importance of related party transactions it would be fair if this was a voting item.

Information regarding charitable donations made during the year shall also be provided by the companies. This kind of information can be found usually in the annual reports or in the income allocation proposal in accordance with Article 7 of the Communiqué of the CMB Serial IV, No. 27. Another non voting item is providing information with respect to the privileges, guarantees, pledges and mortgages provided by the company to third parties or the derived income or interest thereof, in accordance with the decision of the CMB dated 09/09/2009 and numbered 28/780.

Shareholder meetings provide shareholders with the opportunity to join the decisions by casting votes, to raise their voice about wrong and unlawful practices as long as they are well informed in a timely and accurate manner ahead of the shareholder meetings. According to the CGP unless the information is based on the protection of trade secrets and the company's interests the company should allow shareholders to obtain adequate information prior to shareholder meetings. In that sense the BoD should prepare and disclose to public an informative document regarding the agenda items. The invitation should be sent latest three weeks ahead of the meetings, and financial statements and reports, dividend distribution proposals, informative documents, former and latest version of the amended articles should be ready for review thereon.

4. Disclosure Level of Turkish Listed Companies Ahead of the Shareholder Meetings

After drawing a theoretical framework and gaining an understanding about the topics corporate governance, transparency, disclosure and their implications in Turkey and shareholder meetings by means of secondary sources such as books, articles, dissertations, web sites and statistics in the previous parts, this empirical study deals with the question of the disclosure practices of Turkish companies ahead of the shareholder meetings.

4.1 Objective of the Empirical Study

This present study aims to analyze the disclosure levels of the Turkish companies regarding the items discussed at the shareholder meetings during the proxy voting period between 01.01.2011 and 10.07.2011. By doing that in the first part of the study a detailed

picture of the contemporary situation in terms of the disclosure practices for the shareholder meetings will be discussed. That is, it will be explored which items have been discussed by looking at the AGM and EGM agendas. Scanning the relevant Turkish Law it will be found out which items are mandatory to be disclosed.

In the following part, using the findings of the first part, the relationship between disclosure rates and following variables will be analyzed. These variables are listing in ISE CG index, CG overall rating scores, transparency and disclosure rating scores, free float rates, foreign ownership rates, and state ownership rates. This correlation analysis will enable to observe whether those factors have an effect on disclosure practices of Turkish companies.

4.2 Scope and Limitations of the Study

This study is limited to 54 companies of which 22 are listed in the ISE30 Index, 24 are listed in CG Index and 8 are listed in both indexes. There were in total 54 AGMs as well as two companies Koza Altin Isletmeleri and Sekerbank had also EGMs. The items discussed in the EGM are related to M&A operations and the data regarding those meetings were included in the overall assessment.

Table 4.1 Shareholder Meetings Held by Turkish Companies Listed in ISE30 and Corporate Governance Indexes

Index	N	Mean	Std. Deviation	Std. Error
ISE30	23	,57926	,242762	,050619
CG Index	25	,54568	,163717	,032743
ISE30 & CG Index	8	,55456	,146184	,051684
Total	56	,56074	,195554	,026132

The companies in sample had 56 shareholder meetings in total between the dates 01.01.2011 and 10.07.2011; therefore any information disclosed after this date is to be considered irrelevant. This sample is chosen due to the fact the companies listed in the corporate governance index are expected to perform higher disclosure rates than the other companies as explained afore. Moreover, as a basic assumption if those companies listed in ISE30 and Corporate Governance Indexes perform inadequately in terms of the disclosure practices the remaining companies listed in ISE are expected to perform more poorly because of their limited capital power, low level of free float rates, limited number of foreign investors and as well as insignificant state presence in the ownership structures.

The companies are usually disclosing the identity of each foreign shareholder, which has more than one percent in the company. In this sense with the term foreign ownership, it is not meant that the foreign ownership, which has shares from the public offering, as this information can not be reached from publicly available sources.

Before proceeding, it should also be highlighted that this study does not deal with all general disclosure practices of the companies as the other studies did¹⁵⁰, such as disclosure of the information about ownership structures, corporate governance compliance report, corporate social responsibility or any other information which take place on the company's web sites or other relevant sources. On the contrary, this study focuses only on disclosure practices of the companies regarding non routine voting items to be discussed at the shareholder meetings 14 days ahead of the shareholder meetings, since these items play a vital role in the fair governance practices to be able to cast informed votes. For the mandatory items minimum time frame was determined as 14 days prior to the meeting, so it is assumed that sufficient time should be left to the shareholder to be able to assess the proposals after receiving information in advance. On the other hand as mentioned above non-voting and voting routine items are routine formalities and legally obliged in order to legitimate the shareholder meetings in Turkey. Therefore, they do not have a major value on the shareholder rights, thus they are excluded in the study.

4.3 Methodology and Hypothesis

In the analysis apart from charts SPSS was used. When investigating the disclosure practices at the shareholder meetings, it was benefited from the descriptive statistics. For this part the variables regarding the items external auditor appointments, financial statements and statutory reports, board elections, internal auditor appointments, director and internal auditor remunerations, article amendments, income allocation proposal, capital related matters, mergers & acquisitions, debt and bonus issuance (authorization of BoD for bonus and debt issuance) were collected from the agendas of the shareholder meetings. By using nominal scale "1" was given in case of disclosure of the relevant information and otherwise "0" was given.

With respect to data collection regarding the abovementioned variables as well as the independent variables such as listing in corporate governance index, corporate

¹⁵⁰ Please see the Chapter "4.4 Transparency and Disclosure" for broader explanation.

governance overall rating score, transparency and disclosure score, free float rates, foreign ownership as well as state ownership, it was benefited from four means such as Trade Register Gazette¹⁵¹, Public Disclosure Platform¹⁵², the web sites of security issuers and corporate governance rating companies.

For the analysis of DR and listing in corporate governance index 34 companies were investigated. Whereas whole information regarding free float rates and state ownership were able to be collected, only 49 companies made information regarding foreign ownership publicly available.

Upon the collected information non parametrical Kruskall Wallis tests and Pearson Correlation Analysis method were applied to find out as to whether there is a correlation between DR and the above mentioned independent variables.

Table 4.2 Descriptive Statistics for the Variables

Name of Independent Variable	Mean	Std. Deviation	N
Transparency and Disclosure Grade	90,2235	3,54677	34
Average Corporate Governance Grade	83,4921	3,96616	34
Free Float Rate	34,6139	15,49121	56
Foreign Ownership	12,8710	21,73721	49
State Ownership	9,7254	22,76230	56
Disclosure Rate	,56074	,195554	56

In the light of the objective of the study five hypotheses were defined.

Hypothesis 1: Whereas the compliance to the legal provisions regarding disclosure is high in Turkey, the level of voluntary disclosure of the voting items remains relatively low.

Hypothesis 2: There is a positive correlation between DR and listing CG index, the overall corporate governance rating score and transparency and disclosure rating scores.

Hypothesis 3: There is a positive relationship between DR and foreign ownership rates.

¹⁵¹ Official Web Site of Trade Register Gazette, www.ticaret sicil.gov.tr, Accessed on 20.08.2011

¹⁵² Official Web Site of Public Disclosure Platform, www.kap.gov.tr, Accessed on 20.08.2011

Hypothesis 4: There is a positive relationship between DR and free float rates.

Hypothesis 5: There is a negative relationship between DR and state ownership.

4.4 Research Findings and Assessments of the Meeting Items

4.4.1 External Auditor Nominees

External auditors are independent accounting firms,¹⁵³ who check the firm's financial statements, the progress and methods for producing them¹⁵⁴ and finally write a report which includes an unqualified or a qualified opinion about the financial statements. That depends on the company's accounts whether they represent materially the condition of the firm in line with the IFRS and reflect a fair view. They also audit as to whether internal auditors rely on the internally generated reports.¹⁵⁵ External auditor's role is vital in ensuring check and balance that help to monitor management activities, accounting methods thereby increasing transparency as it is stated in the Cadbury Report.¹⁵⁶ Within the independent audit reports on the company's financial statements, disclosure practices of the company become more credible, thereby confidence is instilled in the company's transparency toward the shareholders.¹⁵⁷ This audit process should be in professional care as well. Therefore such important institution should be proposed by board of directors to the shareholders approval at the shareholder meetings.

Whereas the CML Article 16 deals very briefly with the external auditor issues, more specifically the responsibility of the external auditors, the Communiqué of the CMB Serial X, No. 22 regulates the framework of external auditor institutions comprehensively. However, neither the TCC nor the CML and the CMC provides a certain time for the external auditor nominees to be disclosed ahead of shareholder meetings. It means that the disclosure practices of the companies regarding to the external auditor appointments to be appointed are left to the company's initiative.

¹⁵³ OECD, *OECD Principles of Corporate Governance*, 22

¹⁵⁴ Ibid

¹⁵⁵ Kim A Kenneth. and John R. Nofsinger, *Corporate Governance*, 2nd Ed. (New Jersey:Pearson International, 2007),.28

¹⁵⁶ Cadbury Report: "*The annual audit is one of the cornerstones of corporate governance, The audit provides an external and objective check on the way in which the financial statements have been prepared and presented, and it is an essential part of the checks and balances required*"

¹⁵⁷ Jill Solomon,172

According to the practices, as indicated in Table 4.3, it has found out in the study that 39 companies out of 54, namely 69.6 percent have included the item regarding external auditor appointments in their agenda for the general shareholder meetings. The Chart 4.1 shows that 72 percent¹⁵⁸ namely 28 out of 39 companies, which have discussed this item, have disclosed the name of the external auditors.

According to the study of UNCTAD some subject areas, such issues related to auditing, are significantly less reported than other areas, such as financial transparency. The disclosure items in the category of auditing remain among the least reported in the emerging countries as well.¹⁵⁹

Table 4.3 Disclosure Performance for the Names of the Proposed External Auditors

	Frequency	Percent	Valid Percent	Cumulative Percent
Non Disclosure	11	19,6	19,6	19,6
Disclosure	28	50,0	50,0	69,6
Not Discussed	17	30,4	30,4	100,0
Total	56	100,0	100,0	

4.4.2 Financial Statements and Statutory Reports

Turkish public companies and banks have been employed IFRS when disclosing the financial statements since 2005 in order to further integrate to the international standards particularly in the harmonization process to the EU. This makes the analysis of financial statements easier for the foreign investors, since financial statements and statutory reports are also used by the outsider shareholders in order to be able to make a consistent assessment about the company's fiscal position and take reasonable decisions, beside their significant role for the internal analysis. For this reason they are crucial elements acting as information provider to the shareholders.

According to the Article 362 of the TCC, financial statements, which include also the external auditor report, balance sheet, income allocation table, should be ready at least 15 days prior to the shareholders' review. Whereas group companies should issue

¹⁵⁸ The proportions and numbers in this study are rounded up.

¹⁵⁹ United Nations Conference on Trade and Development, "International Accounting and Reporting Issues", (Geneva and Paris: UNDP Publications, 2010), 89-114.

consolidated financial statements, which reflects the whole group financial situation, single companies are mandated only to report unconsolidated financial statements.

In this study it has been found out that 42 companies out of 54 have disclosed their consolidated financial statements 14 days ahead of the shareholder meetings in line with the relevant law. Solely eight companies have disclosed the unconsolidated financial statements, even supposing they are group companies. The remaining 4 companies have disclosed their unconsolidated financial statements, which is not a matter of concern, because they do not have any subsidiaries.

Table 4.4 Disclosure Performance for Consolidated Financial Statements

	Frequency	Percent	Valid Percent	Cumulative Percent
Non Disclosure	8	14,3	14,3	14,3
Disclosure	42	75,0	75,0	89,3
Not Discussed	6	10,7	10,7	100,0
Total	56	100,0	100,0	

Table 4.5 Disclosure Performance for Unconsolidated Financial Statements

	Frequency	Percent	Valid Percent	Cumulative Percent
Disclosure	12	21,4	21,4	21,4
Not Discussed	44	78,6	78,6	100,0
Total	56	100,0	100,0	

4.4.3 Board Elections, Internal Auditor Appointments and Their Remunerations

Board of Directors: According to the Higgs Report,¹⁶⁰ the board of directors, including chairman in ideal corporate governance are responsible for direction and supervision of the company's affairs, for providing a framework of a prudent and effective control system which would enable risk assessment and management so it is obvious that the board is playing a central role in the principle agent problem.

Turkish companies do not disclose as much information on the director elections as do companies in the other corporate governance systems, particularly in the outsider

¹⁶⁰ Derek Higgs, "Review of the role and effectiveness of non-executive directors", *Higgs Report*, (London:UK Stationary Office Publication, 2003), 21

models. For director elections the controlling shareholders generally present their proposals for changes to the shareholders' review at the shareholder meeting itself. The item regarding board elections has been discussed 36 times in the proxy voting period, which is equal to 64,3 percent. It means that the director proposals are a commonly discussed item at the Turkish shareholder meetings. However, the disclosure rate for the director elections remain very low compared to the other items. Taking into consideration Table 4.6 only four companies "Petkim, Sinpas, Koc Holding and Anadolu Efes" have disclosed the names and the resumes of the director nominees ahead of the shareholder meetings in line with the best practice. Nevertheless, although the above mentioned companies have disclosed those names as a bundled voting item, meaning that they propose the directors altogether as one agenda item. This practice does not leave any choice to the shareholders to vote for each director. Bundling of board elections in a common practice in the other Turkish companies as well, regardless they disclose or not. This all or nothing choice skews the power disproportionately towards the board.

All the names of the ratified directors during the year until shareholder meetings were unsurprisingly disclosed due to the Article 315 of the TCC in which it is prescribed that the ratified director names should be made public as they were appointed by the board of directors. As can be observed at Table 8 ratification of the director were discussed at 15 shareholder meetings and all the names were disclosed at the meeting minutes at least 14 days ahead of the shareholder meetings.

Table 4.6 Disclosure Performance for the Names of Proposed Directors

	Frequency	Percent	Valid Percent	Cumulative Percent
Non Disclosure	32	57,1	57,1	57,1
Disclosure	4	7,1	7,1	64,3
Not Discussed	20	35,7	35,7	100,0
Total	56	100,0	100,0	

Table 4.7 Disclosure performance for the Names of the Ratified Directors

	Frequency	Percent	Valid Percent	Cumulative Percent
Disclosure	15	26,8	26,8	26,8
Not Discussed	41	73,2	73,2	100,0
Total	56	100,0	100,0	

Internal Auditors: Internal auditor is an important mechanism to mitigate the information asymmetry and agency problem in the corporations by providing information to the principles.¹⁶¹ In return principles should pay the monitoring costs to hire the internal auditor and ensure the properly functioning mechanism. In Turkey shareholders in exchange the cost of the internal auditors to monitor the management, they expect to compliance with objectivity and independency principles by the internal auditors when they provide a view about the company's management. Therefore shareholders attach a great importance to internal auditor appointments at the shareholder meetings.

The tendency for disclosing the name of the internal auditor resembles the case of director elections. Only few companies provided information in advance of the shareholder meetings. This proxy voting period appointment of internal auditors was discussed 43 times in which 6 times the names of the internal auditor nominees were provided. When basing on the total number of the meetings in which internal auditor appointment is discussed the disclosure rate appears to be equal to 14 percent. It means that the shareholders do not have time to evaluate the potential future internal auditors. It is obvious that the Turkish companies should improve their practice in this area.

Table 4.8 Disclosure Performance for the Names of Proposed Internal Auditors

	Frequency	Percent	Valid Percent	Cumulative Percent
Non Disclosure	37	66,1	66,1	66,1
Disclosure	6	10,7	10,7	76,8
Not Discussed	13	23,2	23,2	100,0
Total	56	100,0	100,0	

Director Remuneration: Table 4.9 indicates that only 3 companies out of 35 disclosed the proposed remuneration of the directors. 9 percent disclosure rate of the remuneration of the listed companies in advance of the shareholder meetings articulates the weak practices in those areas.

¹⁶¹Michael B. Adams, "Agency Theory and Internal Auditor" *Managerial Auditing Journal*, Vol. 9, No. 8 (1994). 8-12

Table 4.9 Disclosure Performance for the Proposed Director Remuneration

	Frequency	Percent	Valid Percent	Cumulative Percent
Non Disclosure	32	57,1	57,1	57,1
Disclosure	3	5,4	5,4	62,5
Not Discussed	21	37,5	37,5	100,0
Total	56	100,0	100,0	

Internal Auditor Remuneration: On the internal auditor side, as it is quite obvious on Table 4.10 the disclosure rate for the information regarding auditor remuneration does also not look very brilliant indeed. Only in two meetings the internal auditor remuneration were disclosed compared to 36 meetings before which the names of the nominees were not disclosed. That is only 5 percent of all companies, which discussed the internal auditor remuneration at the shareholder meetings.

Table 4.10 Disclosure Performance for the Proposed Internal Auditor Remuneration

	Frequency	Percent	Valid Percent	Cumulative Percent
Nondisclosure	36	64,3	64,3	64,3
Disclosure	2	3,6	3,6	67,9
Not Discussed	18	32,1	32,1	100,0
Total	56	100,0	100,0	

Director elections internal auditor appointments and their remuneration are very fundamental and critical components of corporate governance phenomenon and these elements are taken into account as important criteria by the institutional shareholders. They are the most important share ownership right that the shareholders can exercise.

Nevertheless, it should be mentioned that the most Turkish companies inform shareholders about the current board of directors and their remuneration levels via their annual reports, corporate governance compliance reports as well as shareholder meeting minutes. The disclosed information, however, has a reactive character in nature and gives only the information about the results after the shareholder meetings. The second point to be emphasized is that the Turkish companies include the principles of the director elections

and the remuneration to be granted in their company bylaws.¹⁶² This information comprise of some general statements such as term of the office, minimum qualifications of the directors, role and duties of the directors and internal auditors as well as to how the remuneration policy is determined, but they do not provide any precise information on neither nominees names, biographies nor number and type of payments. Although the remuneration levels are at very modest levels in Turkey, the lack of the proactive approach for informing the shareholders about the director, internal auditor nominees as well as exact remuneration levels to be given to the directors and internal auditors appear to be a big issue which prevent the shareholders to cast informed votes at the shareholder meetings.

4.4.4 Article Amendments

Articles of the association is the legal consensus between more than two people with the aim at making and sharing profit, and bring all the qualifications and experiences together to reach this aim. It draws the framework of the structure of the partnership, the borders of the rights and liabilities, interrelations of the shareholders. The TCC prescribes the items to be included in the articles of association in Article 279.¹⁶³ The company's articles of association may be amended as a reaction to the legal and macroeconomic environmental changing factors, provided it is done in line with the relevant articles in the TCC. Any article of the article of association is able to be changed unless there is no counter provision in the commercial code which regulates the article amendments with the Article 386, 368 and 370 of the TCC. Article 368 refers to the compliance with Article 370 when amending the articles. In accordance with the TCC and CMB Corporate Governance Principles the company should make it public its new and old version of the articles of association attached to its meeting agenda.¹⁶⁴

According to the collected data as demonstrated at Table 4.11, 18 companies discussed the article amendments in 16 AGMs and 2 EGMs in 2011.¹⁶⁵ Two companies, which make around 10 percent, Turk Telekomunikasyon and Turkiye Vakiflar Bankasi had yet to disclose the amended version of the articles ahead of the shareholder meetings. However, in overall article amendments a relatively high compliance with the relevant law

¹⁶² See an example in the annual report of Efes Page 7, www.anadoluefes.com, Accessed on 20.08.2011

¹⁶³ Ömer Elmas, "Halka Açık Anonim Şirketlerde Esas Sözleşme Değişiklikleri", *Türk Hukuk Sitesi*, www.turkhukuk sitesi.com, Accessed on 06.08.2011

¹⁶⁴ CMB, *Corporate Governance Principles*, 14

¹⁶⁵ Article Amendments regarding Capital Matters are not included in this subchapter as they will be touched upon in the chapter Capital Matters.

and principles of the CMB can be observed as the companies mainly disclosed the required information.

Table 4.11 Disclosure Performance for the Article Amendments (Old and New Versions of the Articles)

	Frequency	Percent	Valid Percent	Cumulative Percent
Non Disclosure	2	3,6	3,6	3,6
Disclosure	16	28,6	28,6	32,1
Not Discussed	38	67,9	67,9	100,0
Total	56	100,0	100,0	

4.4.5 Income Allocation Proposal

The primary aim of the companies in the capitalistic cycle is making profit. While companies can invest and grow owing to its profits making capability, they also increase the welfare of its shareholders. Shareholders concern in this sense would be the dividend payments as the receiving dividend according to TCC 385 is one of the fundamental shareholder rights. Whereas income allocation is mandatory, dividend payouts are within the BoDs initiative as it is a strategic decision. If the dividend payments are high and regular the shares of the company would be more valuable, on the other hand if the company do not distribute any dividend and use this profit for new and long term investments it would be more profitable for it¹⁶⁶ According to the CGP the companies should disclose the accurate information in a timely manner regarding the meeting items in which income allocation proposal is especially emphasized. With respect to legal framework, contrary to the outsider models such as UK and US the dividend policy regulations are quite strict in Turkey. The relevant legislations for the income allocation are the TCC, CML, and the Tax Law. For the banking industry there are some provisions prescribed by BRSA as well. According to the TCC, Article 368, the shareholders are authorized to approve the income allocation. Whereas equality principle is emphasized in the TCC, that the dividends can be divided in different proportions, provided that the first dividend payments are realized to all shareholders equally pursuant to the CMB Communiqués. Communiqué on the “Informing Public in the Extraordinary Cases” stipulates that the corporations should inform the relevant parties about the income allocation proposal right after the decision has been taken by BoD. TCC Article 362

specifies the time that the income allocation should be made public 15 days ahead of the shareholder meetings.

In practice it appears that Turkish companies have performed in compliance to the relevant law. Only two (Sekerbank and Eregli Demircelik) of 51 companies, which discussed the item regarding income allocation, have not provided the income allocation proposal for the shareholders' view.

Apart from the income allocation proposal, which is announced prior to the shareholder meetings, the companies should disclose also a clearly defined and consistent dividend distribution policy. Shareholders should be informed about the dividend distribution policy sheet which includes general principles, criteria, amount and sources of the dividends, profited parties, time and locations of the dividends.¹⁶⁷ Receiving information on the dividend distribution policy is however a non-voting item with an informative character.

Table 4.12 Disclosure Performance for the Income Allocation Proposal

	Frequency	Percent	Valid Percent	Cumulative Percent
Non Disclosure	2	3,6	3,6	3,6
Disclosure	49	87,5	87,5	91,1
Not Discussed	5	8,9	8,9	100,0
Total	56	100,0	100,0	

4.4.6 Capital Related Matters

Companies in Turkey can prefer either outstanding capital system, which mandates the board of director to get shareholders' approval in each capital increase (TCC 391), or fix their capital ceiling to a certain amount. Once the company decides on a ceiling and takes the approval from the shareholders at a shareholder meeting for this ceiling limit, it does not have to get approval in each case for outstanding share capital increase. Outstanding share capital system debar the company's management from the flexibility; therefore the authorized capital system appears to be the optimal solution. When companies increase the outstanding capital, irrespective to capital system they might increase either through the internal sources by capitalization of reserves or issuance of new shares. In the capitalization of reserves, the company increases its capital and pay dividends to its

¹⁶⁷ Ibid.20,21

shareholders equally without any claims. However, in case the company increases its capital by issuing new shares it should give preemptive rights to the existing shareholders. If not then the company should put a statement regarding the preemptive rights in its articles of association. In order to assess whether the preemptive rights are provided or the shareholder rights are protected in more general terms, informing shareholders emerges as a critical issue. In this proxy period only Sekerbank has increased its authorized capital and parallel increased its outstanding share capital through bonus issuance. Sekerbank and Sinpas Gayrimenkul have both provided necessary information regarding capitalization of reserves to the shareholders review in line with the relevant law.

Table 4.13 Disclosure Performance for Authorized Capital Increase

	Frequency	Percent	Valid Percent	Cumulative Percent
Disclosure	1	1,8	1,8	1,8
Not Discussed	55	98,2	98,2	100,0
Total	56	100,0	100,0	

Table 4.14 Disclosure Performance for Capitalization of Reserves

	Frequency	Percent	Valid Percent	Cumulative Percent
Disclosure	2	3,6	3,6	3,6
Not Discussed	54	96,4	96,4	100,0
Total	56	100,0	100,0	

4.4.7 Mergers & Acquisitions

M&A are significant and dramatic events recently in the corporations worldwide both in the domestic and cross boarder terms. M&A operations occur in different forms. For instance one company acquires another firm with all assets or two firms form a new company in equal terms. They occur also for different objectives among which hostile takeovers and operational and financial synergies can be mentioned as example. Hostile takeovers are realized to control the target company and it is not a common case in Turkey due to the concentrated ownership structures. M&A operations usually take place in order to improve the synergy for operational and financial synergies through cutting costs, risk and economies of scale.

The disclosure of the items regarding M&As plays a very important role to find out the answer as to what the corporate structure and management structure of the company will look like after M&A and what the value of the company will be. Whereas TCC does not include any statements about the time to publish the merger agreements and independent audit reports, it is stipulated in the CML, Article 16/A that the companies should disclose the information regarding significant events with respect to M&A, Capital Increases, transfer of shares as well as collection of certificate shares for the shareholder review ahead of the meetings. The CMB Communiqué Serial 1, Number 30 provides detailed information about the M&A and prescribes that the information should be made available 30 days ahead of the meeting.

There have been three meetings in which M&A operations were discussed this year, Migros Ticaret, Koza Altin and Sekerbank. These all three companies have disclosed the M&A agreements in line with the best practice and there does seem to be any significant corporate governance concerns about this issue.

Table 4.15 Disclosure Performance for Merger Agreements

	Frequency	Percent	Valid Percent	Cumulative Percent
Disclosure	3	5,4	5,4	5,4
Not Discussed	53	94,6	94,6	100,0
Total	56	100,0	100,0	

4.4.8 Debt and Bonus Issuance (Authorization of BoD for Bonus and Debt Issuance)

The information regarding Debt and Bonus Issuance is one of the most important items for shareholders to be able to assess the future risks emanation from the debt/equity ratio and leverage level of the company. As such, shareholders should be informed well ahead of the shareholder meetings about this item.

As per the TCC, Article 423, Turkish Companies can issue bonds following the approval of board of directors at the shareholder meetings. Nevertheless, there does not seem to be any precise statement in TCC regarding the time to disclose relevant information ahead of the shareholder meetings. It is only mentioned in the CML, in article 16/A that the companies should inform the shareholders in case any significant

developments occur. However, this statement is open to interpretation. During the proxy voting period whereas only one company, which provided the necessary information, had bonus issuance authorization in its agenda, four companies discussed the authorization of debt issuance and only one of them disclosed the information about means, volumes, terms and conditions of the debt issuance.

Table 4.16 Disclosure Performance for Authorization of Bonus Issuance

	Frequency	Percent	Valid Percent	Cumulative Percent
Disclosure	1	1,8	1,8	1,8
Not Discussed	55	98,2	98,2	100,0
Total	56	100,0	100,0	

Table 4.17 Disclosure Performance for Authorization of Debt Issuance

	Frequency	Percent	Valid Percent	Cumulative Percent
Nondisclosure	3	5,4	5,4	5,4
Disclosure	1	1,8	1,8	7,1
Not Discussed	52	92,9	92,9	100,0
Total	56	100,0	100,0	

4.4.9 Assessment

Hypothesis 1: Whereas the compliance to the legal provisions regarding disclosure is high in Turkey, the level of voluntary disclosure of the voting items remains relatively low.

Result: Observing Chart 4.1 which provides an overview about the disclosure levels of the items that there is a high compliance among Turkish companies for the disclosure of the information regarding financial statements, article amendments, income allocation proposal, director ratifications made during the year, M&A and capital related matters such as authorized capital increase and capitalization of reserves. However, the information regarding director and internal auditor nominees, as well their remuneration levels and debt issuance are rarely provided by Turkish companies. Performance of the listed companies for the disclosure of ratified directors is significant as well. As a result hypothesis 1 is verified to large extent that the Turkish Companies provides information to the

shareholders ahead of the meetings only because mainly they have to do legally so. It is said “to a large extent” because companies have disclosed the name the external auditor nominees overwhelmingly and some companies exceptionally provided the names of the director and internal auditor nominees as well as their remuneration. In terms of company’s performance¹⁶⁸ Koc Holding, Sabanci Holding and Akbank, which is also a subsidiary of Sabanci Holding, provided all information regarding the non routine voting items in line with best practice. Petkim, Turk Telekom, Yazicilar, Turkish Airlines, Tav Airports, Akenerji, Coca Cola, Dentas Ambalaj, Dogus Oto, Turk Tractor, Turkcell, Migros Ticaret have disclosed around 70 percent of the required information. To sum up, the disclosure practices of Turkish Companies ahead of the shareholder meetings does not seem sufficient for shareholders to be able to take proper decisions.

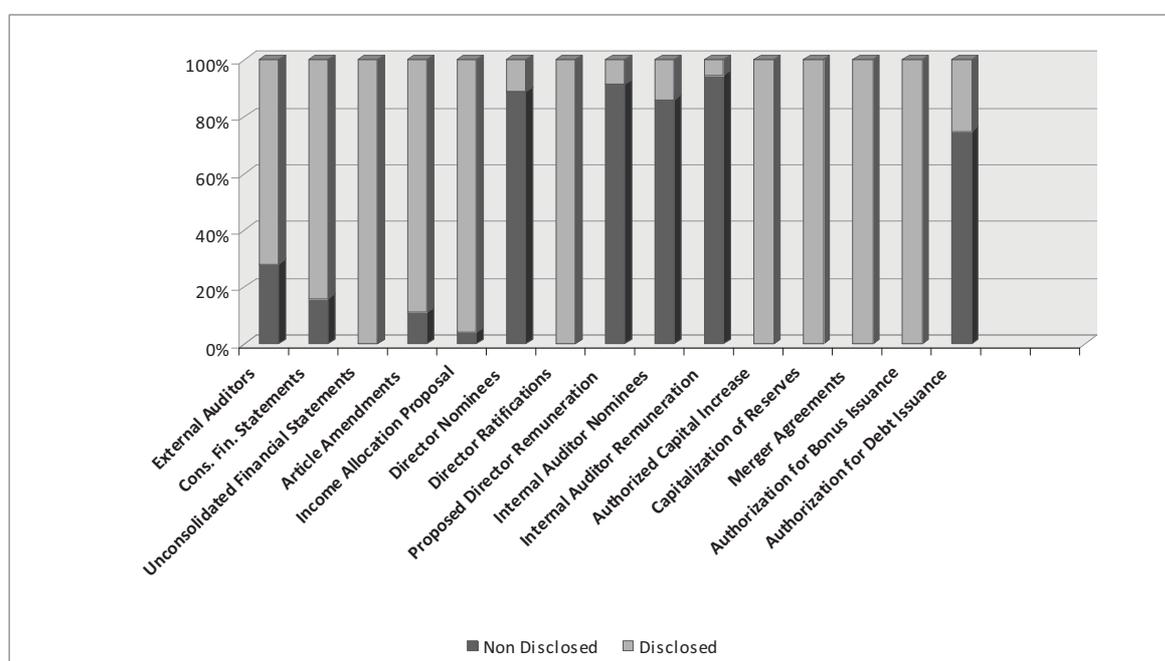


Chart 4.1 Disclosure Performances of Turkish Companies (Per Item)

4.5 Correlations Analysis and Assessment of Determinants

Hypothesis 2: There is a positive correlation between DR and listing CG index, the overall corporate governance rating scores and transparency and disclosure scores.

This claim is based on the assumption that the companies listed in CG Index disclose more information as they are scored by the rating companies with high disclosure

¹⁶⁸ Chart regarding disclosure levels Per Company is available at Annex 2

rates. One of the aims of the establishment of this index is to increase the transparency and disclosure rates of the companies.

However, the results of the analysis at Tables 4.18, 4.19, 4.20 and 4.21 indicate that there is no significant difference in the means of the indexes. This can be showed as result of Kruskal-Wallis Analysis χ^2 (Df=2, N=56)=0.022, P=0.989 and P>0.05 (Alpha Value=0.05). More specifically, the overall test is insignificant and there is no statistical relation between DR and listing in corporate governance index with 95 percent confidence interval for mean which is shown at Table 4.20. The disclosure rates of the companies listed in corporate governance index or ISE30 index or both are similar. Only 34 companies are included in the Corporate Governance index, so the number of observations is equal to 34 for the hypothesis 2.

With respect to the transparency and disclosure scores and overall corporate governance rating scores at Table 4.23 the correlation with these variables and DR is insignificant, although listing in CG index is expected to increase the disclosure level of the companies ahead of the shareholder meetings. More precisely speaking, in the variable “transparency and disclosure”, P=0.635 and P>0.05 and in the variable “Average Corporate Governance Grade” P=0.592 and P>0.05 Alfa Value. So the corporate governance rating scores are not related to the disclosure practices ahead of the shareholder meetings. As a result, this hypothesis should be rejected.

Non Parametric Tests

Table 4.18 Descriptive Statistics for Disclosure Rates

	N	Mean	Std. Deviation	Minimum	Maximum
Disclosure Rate	56	,56074	,195554	,250	1,000
Index Type	56	5,73	,700	5	7

Table 4.19 Ranks (Index Types)

	Index Type	N	Mean Rank
Disclosure Rate	ISE30	23	28,57
	COR_IND	25	28,22
	ISE30&COR_IND	8	29,19
	Total	56	

Table 4.20 Disclosure Rates Confidence Interval for Mean

	95 percent Confidence Interval for Mean			
	Lower Bound	Upper Bound	Minimum	Maximum
ISE30	,47428	,68424	,250	1,000
COR_IND	,47810	,61326	,286	1,000
ISE30&COR_IND	,43235	,67678	,429	,833
Total	,50837	,61311	,250	1,000

Hypothesis 3: There is a positive relationship between DR and foreign ownership Ratios.

With respect to the foreign ownership stakes in the companies, the information of seven companies could not be reached because of the lack of the publicly disclosed information.

Table 4.21 Kruskal Wallis Test Results

Test Statistics ^{a,b}	
	Disclosure Rate
Chi-Square	,022
df	2
Asymp. Sig.	,989*
a. Kruskal Wallis Test	
b. Grouping Variable: Index Type	

Then in 49 companies the foreign ownership varies from 1.73 percent to 83.75 percent. At the expense of duplication, it should be re-highlighted that this ownership rate does not cover the investors in the free float rates. It only covers the information about the foreign shareholder which own more than 1 percent at company. It is assumed that the foreign owners transfer and improve good practices in terms of corporate governance and transparency to the company, in order to protect their own rights on one hand and attract new investors while holding the existing investors on the other. The empirical study shows this at least is applicable to the disclosure of information ahead of the shareholder meetings. Again in Table 4.23, it is indicated as $P=0.047$ and $p<0.05$. This hypothesis is verified and accepted through the analysis that foreign ownership is related to the DR around 28 percent.

This proportion is expected to increase when the foreign investors' stakes in free floating shares.

Hypothesis 4: There is positive relationship between DR and free float rates.

Transparency and disclosure seem vital for the outsider shareholders. Therefore it is expected that dispersed shareholders demand more information from the security issuers through direct engagement or outsourcing the proxy voting services in order to be able to cast informed votes. However, the information which they receive from the company through direct or indirect engagement should be disclosed to all investor in line with the equality principles, meaning that this information should not be a private good. But the pressures coming from the investors especially institutional investors should be a pushing factor that the companies disclose the necessary information overtime. However, this study shows an evidence that there is not any statistically significant relationship between free float rates and DR as $P=0.176$ then $P>0.05$. As such, this hypothesis should also be rejected.

Hypothesis 5: There is a negative relationship between DR and state ownership.

Involvement of the state in the private enterprise is attributed to be an impediment to the improvement of the corporate governance¹⁶⁹, hence transparency in a country especially in emerging markets. However, the analysis shows the state involvement has no relations to the disclosure levels in the companies at least ahead of the shareholder meetings. In the correlation analysis $P=0.285$ then $P>0.05$. This hypothesis in the light of the analysis on Table 4.23 should be rejected as well.

Table 4.22 Descriptive Statistics for the Variables Free Float Rates, Foreign and State Ownership

	N	Minimum	Maximum	Mean	Std. Deviation
Free Float Rate	56	12,36	83,77	34,6139	15,49121
Foreign Ownership	49	,00	83,75	12,8710	21,73721
State Ownership	56	,00	75,06	9,7254	22,76230
Valid N (listwise)	49				

¹⁶⁹ Melsa Ararat and Mehmet Ugur,58-75., Institute of International Finance Equity Advisory Group, Task Report.

Table 4.23 Pearson Correlation Analysis

		Transparency and Disclosure Grade	Avarage CG Grade	Free Float Rate	Foreign Ownership	State Ownership
Disclosure Rate	Pearson Correlation	,085	,095	-,184	,286*	-,145
	Sig. (2-tailed)	,635	,592	,176	,047	,285
	N	34	34	56	49	56

** . Correlation is significant at the 0.01 level (2-tailed).

* . Correlation is significant at the 0.05 level (2-tailed).

5. New Commercial Code

The current TCC, which is in force since 1956 with the number 6762, appears to be far from satisfying modern need of Turkish business doing practices as well for the Turkish enterprises to compete with their counterparts in the international arena as it can be obviously seen when assessing the meeting items.

In that sense the New Commercial Code, which will enter into force in July 2012, is expected to harmonize the existing commercial code with the developments in the European Union in terms of corporate law, improve transparency in line with the Basel II standards, bring the generally accepted reporting standards into effect and overall enhance the corporate governance principles in Turkey.¹⁷⁰ Moreover, the new TCC seems to cover above mentioned inconsistencies between CML, CMB Corporate Governance Principles, CMB Communiqués as well as current TCC. It will bring all relevant law in the same line. In this chapter, the impact of the new TCC on the disclosure practices of the meeting items will be analyzed.

One of the most important amendments is that the new TCC enables the shareholders to participate more to the general meeting decisions by means of audio and video conferences and electronic voting mechanisms, which would increase the participating rates of the outsider shareholders to the shareholder meetings hence would increase demand for the disclosure of the information by minority shareholders. The TCC will force the companies to have a web site in order to inform shareholders through certain

¹⁷⁰ Hürriyet Daily News, "New Turkish commercial code to bring transparency, author says", Available at: <http://www.hurriyetdailynews.com/n.php?n=turkey8217s-new-commercial-code-to-bring-transparency-author-says-2011-01-31>, Accessed on 31.03.2011.

documents such as annual reports and corporate governance reports. Although it is commonly advocated that the mandatory web site increases the transparency¹⁷¹ this would not have no or little effect as all companies have web sites in line with the CML. The amendments regarding meeting items are as follows:

Auditors: Pursuant to New TCC, the information regarding external auditor nominees should be disclosed until the end of 4th month in the financial year. Although this would increase the disclosure rates of the external auditor nominees the disclosure of the external auditor nominees at the meetings took place before this date remains ambiguous.

The new TCC will remove the internal auditing institution as well. The function of internal auditor will be realized then by the external auditors. This would foster the independence of the auditing function and disclosure the names of the auditor nominees however; there would be some concerns to be made clearer. For instance one critical point is that the external auditor remuneration is not mentioned in the new TCC. Furthermore, it may lead to delays in the companies which are willing to disclose the names of the external auditor nominees on time because of the fact that the companies are given more time.

Whereas the new TCC mandated the companies to improve the disclosure practices regarding voting items, especially regarding M&A agreements, nothing was amended regarding voluntary items such as director elections and remunerations. It means that the new commercial code approves merely the provisions of CML.

CONCLUSION

This study has proven that the notions, corporate governance and transparency are core elements to establish confidence in the capital markets and prevent the crises in the world economy. On the other hand they are the most vital tools for the states to attract investors into the country and be competitive in the financial market as the investors prefer more transparent markets. This is also applicable at the corporate level. In order to benefit from the financing opportunities from the IPOs, the corporations should establish efficient and transparent governance mechanisms.

¹⁷¹ Hürriyet Daily News, "New Turkish commercial code to bring transparency, author says", Available at: <http://www.hurriyetdailynews.com/n.php?n=turkey8217s-new-commercial-code-to-bring-transparency-author-says-2011-01-31>, Accessed on 31.03.2011

On the other hand disclosure can lower the cost of equity considerably in emerging markets whereas transparency and disclosure play an essential role to eliminate or at least minimize the agency problem, information asymmetry, adverse selection of moral hazard in the corporations. Thus, a fair atmosphere can be possible as the aim of corporate governance is to increase investor confidence by determining mutual rights and liabilities to decrease misconducts of the people who are in charge. To be able to monitor as to whether there is misconduct of activities, there need to be established an efficient disclosure platform to deliver necessary information to the shareholder by different means. Shareholder meetings in that sense play a fundamental role in corporate governance and transparency since the information about significant development within the company is delivered to the shareholders through shareholder meetings. Furthermore shareholders are involved in the corporative decisions in the strictest sense through informed voting at the shareholder meetings. However, shareholders should be informed about the voting items in advance of the meetings in order to be able to cast informed voting.

In this study the level of disclosure practices for the voting meeting items ahead of the shareholder meetings and motivations factors to disclose those information to the shareholders have been examined. The findings indicate that whereas there is high compliance with the exiting legal provisions, the disclosure level does not exceed the legal obligations, meaning that voluntary disclosure practices remain quite low in Turkey. This is particularly the case for the board elections, internal auditor appointments as well as their remuneration levels.

In the second part of the study, the determinants for the disclosure practices have been investigated by taking into account five variables such as involving in the corporate governance index, corporate governance overall rating scores, scores for transparency and disclosure, free float rates, foreign ownership and state ownership. It has been found out in the correlation analysis that the disclosure rates ahead of the shareholder meetings are only related positively to the degree of foreign ownership in the companies.

In the last chapter the capability of new TCC in covering the weakness in the disclosure practices such as director elections, internal auditor appointments as well as their remuneration have been briefly assessed. It seems far from providing a legal framework for disclosure of the names and biographies of the director and internal auditor candidates, and their remuneration levels.

In this sense one can conclude that Turkish companies do not go beyond the legal compliance. The overall disclosure practices is likely to be achievable with more internationalized and developed capital market as there seems to be a correlation between foreign ownership and disclosure rates.

Last but not least, Turkey, so to speak with infant but rapidly growing capital markets is offering many opportunities to the international investors within the liberalization period. However it still needs to take some further steps to enhance confidence and stability in the economy, develop the transparency mechanisms and disclosure practices in order to attract the investors in to the country.

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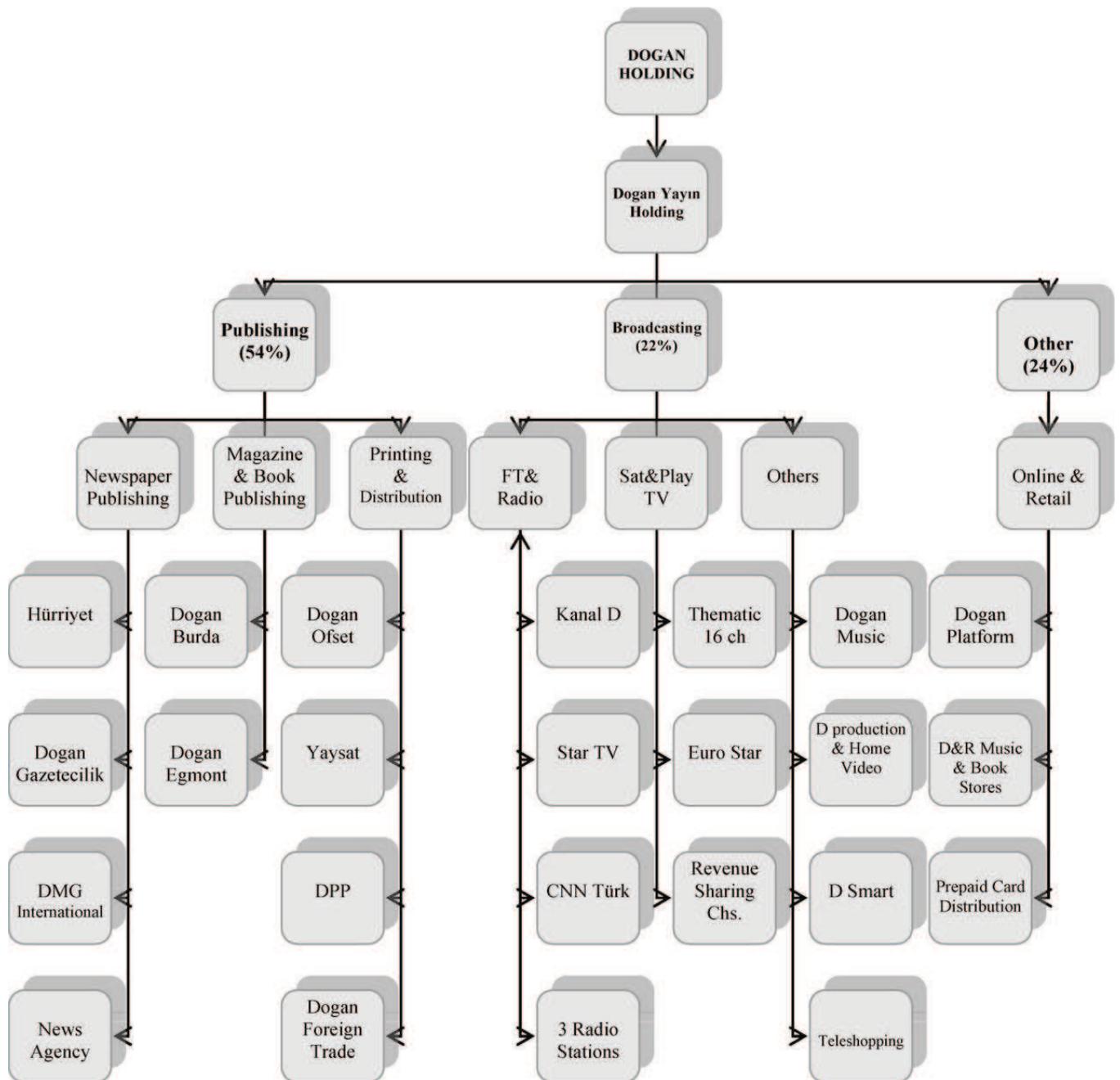
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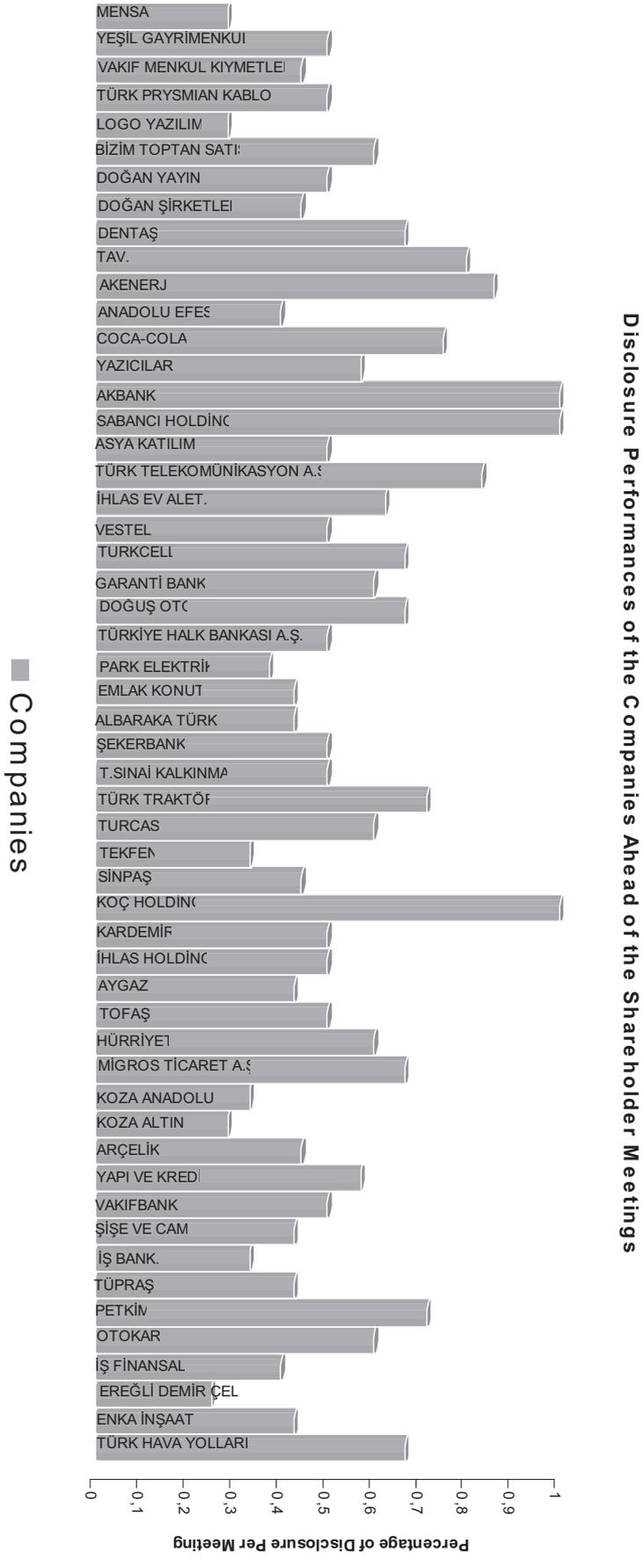
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Appendix 1 Ownership Structure of Dogan Holding



Source: Serap Atakan, Zeynep Özsoy and Beyza Oba, "Implementation of good corporate governance in Turkey: The case of Dogan Yayın Holding" *Human Systems Management* 27 (2008): 201–216

Appendix 2 Disclosure Performances of Turkish Companies Ahead of the Shareholder Meetings



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DECLARATION OF AUTHORSHIP

I declare that this thesis and the work presented in it are my own and have been generated by me as the result of my own original research.

None of the parts of this thesis has previously been submitted for a degree or any other qualification at this university or any other institution.

The written document matches completely to the CD version.

Where I have quoted from the work of others, the source is always given within the reference part of my Thesis.

Hamburg

13.09.2011



Place

Date

Signature