Corporate Governance in Turkey: an introduction to the Special Issue[1]

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Over the last two decades considerable attention has been devoted to differences in the institutional structures of countries and the effects of such structures on corporate performance. An important branch in this literature brings together comparisons of financial and legal systems, a branch for which increasingly the term "corporate governance" is used.

An overwhelming proportion of this literature has concentrated on developed countries with sophisticated financial and legal systems. Much less research has been conducted on the determinants and effects of corporate governance structures that are found in developing and/or emerging market economies and on the dynamic evolution of these determinants. Together with the large-scale privatisation and deregulation that took place over the last two decades in these economies, the Asian crisis in mid 1997 added a new dimension to the importance of these issues. Academic research (Singh, 2003) and some influential economic analysis, including that of the IMF (1998) and leading US officials (Summers, 1998), suggest that the fundamental causes of the Asian crisis lay not so much in the macroeconomic imbalances, but rather in the normal microeconomic behaviour of microeconomic decision-makers in these economies. This type of (structuralist) analysis of the Asian crisis emphasises the lack of competition and the lack of sufficiently strong corporate governance structures as the major reasons of the crisis.

While in recent years this picture has changed dramatically for the crisis-hit countries,[2] we still lack systematic studies on other emerging countries such as Turkey. Deficiencies in data on institutional frameworks and firms, as well as the methodological issues such as simultaneity and endogeneity, hamper the deepening of our understanding of corporate governance issues in these countries. Not long ago, 50 researchers came together at the World Bank to discuss issues related to corporate governance research in developing and emerging markets and concluded that "ownership structures, and legal and economic environments . . . pose challenges to reform and [their] implications for effective strategies are not fully understood . . . There is limited synergy between efforts in terms of data collection, exchange of ideas and development of a broad research agenda that tackles the most urgent issues from a policy perspective."[3]

This Special Issue is an attempt to bring together some recent work on the nature and impact of the corporate governance regime on corporate performance in Turkey as a case. To put the specific country studies into a global perspective, the Special Issue starts with two papers, which analyse some of the issues that arise concerning different corporate governance systems, focusing particularly on their relevance for developing countries. These two papers are followed by a survey of privatisation in developing countries (by William Megginson and Natalie L. Sutter) and by an international comparison of the ownership structures and performance of listed and non-listed European firms (by Stijn Claessens and Konstantinos Tzioumis).

Five papers on specific dimensions of the corporate governance in Turkey and its impact on several measures of firm performance follow these four international studies, which provide an overview of corporate governance issues around the world.

In the first paper of the international studies, Dennis C. Mueller starts with a question that is central to any discussion of corporate governance systems: How well does a particular set of institutions mitigate the various principal/agent problems that arise in a firm? After reviewing the basic principal/agent problem, Mueller discusses the relevance of this ques-

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tion for developing countries. His discussion is centred on the perennial question of whether the so-called "Anglo-Saxon" system of corporate governance is well-suited to developing countries as opposed to some other model. Although he stresses the case for having strong corporate governance institutions to facilitate the creation of thick equity markets in the context of developing countries, he also examines the case for relying on alternative sources of capital (such as a bank-led system) including the state. While Mueller recognises that there may be more than one route for development success, he argues that the best development strategy for an emerging market country is to constitute the conditions that produce a large equity market, for which strong corporate governance institutions are a pre-condition.

In the second paper of the Special Issue, Ajit Singh and Ann Zammit take a critical stance to Mueller's arguments and to his conclusion. As the title of this paper indicates, the authors investigate whether emerging markets should adopt the US corporate model based on shareholder wealth maximisation subject to the discipline of liquid stock markets. According to Singh and Zammit, this model has, in recent years, been hailed as a major reason for superior US technological performance and very fast productivity growth relative to other advanced industrial countries. In its more extreme form, the proponents of the model suggest that there is not much room for manoeuvre left for emerging markets under globalisation except to be obliged to adopt, to absorb or to establish those institutions which have proved to be universally the most efficient. The paper critically examines these claims conceptually and empirically and concludes that they are seriously wanting. It argues that the US corporate model is not only unsuitable for most emerging countries but is also perhaps not in the best interests of the US economy itself. The paper notes, *inter alia*, the paradox that the virtues of the stock market based US corporate model for technological progress, and particularly for the expansion of ICT technology, are being extolled in a period which has seen an enormous boom and bust in share prices of technology stocks, as well as shocking corporate scandals. The emphasis of the paper is on this paradox and its implications for the corporate governance systems of developing countries.

The third paper is by William Megginson and Natalie L. Sutter and it offers a comprehensive survey of empirical studies on the effects of privatisation in developing economies. The papers that are discussed in the survey suggest that privatisation is generally associated with improvements in the operating and financial performance of divested firms, while a few studies point to performance declines. After the privatisation output, efficiency, profitability and investment levels of privatised entities show significant improvements. The surveyed studies also suggest that there is a significant decline in the leverage. With two exceptions, all of the surveyed papers document that employment levels fall after privatisation. The performance improvements are stronger in regulated industries, in firms that restructure operations after privatisation, and in countries providing greater amounts of shareholder protection.

An important contribution of the paper by Megginson and Sutter is that it points to other reforms (effective regulatory regime) that should complement ownership changes (privatisation) to promote performance improvements, to ensure that efficiency gains are shared with consumers.

Taken from a corporate governance perspective these results have important implications. There has been an extensive amount of research in the effects of the identity and concentration of owners on corporate performance. As in almost all areas of economics, this strand of the literature on corporate governance has also been dominated by studies focusing on the US and the UK. Concerning other countries and especially developing countries, there is less research and consequently less agreement on this issue. While family ownership is the most common form of ownership in these countries, the state also emerges as an alternative owner at least in some industries. FDI in form of takeovers is considered as a way to ensure that firms in developing countries will be subject to better corporate governance environments.[4]

These questions are closely related to the nature and impact of family ownership in developing countries such as Turkey. Many important markets in developing countries are small relative to developed economies. Given that many firms in these countries have established their product market positions early on, they potentially enjoy a great deal of market power, which provides them with enough cash flow over which they can exercise their discretion. Without parallel changes in competition policy and regulative activities, policies that are directed towards changing the balance of powers in the firms' governance structure may not be effective. Hence, besides being a comprehensive survey of privatisation and indirectly of state ownership, this paper has also implications on the way we think about other shareholder identities in developing countries.

The fourth and final overview paper is by Stijn Claessens and Konstantinos Tzioumis. This paper presents a comparison of ownership and financing structures and performance in 19 European countries. Listed companies are contrasted with large non-listed companies. The findings suggest that a substantial majority of non-listed companies have either a large or medium block-holder. This contrasts the ownership structure of listed companies, which generally have no large block-holder. Using a matched sample methodology, the paper suggests that non-listed companies are more capital intensive than listed ones. Non-listed companies do also exhibit higher returns on assets and equity than listed companies.

For obvious reasons, the literature on corporate governance has to a large degree focused on listed companies in countries with developed capital markets and paid special attention to the consequences of widely dispersed ownership structures. Consequently, policy issues have concentrated on the design of institutional mechanisms that should align the interests of shareholders (outsiders) and managers (insiders). In countries with relatively underdeveloped stock markets such as some European countries, transition economies and developing countries, a substantial fraction of the economic activity takes place in non-listed companies. The issues analysed in this paper are slowly attracting attention. For example, contributions to a recent OECD conference[5] point to several important issues for which we have insufficient empirical evidence such as (1) the corporate governance characteristics of non-listed companies; (2) the driving forces for improving corporate governance practices in non-listed companies; and (3) the role of a public policy framework in supporting good corporate governance of non-listed companies.

This paper contributes to our understanding of differences between non-listed and listed companies by presenting detailed statistics of various measures of ownership structures and their relationship to financing patterns and performance. Hence, it makes an important contribution to at least two of the abovementioned research questions. In this way, it complements the remaining papers in the Special Issue by drawing our attention to the existence of a large fraction of companies for which other, non-traditional governance structures are required.

The second set of papers in this Special Issue focus on specific questions related to corporate governance and firm behaviour in Turkey. In our view Turkey deserves attention for various reasons. First of all, the pace and depth of recent institutional reforms provide a rich case to observe and analyse the relationship between institutional variables and corporate governance. Second, the prospects of growth and integration with Europe trigger change in ownership structures through local and cross-border acquisitions and enrich the case of Turkey for researchers.

The first of the papers on Turkey, by Mine Aksu and Arman Kösedag, is on the transparency and disclosure (T&D) practices of Turkish listed companies. Recent research suggests that shareholders should be able to protect themselves better against self-serving managers and to make better decisions concerning the purchase of new equity issues, the better the quality of accounting information at their disposal (Gugler *et al.*, 2003; Berglöf and Pajuste, 2005). Accordingly, T&D practices are critical for minority shareholders in reducing the costs associated with detecting expropriation by large shareholders. Transparent and good-quality disclosure of relevant information is especially vital for Turkey where the biggest agency problem centres on asymmetric information and expropriation by majority shareholders.

The paper is based on an international methodology first developed by Standard and Poor's (S&P) and it is based on survey evidence concerning the availability of 98 desirable T&D attributes in three categories: (i) ownership structure and investor relations, (ii) financial transparency and information disclosure and (iii) board and management structures and processes. The authors evaluate the T&D practices of the 52 largest and most liquid firms on the Istanbul Stock Exchange (ISE), based on their annual reports and websites. The findings suggest that the T&D scores of the ISE companies compared to developed countries are rather weak. While this result may simply be driven by a "size effect",[6] the results suggest substantial room for improvement in the T&D practices of ISE companies. The authors also consider a simple econometric model that tries to link agency costs and other factors to the T&D scores. Proxies for agency conflicts, firm size, financial performance, market-to-book equity contribute to explain the variation in T&D scores of Turkish listed firms.

The objective of the second paper on Turkey (by Halit Gönenc and C. Bülent Aybar) is to evaluate the impact of concentrated ownership and business group affiliation on the performance of Turkish listed companies during the 2001 financial crisis. The main point of the paper is similar to the studies by Johnson *et al.* (2000), Mitton (2002) and Lemmon and Lins (2003) in that it exploits the notion that

companies that offer their minority shareholders stronger protection (e.g. better disclosure, greater transparency, a more favourable ownership structure, and a more focused organisation) are likely to experience smaller value losses during a financial crisis. The paper focuses on a 12-month window encapsulating the February 2001 financial crisis and looks at the performance over this period by controlling for balance sheet currency exposure, international involvement and the size of the sample companies. The findings suggest that balance sheet exposure is the key determinant of the firm performance during the crisis periods. While the authors find empirical evidence that firms with higher concentrated ownership experience lower stock market performance prior and during the financial crisis, business group affiliation is not significantly correlated with performance. The paper also offers a somewhat weak relationship between stock market performance and the level of business group diversification.

Despite two powerful irrelevance theorems established by Modigliani and Miller (1958, 1961), a literature going back to 1950s has found a consistent and often strong relationship between real and financial choices at the firm level.[7] In a comparative study, Booth *et al.* (2001) analyse the capital structures of ten developing countries and argue that differences in the institutional structures of these countries systematically affect their companies' capital structure choices. The claim that distinct features of a country's financial and legal systems do influence such choices is also documented in the context of Turkey (Güney *et al.*, 2006).

The next paper of this Special Issue, authored by Özgür Arslan and Mehmet Baha Karan, returns to the "company characteristics" issue and analyses the impact of ownership structures on the debt maturity structure for Turkish firms. They model leverage and debt maturity as jointly endogenous using a simultaneous equations framework. Their results indicate that (1) both concentrated ownership structure and presence of a large shareholder is directly (albeit moderately) related to corporate debt maturity, (2) Turkish firms match maturity of their assets with maturity of their liabilities.

These findings lend support to the prediction that as firms get financially strong or have more growth opportunities, they shorten their corporate debt maturity structure. A further finding of the paper is that despite the presence of a controlling, large shareholder or a concentrated ownership structure, firms with growth opportunities still prefer shorter maturities, a finding that suggests the existence of underinvestment problems.

The fourth paper on Turkey revisits the "country characteristics" debate by examining the linkage between macroeconomic instability and corporate governance quality in Turkey. The paper hypothesises that macroeconomic volatility and the absence of a rule-based economic policy framework that usually underpins macroeconomic stability would be conducive to low corporate governance standards. This hypothesis is derived from a model of corporate governance quality under imperfect information (Ugur and Ararat, 2003). After demonstrating the negative effect of macroeconomic instability on the quality of corporate governance standards analytically, the paper also demonstrates why the return to macroeconomic stability after the 2001 crisis could be conducive to quality-improving corporate governance reforms. Ugur and Ararat then provide a detailed analysis of the post-2001 corporate governance reforms and highlight the linkage between these reforms and the return to macroeconomic stability (and to a rule-based economic policy framework that underpins it).

The fifth paper looks at the impact of ownership structures of Turkish listed companies on their investment performance. In spite of the fact that most of the research has concentrated on the typical agency problem between managers and dispersed shareholders, in many countries large shareholders are much more frequently observed than firms with dispersed ownership structures. While large shareholders are perceived as a potential solution to the typical agency problem between managers and dispersed shareholders, less research has been done on the costs of large shareholders. One important issue in this literature is that deviations of cash flow rights from voting rights often result in substantial value discounts. The paper by Hakan Orbay and B. Burcin Yurtoglu estimates the impact of such deviations on corporate investment performance in Turkey. To measure corporate investment performance, they estimate returns on investment relative to company costs of capital using a methodology that overcomes the endogeneity problem that contaminates some important results in the empirical corporate governance literature. Consistent with existing studies, the paper reports that the average Turkish listed company has a return on investment which is less than its cost of capital. Orbay and Yurtoglu also report significantly better investment performance for companies that do not deviate from one share–one vote by using pyramidal ownership structures, dual-class shares and

other devices that enhance the control power of large shareholders beyond their cash flow rights. One interesting finding of the paper is that business group membership and deviations of cash flow rights from voting rights have substantially different effects on investment performance.

While these papers do not constitute a coherent body that is likely to give a full description of the development and the state of corporate governance in Turkey, they are related in important ways.[8] They indicate that academic research on corporate governance in Turkey is alive and growing. We hope that they will also encourage others to evaluate, criticise and enhance these and many other unexplored issues.

Notes

1. This Special Issue was co-edited by Melsa Ararat and Burcin Yurtoglu when the latter was a visiting professor at Sabanci University during November 2005–February 2006.
2. Recent exceptions, which offer a synthesis of the available research on developing/emerging countries, include Claessens and Fan (2002), Singh (2003) and Allen (2005).
3. Unpublished synthesis note of the workshop on "The future of research on corporate governance in developing and emerging markets", World Bank, Washington DC, 5 April 2002.
4. See also, the discussion in Gugler *et al.* (2004, pp. 148–152).
5. International Experts Meeting on Corporate Governance of Non-Listed Companies, Istanbul, Turkey. This meeting, held on 19–20 April 2005, brought together policy makers, business leaders and other experts to discuss the policy implications of the debate on corporate governance of non-listed companies. Proceedings of the conference and a synthesis document are available from http://www.oecd.org/daf/corporate-affairs.
6. In this view, one might even consider the T&D scores of ISE companies as quite strong, should one choose similar sized UK or US companies as a benchmark. We are grateful to an anonymous referee for this (and further related) remarks.
7. For a detailed overview of this topic the reader can consult Mueller (2003, Chapter 7).
8. For a descriptive study of corporate governance prior to structural reforms in Turkey see Ararat and Ugur (2002) and IIF (2005) for a recent review.

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