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YÜKSEK LİSANS TEZİ

AN EMPIRICAL ANALYSIS OF THE RELATIONSHIP BETWEEN CORPORATE GOVERNANCE AND FIRM PERFORMANCE AT ISTANBUL STOCK EXCHANGE

Pınar ŞENÇİTAK

Danışman
Prof. Dr. M. Banu DURUKAN

2007

Yemin Metni

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ABSTRACT

Master of Thesis

An Empirical Analysis of the Relationship between

Corporate Governance and Firm Performance at Istanbul Stock Exchange

Pınar ŞENÇİTAK

Dokuz Eylül University
Institute of Social Sciences
Department of Business Administration (English)
Finance (English)

Corporate governance is a system of mechanisms and principles related to how the company is directed and controlled. Countries realized the importance of corporate governance in the last decade as a result of the big corporate scandals. Then, regulatory bodies attempted to increase the effectiveness of corporate governance in both private and public sectors. Similarly, Turkish Capital Market Board issued the corporate governance principles in 2003 in order to improve corporate governance system of the firms at quoted Istanbul Stock Exchange (ISE).

The aim of the study is to analyze corporate governance and its effects on firm performance empirically and theoretically. It also aims to analyze whether there is a relationship between corporate governance and firm performance or not for firms quoted at ISE.

The first chapter defines corporate governance and discussed the principles for the establishment of an effective corporate governance system. In the second chapter, corporate governance mechanisms are covered and within this framework governance in Turkey is discussed. Third chapter reviews the literature on the effects of corporate governance on firm performance. In the fourth chapter, the empirical analysis of the study is provided.

The data is obtained from the web-sites of the sample firms and ISE database for the year of 2006 and the analysis is applied to 45 manufacturing firms included in the ISE 100 Index.

The results show that there is a relationship between corporate governance and firm performance at ISE for manufacturing firms. In addition, the relationship direction is positive.

Key Words: 1) Corporate Governance 2) Firm Performance 3) Corporate Governance Score 4) ISE 5) Corporate Governance Mechanisms

ÖZET

Yüksek Lisans Tezi

Kurumsal Yönetim ile Firma Performansı Arasındaki İlişkinin İstanbul Menkul Kıymetler Borsasında Ampirik İncelemesi

Pınar ŞENÇİTAK

Dokuz Eylül Üniversitesi
Sosyal Bilimler Enstitüsü
İngilizce İşletme Anabilim Dalı
İngilizce Finansman Programı

Kurumsal yönetim, firmaların yönetilmesi ve kontrol edilmesi ile ilgili yöntemler ve mekanizmalar sistemidir. Ülkeler, kurumsal yönetimin önemini son on yılda yaşanan büyük firma skandalları sayesinde fark ettiler. Dolayısıyla, düzenleme kurumları, kurumsal yönetimin etkinliğini özel sektörde ve kamu sektöründe arttırmaya çalışmaktadırlar. Benzer şekilde, Türkiye Sermaye Piyasası Kurulu İstanbul Menkul Kıymetler Borsasına (İMKB) kote olmuş firmaların kurumsal yönetim sistemlerinin gelişmesi için 2003 yılında kurumsal yönetim ilkelerini yayınladı.

Bu çalışmanın amacı, kurumsal yönetim ve kurumsal yönetimin firma performansı üzerindeki etkilerini teorik ve ampirik olarak analiz etmektir. Bu çalışma ayrıca, IMKB'de kote firmalar için kurumsal yönetim ve firma performansı arasında bir ilişki olup olmadığının incelenmesini amaçlamaktadır.

Birinci bölümde, kurumsal yönetim tanımlanmakta ve ayrıca etkin bir kurumsal yönetimin kurulma prensipleri ele alınmaktadır. İkinci bölümde, kurumsal yönetim mekanizmaları sunulmuştur ve bu çerçevede Türkiye'deki kurumsal yönetim anlatılmıştır. Üçüncü bölüm kurumsal yönetimin firma performansına etkisini ilgili literatür ışığında anlatmaktadır. Dördüncü bölümde, çalışmanın ampirik sonuçları sunulmaktadır.

Bilgiler, örneklemi oluşturan her bir firmanın web sitesinden ve IMKB bilgi bankasından 2006 yılı için elde edilmiştir ve analiz İMKB 100 endeksi kapsamındaki 45 üretim firması için yapılmıştır.

Sonuçlar, IMKB'de üretim firmaları için kurumsal yönetim ile firma performansı arasında bir ilişki olduğunu göstermektedir. Ayrıca, bu ilişkinin yönü pozitiftir.

Anahtar Kelimeler: 1) Kurumsal Yönetim 2) Firma Performansı 3) Kurumsal Yönetim Skoru 4) IMKB 5) Kurumsal Yönetim Mekanizmaları

INDEX

CHAPTER II

CORPORATE GOVERNANCE MECHANISMS AND CORPORATE GOVERNANCE IN TURKEY

CHAPTER III

CORPORATE GOVERNANCE AND FIRM PERFORMANCE

CHAPTER IV

AN EMPIRICAL ANALYSIS OF THE RELATIONSHIP BETWEEN CORPORATE GOVERNANCE AND FIRM PERFORMANCE AT ISTANBUL STOCK EXCHANGE

LIST OF ABBREVATIONS

AGM	Annual General Meeting
CEO	Chief Executive Office
CFA	Chartered Financial Analyst
CFO	Chief Financial Officer
CGQ	Corporate Governance Quotient
CGS	Corporate Governance Score
CMB	Capital Market Board of Turkey
CML	Capital Market Law
ECGF	European Corporate Governance Forum
EU	European Union
ESOP	Employee Stock Ownership Plans
EVA	Economic Value Added
Gov-S	Overall Corporate Governance Score
Gov-S_1	Corporate Governance Sub-Score of Shareholders
Gov-S_2	Corporate Governance Sub-Score of Public Disclosure and Transparency
Gov-S_3	Corporate Governance Sub-Score of Stakeholders
Gov-S_4	Corporate Governance Sub-Score of Board of Directors
IFF	The Institute of International Finance
IFRS	International Financial Reporting Standards
ISE	Istanbul Stock Exchange
ISS	Institutional Shareholder Services
MVA	Market Value Added
OECD	The Organization for Economic Co-operation and Development
OLS	Ordinary Least Squares
pp.	Page Number
ROA	Return on Asset

ROE	Return on Equity
SIS	State Institute of Statistics
US	United States
UK	United Kingdom
TCC	Turkish Commercial Code
TUSIAD	Turkish Industrialists' and Businessmen's Association
WFE	World Federation of Exchange

TABLE LIST

FIGURE LIST

INTRODUCTION

Corporate governance is the process concerning with how companies are directed and controlled. Corporate governance system serves well the interests of individuals, of corporations, and of society. Effectiveness of the modern corporate system relies on corporate governance which is widely recognized as an essential component in the market economy. Especially, corporate scandals have led to increasing attention to corporate governance mechanisms in business life. In addition, the quality of corporate governance is recognized as one of the important drivers of sustainable economic development. As a result, this field has been continually evolving in recent years.

Corporate governance is more broadly defined as a set of relationships between a company's management, its board, its shareholders and other stakeholders. Significantly, it is a tool to achieve business integrity and to promote economic growth. Corporate governance has received more attention in the last decade with globalization. The integration of financial markets and mobilization of capital have forced countries for effective corporate governance standards. Based on this issue, countries realize the importance of corporate governance in both public and private sectors, and efforts to improve corporate governance systems have increased in order to attract foreign investments.

Similarly, corporations that operate in fair, transparent, and accountable manner are increasingly required by government, investors, suppliers, and public in recent years. The rise in demand for and supply of private capital has resulted in need for broadening and deepening corporate governance systems. Recent economic and financial crises in the world and huge corporate scandals such as Enron have decreased investor confidence, and weak corporate governance is seen as a major cause to these crises and scandals. Effective corporate governance can protect

investors and create well functioning financial markets. In other words, corporate governance is needed to improve investor protection required to encourage them to provide capital. Then, long-term foreign capital is attracted and the local capital market broadens and deepens with this effective corporate governance.

Defining good governance is precisely difficult since there is no one-size-fits-all system for all countries and corporations as depicted in the Survey of Corporate Governance Developments in The Organization for Economic Co-Operation and Development (OECD) Countries (2002, 23). On the other hand, there are structures, policies, and mechanisms which are essential to ensure good corporate governance. Introduction of codes, regulations, and standards to formulate the governance framework are required for a corporate governance system. The main set of standards for corporate governance is *"OECD Corporate Governance Principles"* adopted by OECD in 1999. Capital Market Boards of countries also issue corporate governance principles in order to provide a basis for transparent and accurate market economy for their countries. Capital Market Board of Turkey (CMB) defined and issued Corporate Governance Principles in June, 2003 and amended in February, 2005.

Corporate governance systems in the world vary due to the differences in cultures, economic systems, and business content. Despite the diversity of corporate governance systems, they can be grouped into two basic corporate governance systems as market-based and relationship-based. Furthermore, globalization of markets forces a convergence in corporate governance systems.

In the literature of corporate governance, researchers mainly analyze two questions. First, if any particular corporate governance mechanism in question minimizes the gap between managers' and shareholders' interests or not. Second, if the mechanism in question has a significant impact on firm's performance or not. It is expected that if any governance mechanism is effective, then that mechanism should have a positive impact on firm value. Those questions form the base of the hypotheses in numerous studies.

Additionally, there are a number of studies in the corporate governance literature investigating the relationship between company performance and corporate governance. Literature provides evidence that better governed firms have higher firm performance measured by various variables. There are also studies concerning the effects of individual corporate governance mechanisms such as ownership structures and board size on company performance and value. Construction of corporate governance scores or indexes, and analyses of their effects on corporate value are other current topics studied in the literature.

In light of the above explanations, the aim of this study is to investigate the effect of corporate governance on firm performance through constructing a corporate governance score for Istanbul Stock Exchange (ISE) 100 Index firms. The underlying assumption of the study is that better governed corporations measured by higher governance score have higher firm performance.

Governance score is constructed through minimum corporate governance attributes based on Capital Market Board Corporate Governance Principles. A composite corporate governance score is computed by giving 1 point to each corporate governance attribute if the firm satisfies minimum acceptable governance standard and 0 otherwise. The score includes four main sections: 1) Shareholders, 2) Public Disclosure and Transparency, 3) Stakeholders, 4) Board of Directors. The data for the score is obtained through publicly available information. Firm performance is considered through marked-based measure of Tobin's Q (Q). The data for the measure is obtained from ISE.

The study is structured as follows. In the first chapter, definition of corporate governance is provided and its importance is discussed. Governance mechanisms as market-based and relationship-based, and the convergence of those systems are examined. Corporate governance principles for the creation of a sound system are discussed in detail.

Second chapter provides a discussion of mechanisms of corporate governance. Within this framework, corporate governance in Turkey is also covered. The next chapter discusses the effects of corporate governance on firm performance by reviewing the literature. It also analyzes different methods used in the construction of corporate governance scores and indexes.

The fourth chapter includes the empirical analysis of the effect of corporate governance on firm performance at ISE by constructing a corporate governance score. The sample is defined and the methodology and the hypothesis of the study are conducted. Finally, the results are given and interpreted in order to find evidence for the relationship between corporate governance and firm performance. The last part concludes by identifying the limitations of the study and research issues that require further attention.

CHAPTER I

CORPORATE GOVERNANCE

Siebens (2002; 111) defines corporate governance as both the knowledge and the art of weighting divided interests of all the stakeholders. In other words, it is the effort of balancing the relationships of power. The importance of corporate governance has been realized all over the world with the integration and liberalization of financial markets. As Gregory (2000; 2) discusses, demand for investment capital is increasing throughout both developed and developing countries. With the free flow of capital, policy makers have recognized that quality of corporate governance is relevant to capital formation. According to McKinsey survey (2002), investors from all over the globe indicate that they are willing to pay large premiums for companies with effective governance. Thus, good corporate governance is believed to affect firms' performance positively.

Before analyzing the relationship between corporate governance and firm performance, corporate governance itself, systems, and convergence of these systems are discussed in this chapter. At the end of the chapter, a comparative analysis of principles of corporate governance issued by different institutions is provided. By thoroughly understanding corporate governance, its effects on firm performance will be realized in more depth.

1.1. Overview of Corporate Governance

In the literature, definitions of the term "Corporate Governance" can be grouped into two based on their point of view as agency view and stakeholder view. The agency view regards corporate governance as a framework by which shareholders of corporations monitor managers (Shleifer and Vishny, 1997; 737). This view sees managers as agents to operate corporations on behalf of shareholders.

The stakeholder view regards corporations as a coalition of stakeholders consisting of shareholders, managers, employees, creditors, and so forth. According to this view, there are other groups who have a stake in the actions of corporations besides stockholders (Freeman and Reed, 1983; 89). Thus, corporate governance, as defined in Organizational for Development Co-Operation and Development (OECD) Principles of Corporate Governance (2004a; 11), is "a *set of relationships between a company's management, its board, its shareholders and other stakeholders."*

Corporate governance, from an agency theory perspective, is a set of institutional and market mechanisms that induce managers to maximize the value of residual cash flows of the firm on behalf of its shareholders (Denis, 2001; 192). There are problems related with the separation of ownership and control. Interests of managers and shareholders can conflict since the nature of their interests is different from each other. Shareholders desire high value of shares as possible whereas managers desire to establish their own needs such as recognition and power which can be inconsistent with the goal of maximizing shareholder value. In this case agency problem arises.

As Denis (2001; 192) states the root of the agency theory goes back to Adam Smith. According to Adam Smith, there is a conflict between managers and owners derived from the separation of ownership and stewardship which is called the "Agency Theory". Denis (2001; 192) also provides that, in 1932, Adolph Berle and Gardiner Means suggested that the agency problem resulted in unsustainable form of organization.

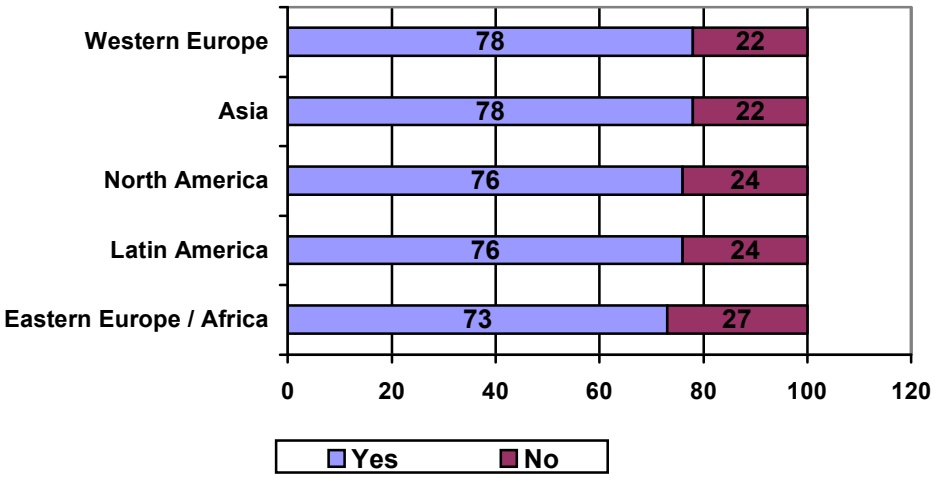
Main researches on corporate governance began with Michael Jensen and William Meckling with their study on theory of firm. Jensen and Meckling (1976) define agency relationships, concept of agency costs, and show its relationship to the "separation and control" issue. They define an agency relationship as *"a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent"* (Jensen and Meckling, 1976; 5). They apply

the agency theory to modern corporations and provide that a manager who owns less than 100% of the residual cash flow rights of the firm has potential conflicts of interest with the outside shareholders.

The variety of mechanisms to solve agency problems including profit sharing, direct monitoring by boards, competition among managers, the capital market, and the market for take-over are stated in the corporate governance literature (Miozzo and Dewick, 2002; 990). Therefore, corporate governance is important as a means of reducing "agency costs" imposed by managers who are acting in their own interest.

Additionally, the Committee on the Financial Aspects of Corporate Governance in the United Kingdom (U.K.) defines corporate governance as *"a system by which companies are directed and controlled"* (Cadbury Committee, 1992; Introduction). Namely, it includes the set of rules by which corporations, shareholders and management govern their behavior. Such factors may include a corporation's ownership structure, its relationships with stakeholders, financial transparency and information disclosure practices as well as the design of its managing boards.

Furthermore, Global Investor Opinion Survey (2002) conducted by Mc Kinsey indicates that significant majority of investors pay a premium for well-governed company. The percentage of investors who pay a premium for corporate governance varies by country as seen from Figure 1. It is understood that corporate governance is perceived as valuable by investors who are willing to pay significant premium for the stocks of well-governed firms.



(Source: McKinsey Global Investor Opinion Survey on Corporate Governance – Exhibit 3, 2002; 5)

Figure 1: Percentage of Investors Paying a Premium

In summary, corporate governance includes a set of standards to balance divided interests within the board and the whole organization. Responding to the worldwide corporate governance requirements, policy makers and corporations have taken an intense interest in formulating effective corporate governance systems.

1.1.1. Importance of Corporate Governance

Importance of corporate governance relies on its contribution to economic growth. Effective corporate governance promotes the efficient use of resources both within the firm and country (Gregory and Simms, 1999; 4). The effective mechanism maximizes value and productivity. Nonetheless, globalization and privatization programs around the world make effective corporate governance a necessity for sustainable economic development. There occurred increase in both importance and size of capital markets in almost all countries. The corporate governance, then, takes important roles in providing transparent and well-functioning capital markets.

As depicted by Claessens (2003; 14), there are five channels identified through which corporate governance affects growth and development. These include the following (Claessens, 2003; 14-23):

- **Increased access to financing:** Better creditor shareholder rights are associated to more developed banking and capital markets through strong protection of property rights.

- **Higher firm valuation:** The firm value is affected positively from the quality of the corporate governance framework through lowering the cost of capital.

- **Better operational performance:** Corporate governance adds value by improving the performance of firms through more efficient management, better asset allocation, better labor policies, and similar efficiency improvements. A number of studies published in recent years have shown a link between good corporate governance and profitability and performance measures. For example, Aggarwal and Williamson (2006), Brown and Caylor (2004), Black, Jang and Kim (2003), and Gompers, Ishii, and Metrick (2003) focused on the relationship between corporate governance and firm performance.

- **Reduced risk of financial crises:** The quality of corporate governance also affects the functioning of country's financial market and behavior of firms in times of economic shocks.

- **Better relations with other stakeholders:** Companies deal with stakeholders including creditors, labor and the government besides the principal owner and the management. Each of stakeholders monitor, discipline, motivate and affect the management and the firm through many ways.

Importantly, Gregory (2000; 7) outlines that effective corporate governance:

- Promotes the efficient use of resources both within the company and the larger economy,
- Helps ensure that the company is in compliance with the laws, regulations, and expectations of society,
- Provides managers with oversight of their use of corporate assets,
- Supports efforts to reduce corruption in business dealings, and
- Assists companies in attracting lower-cost investment capital.

The conclusion is that it is important to realize that enhancing corporate governance will result in economic growth and development. In addition, the importance of corporate governance for access to financing, cost of capital, valuation, and performance has been documented in number of countries (Claessens, 2003; 30).

1.1.2. Evolution of Corporate Governance

Corporate governance has evolved over the decades generally in response to corporate failures and economic crises. Maxell Corporation (1991), Barings Bank (1995), Enron (2001), WorldCom (2002), and Parmalat (2003) are examples of high profile corporate corruption scandals which resulted in loss of investor confidence and financial integrity of some of the world's largest financial markets.

Through its evolution process, sets of laws and regulations have been established by developed countries with the aim of achieving accountability in corporate governance systems (Iskander and Chamlou, 2000; 1).

Countries also realize that good corporate governance is a source of competitive advantage. In recent years, investors base their decisions not only on a company's financial outlook, but also on its reputation and governance (Iskander and Chamlou, 2000; 15).

In particular, interest in corporate governance has grown among developed countries by the early 1990s. The publication of the Cadbury Report (1992) in the United Kingdom of Great Britain and Northern Ireland was the result of large-scale official efforts in OECD countries (Cheung and Chan, 2004; 2).

The Cadbury Code of Best Practice, the Greenbury Report on Director's Remuneration and Cadbury's successor, the Hampel Committee on Corporate Governance have strongly contributed to the discussion on openness, the integrity and the accountability of board of directors in publicly held companies (Maaessen, 2002; 124).

The report of Cadbury Committee published in December 1992 by the Cadbury Committee derived its name from Sir Adrian Cadbury who chaired the committee. By following this report, the Hampel Committee was set up in November 1995 and issued its final report in 1998 which highlighted the need for corporate governance to be based on principles. Additionally, the Greenbury Report and Code of Best Practice on the determinants of director's remuneration were issued in July 1995. These three codes aimed to improve corporate governance in the U.K. Then, the Combined Code (1998), providing a set of principles and codes to embrace the Cadbury, Greenbury, and Hampel recommendations, was published by the Hampel Committee (Short et al., 1999; 337).

First set of international corporate governance standards are discussed and adopted by the OECD member countries. The OECD formed the Business Advisory Group in 1996 and published a set of core principles of good corporate governance (Iskander and Chamlou, 2000; 19).

Accordingly, several key historical events have contributed to the recognition of the importance of corporate governance. Through globalization, countries have learned from each others' best and worst practices. Today, both developed and developing countries are improving their corporate governance frameworks.

1.2. Corporate Governance Systems

All countries and economic systems have the problem of principal-agent costs and each has a distinctive set of rules to deal with this problem. Significantly, corporate governance models differ in their business framework as companies in different countries are operated under different cultures, legal and economic systems. Firms in the United States (U.S.) and the United Kingdom (U.K.) significantly rely on legal protection of investors. In much of Continental Europe as well as in Japan, there is less reliance on legal protections and more reliance on large investors and banks (Shleifer and Vishny, 1997; 769).

Despite differences between countries, it is possible to identify two distinctive patterns denominated in world economies – market-based and relationship-based systems as grouped by Rajan and Zingales (2003). Market-based system also goes by such names as the outsider system, Anglo-American system, or stock-market capitalism whereas the relationship-based system goes by names as the insider system, the dedicated-capital system, and welfare capitalism (Jacoby, 2001; 2). Corporate governance systems of the U.S. and the U.K. are examples of a market based system whereas the systems of Germany and Japan are examples of a relationship-based system.

Market-based system is characterized by the arm's length relationships between corporations and inventors. This system is one in which equity is a relatively important form of corporate finance; corporate shares are widely held and easily traded; and shareholders have right to elect the board of directors because of their status as the corporation's residual claimants. On the contrary, relationship-based system is one in which shareholding is more concentrated, with large

proportion of shares held by banks, other corporations, and families; and debt financing is commonly used (Jacoby, 2001; 3).

Besides, there are two important distinctions between those two systems. First distinction is their different degrees of reliance on legal enforcement. Relationship-based systems can survive in environments where laws are poorly drafted or contracts not enforced. By contrast, those are a pre-condition for the viability of a market-based system. Another distinction between the two systems is the relative importance of transparency. Market-based system requires transparency as a guarantee for protection whereas relationship-based system is designed to preserve transparency (Rajan and Zingales, 2003; 571).

The market-based system of the U.S. and the relationship-based systems of Japan and Germany have been most often compared and contrasted since those are the best representatives of these two types of corporate governance systems as stated by Iskander and Chamlou (2000; 6). In particular, the main focus of each system is different. The U.S. system highlights the role of a free market while the Japanese system emphasizes business networks. In the German system, the corporation is emphasized over market.

Additionally, in terms of measure of corporate governance effectiveness, those systems are different, too. Corporate success is measured by return on invested capital in the U.S., by returns on social capital in Japan, and by returns on human capital in Germany (Rubach and Sebora, 1998; 169). The comparison of those systems is exhibited in Table 1. As seen from this table, there is also a difference in participant claim ranking. Claims' ranking of six groups of participants including individuals, institutional investors, businesses, banks, employees, and the government varies according to the systems. The claim of individuals, business networks, and banks come first in the U.S., Japanese, and German corporate governance systems, respectively.

Neither system provides a perfect corporate governance mechanism to reduce agency costs as each one has its own strengths and weaknesses as also summarized in Table 1. The U.S. system offers continuous discipline and transparency. On the other hand, it is argued that market for corporate control is inefficient to act quickly and it is costly. In Japan and Germany, relational system provides an effective monitoring system through direct owner influence and multiple risk aversion. On the other hand, it reduces the firms' ability to cope with changes (Rubach and Sebora, 1998; 177).

Table 1: Comparison of Corporate Governance Systems

	U.S.	Japan	Germany
Strengths	Continuous discipline	Reduction of opportunism	Multiple risk aversion
	Transparency	Direct owner influence	Mutual benefit
Weaknesses	Inefficient	Resistance to change	Slow to react
Participant Claim Ranking	Individuals	Business network (Keiretsu)	Banks
	Institutions	Banks (main bank)	Business network
	Business network	Government	Employees
	Employees	Institutions	Government
	Government	Individuals	Individuals
	Banks	Employees	Institutions
Governance Focus	Capital market	Transaction Network	Corporation
Measure of Governance Effectiveness	Return on financial capital	Return on social capital	Return on human capital

(Source: Rubach and Sebora, 1998; 169, 171)

With the integration of world financial markets, the question of whether there can be one corporate governance system that serves best for business operations of all countries is arisen. Therefore, convergence of corporate governance systems is born from collective advantages of systems. In addition, global providers of market finance are increasingly demanding uniform standards of corporate governance. Every model has its own limitations and ineffectiveness which force nations to adapt

a single efficient form. Convergence in corporate governance systems is still continuing and both models seem to be in convergence.

1.2.1. Market-Based Corporate Governance Systems

The market-based systems are found in the U.S. and the U.K. The characteristic features of this model include dispersed equity ownership with large institutional holdings, the recognized primacy of shareholder interests in the company law, a strong emphasis on the protection of minority investors in securities law and regulation, and relatively strong requirements for disclosure. In general, the widely dispersed groups of individual and institutional investors own the equity in these countries (Nestor and Thomson, 2000; 5).

In this system, equity is a relatively important form of corporate finance. Additionally, this system depends on the dispersed ownership styles. The U.S. and the U.K. are best representatives of this corporate governance system. In those countries, many companies are listed and their shares are publicly traded. So that, shareholders split their money into lots of companies which represents only small percentages of an enormous of capital. Additionally, the sizes of the companies are huge and owning large percentages requires huge capital investments which is almost impossible for investors (Ooghe and Vuyst, 2001; 5).

For the U.S., the ideal type is the equity ownership dispersed among a multitude of small stockholders. A degree of control over management is provided by the market for control such as proxy contexts, hostile takeovers, and leveraged buy-outs. There are also legal rules to impose managers to fulfill fiduciary duties meaning acting in the best interests of stockholders in the condition of conflict of interests. The requirements of information for monitoring and market exchanges resulted in a governance system focused on disclosure of corporate actions and transparency in financial practices (Scott, 2003; 528).

On the other hand, institutional investors play an important role in market-based corporate governance systems. Adams (2003; 740) states that ownership has become more concentrated into the control of large institutional investors in the U.S. after 1990s with the evolution of American corporations. Therefore, shareholders get power to influence and improve the performance of firm with the increasing concentration of the institutional investors leading to effectively governed firms.

1.2.2. Relationship-Based Corporate Governance System

Relationship-based systems are usually bank-centered. Firms are mainly financed by debt and thus have high debt/equity ratios. As well, banks tend to have more complex and longer term relationships with corporate clients. Capital markets are in general less developed compared to the market-based systems (Nestor and Thomson, 2000; 10).

The stakeholder or relational system is one in which shareholding is more concentrated, with large blocks held by banks, other corporations, and families. In other words, it is characterized by large groups of related corporations like the Japanese Keiretsu, Korean chaebol, or European holding company structures (Gilson, 2000; 1). There is greater reliance on debt financing and a governance role for banks. Japanese and German systems are founded on relationship-based system.

In German corporate governance, banks have a dominant role. Additionally, share ownership is heavily concentrated and over half of shares are owned by non-financial companies, banks and insurance companies (Jürgens and Rupp, 2002; 4). German shareholders are relatively small in number, own large voting blocks of stock in corporations, and have long-term interests in the corporation. The principal advantage of the German system is the management accountability just as in Japan. Since German banks are allowed to hold large blocks of stock and to place their representatives on a corporation's governing board; they are able to exercise direct influence on corporate decision making (Adams, 2003; 763).

In Germany, there is worker's co-determination which has strong influence on management-labor relations. It refers the active participation of employees in the decision making process of firms. Worker's co-determination is executed through a dual board structure. Co-determination on the work council represents the plant level, and union representation on supervisory boards represents the firm level (Reinecke, 2004; 7). The main goal of the corporation is to promote interests of all stakeholders rather than maximizing its profits for the benefit of shareholders.

In Japan, there is "keiretsu" which is a group of companies linked by cross-shareholdings and seller-buyer relationships. The Japanese governance system is characterized by its heavy reliance on debt financing. To obtain financing, Japanese corporations rely on their connections with *zaibatsu* – industrial conglomerates (Adams, 2003; 747). There is also close and continuous bank-firm relationship so-called "main bank system". A parent company and main bank monitor the performance of managers and intervene in the case of financial distress. Main bank system enables corporations to efficiently obtain financing, to maintain efficient business operations by disciplining corporations, and assist corporations to invest in riskier projects (Okabe, 2004; 9).

1.2.3. Convergence of Corporate Governance Systems

In the last decades, globalization has affected financial markets to integrate through the world and create market for investors. Market-based and relationship-based systems have been converging to each other to create a corporate governance system that serves best for all investors all over the world. This convergence is evident in both developed and developing nations.

Convergence process has started with the integration of capital markets during the 1990s. In those years, firms entered to the U.S. equity market in order to take advantage of prestige and potential funds in this market by meeting listing requirements. Therefore, governance systems of continental Europe and Japan became more like Anglo-American system. On the other side, U.S. investors have

demanded stronger protection for their investments in other countries and are trying to build U.S. style capital markets and demand market-based corporate governance system (Jacoby, 2001; 11).

Another force for convergence has been economic stagnation in Europe and Japan when there has been economic growth in the U.S. The combined result has been concluded in changes in governance systems more along Anglo-American style. In Germany and Japan, during 1990s, there occurred structural changes in corporate governance systems, such as those permitting shareholder class-action suits and stock repurchases by corporations. Furthermore, financial deregulation and the growth of foreign ownership are forcing Japanese managers to pay greater attention to shareholders and have induced voluntary changes such as smaller boards of directors. Another driving issue in governance reform in Japan and Europe has been the aging of the population. Increased interest in pension funds and higher returns on equity investments has led regulating bodies to make reforms towards a market based systems (Jacoby, 2001; 12).

In other words, global providers of finance demand uniform standards of corporate governance. This is the key driver for corporate governance convergence. The OECD Principles of Corporate Governance is the first conceptual framework for policy makers, companies, and others around the world. Convergence occurs in both sides – market-based and relationship-based systems. Global convergence does not at all mean global uniformity of corporate governance norms and behaviors. It means that investors and corporations are able to increasingly trust one another across national borders, by respecting and learning from each other (Nestor, 2007; 60).

According to Macey (2003; 603), there is no consensus about generally accepted criteria in the determination of which particular system of corporate governance is best. Nestor and Thompson (2000; 23) also provide that convergence does not mean victory of one system over another. In fact, it is giving more choices to firms based on their needs and characteristics.

There is harmonization and modernization progress in both corporate governance principles and company laws of European Union (EU) countries. The Company Law and Corporate Governance Action Plan have been adopted or are in the process of adoption (Single Market News, 2006; 11). Short term priority of the Action Plan is to promote good governance practices throughout the EU. The article provides that there is a market driven trend towards convergence in Europe and policymakers also believe that there is no one-size-fits-all approach. Therefore, they are organizing European Corporate Governance Forum (ECGF) in order to promote convergence. Their objective is to establish the "comply or explain" approach principle which is dependent on the appropriate regulatory framework. The corporate governance statement which explains areas of compliance as well as the reasons for non-compliance is the fundamental issue (Single Market News, 2006, 12).

There are three things that would have to happen for convergence of American, German, and Japanese systems as depicted by Macey and Miller (2003). First, German and Japanese banks would have to decrease their concentrated levels of share ownership in order to promote more liquid capital markets and the development of a market for corporate control. Second, the control over corporate funding currently enjoyed by German and Japanese banks would have to diminish in order to facilitate the development of capital markets. And finally, patterns of concentrated share ownership would have to emerge in the U.S. (Macey and Miller, 2003, 566).

As depicted by Khanna et al (2002; 6), functional convergence in corporate governance systems is less costly to improve corporate performance by working within current institutions than creating new institutions. Furthermore, Gilson (2000; 32) discusses three types of corporate governance convergence including functional, formal and contractual convergences. *Functional* convergence is existed when governance institutions are flexible enough to respond to the demands of changing circumstances without altering the institutions' formal characteristics. For example, all countries are equally sensitive to poor performance and the system finds a way to replace poorly performing managers. Stock market information and external pressure

in the U.S., bank monitoring in Germany and Japan solve that problem which is an example of functional convergence *Formal* convergence is occurred when an effective response requires legislative action to alter the basic structure of existing governance institutions. And, *contractual* convergence is stated where the response takes the form of contract because existing governance institutions lack the flexibility to respond without formal change, and political barriers restrict the capacity for formal institutional change. The study concludes that all three types of convergence occur based on the diversity of circumstances (Gilson, 2000; 12, 32).

There are signs of change in relationship-based systems. There is a general movement for more disclosure of both financial and investor related information in Germany and Japan. Liberalization and internalization in Japanese financial markets resulted in more reliance on equity financing rather than debt financing. Market-based corporate governance system has begun to penetrate in Japan. Practices of managerial compensation and few hostile takeover bids and slow trend toward ending "life time employment" have taken place in Japan. Furthermore, ongoing economic, slowdown has made long-term cross-shareholding arrangements difficult to maintain (Yafeh, 2000; 82).

The changes are not happening only on the relationship based systems. Market based systems are also going through change converging towards relationship based systems. Institutional investors are beginning to play a more significant role in Anglo-American systems. As Macey (1997; 601) states in his study, scholars have suggested that institutional investors are the group most likely to resolve America's corporate governance problem. Institutional investors have increased both their overall holdings and the concentration in the U.S. market. This concentrated ownership allows them to take more active roles in corporate governance. In addition, as depicted in the study of Aguilera and Cuervo-Cazurra (2004; 430), the number of the U.S. styled institutional investors have increased in international markets with globalization and growth in financial markets. Then, the increasing power of these institutional investors searching for worldwide investment opportunities has led the need for effective governance.

American firms are also adopting long-term relational investing strategies already common in Japan and Germany (Rubach and Sebora, 1998; 178). The U.S. governance system has begun to recognize interests of non-shareholders including employees, customers, creditors, suppliers, and local communities. Through employee stock ownership plans (ESOP), employees have rights to own company's share (Gray and Hanson, 1993; 15).

In conclusion, the convergence in corporate governance in both relationship-based and market-based systems is evident. There will be improvements in countries' governance by adopting features of corporate governance employed in other countries.

1.3. Corporate Governance Principles

There is no one model of corporate governance that works in all countries and all companies. In fact, there are many different codes of "best practices" in individual countries (Standards and Poor's, 2002; 1). Parallel to this argument, Gregory (2000; 18) states that the international agreement on a single model of corporate governance or a single set of detailed governance rules is both unlikely and unnecessary.

Auguilera and Cuervo-Cazurro (2004) defines codes of good governance as a set of best practice recommendations concerning the behavior and structure of the board of directors of a corporation. Fundamentally, there are two objectives of codes consisting to improve the quality of companies and to increase the accountability of companies to shareholders. Codes include set of norms on the role and composition of the board of directors, relationship with shareholders and top management, auditing and information disclosure, and the selection, remuneration, and dismissal of directors and managers (Auguilera and Cuervo-Cazurro, 2004; 419).

Numerous private sector and government related organizations, institutional investors, and capital markets have become active players in corporate governance reform. The first code of corporate governance was issued in the U.S. in the late

1970s entitled “The Role and Composition of Directors of the Large Publicly Owned Corporations” by business roundtable. The Securities Exchange Commission, the New York Stock Exchange, and the Roundtable have issued codes since the late 1970s in the U.S. Some countries followed the U.S., nevertheless, the development of codes grew rapidly in the early 1990s following the 1992 Cadbury Committee Report. This report has become a benchmark best practice for both companies and stakeholders in the world (Auguilera and Cuervo-Cazurro, 2004; 420, 421).

The Hampel Report, issued in 1998, effectively consolidated the Cadbury and Greenbury advice into a Combined Code. U.K. companies have reported under the Combined Code on corporate governance for the first time in 1999 (Iskander and Chamlou, 2000; 90).

Furthermore, Sarbanes–Oxley Act of 2002 in the U.S. provides the way public companies do business and how the accounting profession performs required audits. It has also strengthened the role of existing supervisory boards. Securities Market Commission perceives effective audit committees as an essential element of an efficient securities market. Under the provisions of Sarbanes–Oxley Act of 2002, audit committee must be independent. As well, this act includes provisions regarding to corporate governance stated in section 303A (Rezaee, 2005; 285).

In general, good corporate governance practices try to ensure that (CFA Centre for Financial Integrity, 2005; 7):

- Board members act in the best interest of shareholders;
- The company acts in a lawful and ethical manner in its dealings with all stakeholders and their representatives;
- All shareholders have the same right to participate in the governance of the company and receive fair treatment from the board and management, and all rights of shareholders and other stakeholders are clearly delineated and communicated;

- The board and its committees are structured to act independently from management, individuals or entities that have control over management, and other non-shareholder groups;
- Appropriate controls and procedures are in place covering management's activities in running the day-to-day operations of the company; and
- The company's operating and financial activities, as well as its governance activities, are consistently reported to shareholders in a fair, accurate, timely, reliable, relevant, complete and verifiable manner.

1.3.1. OECD Principles

The OECD Principles of Corporate Governance were endorsed by OECD Ministers in 1999 and have since become the international benchmark for policy makers, investors, corporations and stakeholders worldwide. The principles are intended to assist OECD and non-OECD governments in their efforts to evaluate and improve the legal, institutional and regulatory framework for corporate governance in their countries (OECD, 2004a; 11).

The OECD principles are guidance and suggestions for all parties involved in the corporate governance process. Publicly traded companies both financial and non-financial are the primary focus of these principles. However, principles are also useful and applicable for non-traded companies. According to the OECD (2004a; 11), corporate governance is one key element in improving economic efficiency and growth as well as enhancing investor confidence. Additionally, proper functioning of a market economy is gained through a degree of confidence obtained from the presence of an effective corporate governance system.

Some common elements that underlie good corporate governance have been identified by the OECD and non-OECD countries. OECD standards firstly define a basis for effective corporate governance framework and continue with principles of governance. In the principles, six areas of concern are covered: (1) Ensuring the

basis for an effective corporate governance framework, (2) the rights of shareholders, (3) the equitable treatment of shareholders, (4) the role of stakeholders in corporate governance, (5) disclosure and transparency, and (6) the responsibilities of the board as summarized in Table 2 (OECD, 2004a; 14).

Millstein Report (1998) issued by the Business Sector Advisory Group on Corporate Governance provides the common principles of corporate governance from a private sector point of view. It focuses on four core standards – fairness, transparency, accountability, and responsibility. According to Millstein Report, as stated by Gregory (2000; 13), fairness is achieved by ensuring both the protection of shareholder rights and the enforceability of contracts with resource providers. Transparency is accomplished by requiring timely disclosure of adequate, clear and comparable information concerning corporate financial performance, corporate governance and corporate ownership. Accountability involves the clarification of governance roles and responsibilities, and supports the voluntarily efforts to make sure that managerial and shareholder interests are aligned. Lastly, responsibility is achieved by ensuring corporate compliance with other laws and regulations that reflect the respective society's values.

Accordingly, OECD Principles are built on those four core standards as set out in Millstein Report (Gregory, 2000; 11). The concepts of fairness in Principle I and II, responsibility in Principle III, transparency in Principle IV, and accountability in Principle V are covered by the OECD Principles.

Table 2: The Summary of OECD Corporate Governance Principles

OECD CORPORATE GOVERNANCE PRINCIPLES	
I. Ensuring the basis for an effective corporate governance framework	The corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities.
I. The rights of shareholders	The corporate governance framework should protect and facilitate the exercise of shareholders' rights.
II. The equitable treatment of shareholders	The corporate governance framework should ensure the equitable treatment of all shareholders, including minority shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.
III. The role of stakeholders in corporate governance	The corporate governance framework should recognize the rights of stakeholders as established by law and encourage active cooperation between corporations and stakeholders.
IV. Disclosure 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.
V. The responsibility of the board	The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board's accountability and loyalty to the company and the shareholders.

(Source: Summarized from OECD Corporate Governance Principles, 2004a)

1.3.2. Corporate Governance Principles in Turkey

Parallel with the corporate governance practices in the world, there are two corporate governance principles in Turkey. First code was issued by Turkish Industrialists' and Businessmen's Association (TUSIAD) and launched in December 2002 named *"Corporate Governance Code of Best Practice: Composition and Functioning Board of Directors"*. This code is focused on the functions and responsibilities of the board. Second code was developed by Capital Market Boards

of Turkey (CMB) in June 2003 and amended in February 2005. The CMB examined worldwide recommended principles and prepared those principles based on primarily the "OECD Corporate Governance Principles" of 1999 together with the particular conditions of our country. Four areas are focused on (1) shareholders' rights and responsibilities, (2) disclosure obligations and transparency, (3) the role and responsibilities of stakeholders, and (4) the role and responsibilities of the board of directors as depicted in Table 3 (CMB Corporate Governance Principles, 2005; 8).

Table 3: The Summary of CMB Corporate Governance Principles

CMB CORPORATE GOVERNANCE PRINCIPLES	
I. Shareholders	1. Facilitating the exercise of shareholders' statutory rights 2. Shareholders' right to obtain and evaluate information 3. The right to participate in the General Shareholder's Meeting 4. Voting rights 5. Minority rights 6. Dividend rights 7. Transfer of shares 8. Equal treatment of shareholders
II. Public Disclosure and Transparency	1. The principles and means for public disclosure 2. Public disclosure of relations between the company and its shareholders, the board of directors and executives 3. Periodical financial statements and reports in public disclosure 4. Functions of external audit 5. The concept of trade secret and insider trading 6. Significant developments that must be disclosed to the public
III. Stakeholders	1. The company policy regarding stakeholders 2. Stakeholders' participation in the company management 3. The protection of company's assets 4. The company policy on human resources 5. Relations with customers and suppliers 6. Ethical rules 7. Social responsibility
IV. Board of Directors	1. Fundamental functions of the board of directors 2. Principles of activity and duties and responsibilities of the board of directors 3. Formation and election of the board of directors 4. Remuneration of the board of directors 5. Number, structure and independence of committees established by the board of directors 6. Executives

(Source: CMB Corporate Governance Principles, 2005; 3)

The principles mainly address publicly held joint stock companies. However, it is considered that other joint stock companies and institutions, active in private and public sectors, may also implement these principles. The CMB Principles are "comply or explain" basis. In addition to these, the CMB has designed a *"Corporate Governance Compliance Report"* which must be included in the 2005 annual reports of all listed companies. Under the new CMB requirements, company boards must have an audit committee chaired by a non-executive board member and composed of a majority of non-executive members.

1.3.3. Comparison of Corporate Governance Principles

Corporate governance principles of OECD and CMB of Turkey are compared and summarized by using the OECD principles as a comparison base for CMB Principles. The primary sources of corporate governance regulations in Turkish Law are Turkish Commercial Code of 1956 (TCC), the Capital Markets Law (CML) of 1981 (applicable to listed companies), Corporate Governance Principles (applicable to listed companies), and regulations issued by the CMB (World Bank Group, 2007; 5).

1.3.3.1. The Rights of Shareholders and the Equitable Treatment of Shareholders

The protection of shareholder rights is one of the key principles for effective corporate governance. Basic shareholder rights should include the rights to (OECD, 2004a; 18):

1. secure methods of ownership registration;
2. convey or transfer shares;
3. obtain relevant and material information on the corporation on a timely and regular basis;
4. participate and vote in general shareholder meetings;

5. elect and remove members of the board; and
6. share in the profits of the corporation.

Share registration allows interested parties and other shareholders to identify registered security holders in addition to the type, nominal value and amount of securities they own. The effective protection of shareholder's ownership rights are maintained through consistent efforts by stock exchanges and securities commissions through monitoring and enforcing registration (OECD, 2004b; 30). In Turkey, company's article of association is the main document governing shareholder rights. These rights are strengthened by provisions of the Capital Market Law (World Bank Group, 2007; 5).

Shareholder meetings have a role to play as a mechanism for informing all shareholders and enabling them to participate in the deliberations and voting on agenda items. The minimum notification period is stated in the company law and the information relating to agenda items should also be sent to the shareholders or be easily accessible. All shareholders have the right to participate and vote in shareholder meetings. In general, the principle of one share of common stock one vote is applicable around the world. However, non-voting shares are also widely used. Shareholders are permitted to vote in person and through proxies (OECD, 2004b; 31).

The CMB issued a Communiqué that outlines proper procedures for proxy voting. In Turkey, there is no mandatory restriction on either non-voting shares or shares that carry multiple voting rights. Furthermore, under the Turkish Commercial Code, meeting notices and all relevant documents should be provided to shareholders at least 15 days in advance of all shareholders' meeting (Institute of International Finance Task Force, 2005; 12). The right to receive dividend is the basic shareholder right. Dividend distribution decision is generally made in the competence of the general shareholder meeting. To sum up, shareholder awareness has slightly improved in countries in which specific programs have been put in place for informing shareholders about their rights.

1.3.3.2. The Role of Stakeholders

Stakeholders include employees, suppliers, customers, creditors and the government. Good employee relation is resulted in increased motivation, reduced turnover, and encouraged workers to acquire skills that benefit the company. The corporate governance should have mechanisms to constructively bring employees into the wealth creation process (OECD, 2004b; 63).

Bank loans, bonds, and other kinds of credit are normally the primary source of external funds for companies. In addition to providing loans, creditors can also develop long-term relationships with companies by providing long-term capital. They can also act as effective monitors of corporate governance (OECD, 2004b; 65).

Companies should ensure the legal rights of all their stakeholders, not just creditors and employees. Improving the treatment of stakeholders is important for achieving an effective governance system.

The TCC or the CML do not contain specific provisions governing the role of stakeholders. However, the CMB Principles propose the participation of stakeholders in the management and corporate governance process.

1.3.3.3. Disclosure and Transparency

Full, accurate and timely disclosure is essential for good corporate governance. A strong disclosure regime is a central element of accountability with improving the way a business is managed and enhancing its efficiency and growth (OECD, 2004b; 41).

Fair and timely information is important for both boards of directors and decision-makers outside the company. The board of directors makes good decisions and enhances company performance and effectiveness by reviewing timely and

accurate information and achieves corporate accountability. Shareholders, investors and lenders use accurate, timely, and relevant information in their investment decisions. Regular financial reporting enables investors to obtain such information. Not only financial information is valuable to assess a company's performance and governance but also non-financial information is relevant to understand the company from financial, governance, and operational sides.

The legal framework of Eurasian countries requires companies to disclose material information to public. The materiality refers the information whose omission or misstatement could influence economic decisions (OECD, 2004b; 44). Under the provisions of the CMB Principles, members of boards and service management, and shareholders owning 5% or more of equity capital must provide information to the CMB in Turkey (Institute of International Finance Task Force, 2005; 15).

Regarding to corporate governance, companies are also generally expected to disclose key information related to directors, shareholding in the company and its subsidiaries. In addition, financial information is disclosed through annual reports and audited financial statements. The harmonization of standards of accounting and auditing in countries is crucial for financial results to be understood across national boundaries. Auditing of annual account is generally required for listed firms to obtain reasonable assurance about whether the annual accounts are free of misstatement.

In recent years, Eurasian countries have either adopted national accounting standards based on International Financial Reporting Standards (IFRS) or modified their accounting standards based on IFRS (OECD, 2004b; 43). According to the CMB principles in Turkey, all listed companies use standards that are similar to IFRS and present audited financial statements on a semi-annual basis (Institute of International Finance Task Force, 2005; 16).

1.3.3.4. The Responsibilities of the Board

The board plays a central role in developing the strategy of the company and overseeing its management. The board should be big enough to have a range of skills and specific financial, legal and industrial knowledge and include enough independent non-executive board members to avoid conflict of interest (OECD, 2004b; 55). In Turkey, board members can be nominated only by shareholders and only during the general meeting.

Listing requirements and OECD Corporate Governance Principles require independent boards and board members. Independent is defined as independent from significant and especially controlling shareholders. Exercising objective judgment and provision of informed opinions independent of the desires of particular shareholders are achieved through independent directors.

The CMB Principles in Turkey state that a majority of the board should be non-executive and at least one-third should be independent. There is also a requirement that companies should have an audit committee consisting of a minimum of two non-executive directors (CMB, 2005; 51, 52).

Duties and responsibilities of Board of Directors under Turkish Law are as follows (Paksoy and Aziz, 2007; 6):

- Acting in the best interest of company;
- Acting in good faith;
- Loyalty;
- Drafting annual financial statements;
- Reporting on the business to the shareholders;
- Proposing dividend resolutions;
- Calling shareholders' meetings;
- Implementing of decisions taken at shareholders' meeting;

- Informing the court of the district where the company is registered if the company's liabilities exceed its assets;
- Review decisions taken by previous board members and taking any necessary measures to rectify the wrongful transactions;
- Insuring administrative and financial control of the corporation;
- Insuring legal compliance of the internal and external practices, activities, and the behavior of the corporation;
- Developing and monitoring the implementation of corporate governance practices for listed companies (recommended under the CMB Principles).

In this chapter, corporate governance systems and principles are discussed briefly. Different systems, structures and codes aim to achieve and maintain the same objective: effective corporate governance.

CHAPTER II

CORPORATE GOVERNANCE MECHANISMS AND CORPORATE GOVERNANCE IN TURKEY

The mechanisms of corporate governance define structures and rules forming the system. In other words, they define the relationship among the key players in the corporation and external forces that govern the behavior and performance of the corporation. In this chapter, two principal governance mechanisms, internal and external, are given in detail. Then, corporate governance in Turkey is discussed following the same framework. Finally, the present condition in Turkey is summarized.

2.1. Corporate Governance Mechanisms

There are two principal mechanisms to protect stockholders rights – one is the law and the other is governance. Law sets fiduciary rules that require managers to act in the best interests of stockholders. Corporate governance includes mechanisms forming the system of relationship between boards, shareholders, and stakeholders, and is the balance between divided and separate interests of different groups. Obviously, corporate governance is an issue mainly for minority shareholders in companies that are controlled by managers and in which there are no significant stockholders (Scott, 2003; 510).

Corporate governance is needed for three reasons. First, the incomplete nature of corporate contracts creates a need for rules to decrease risks and contingencies that confront investors. Second, corporate governance provides set of rules to monitor managers affectively and decrease the agency problem. Lastly, the properly functioning corporate governance system is needed to protect the firm specific investments made. Such system provides firms and individuals with necessary incentives to make such investments (Macey, 2003; 581).

Corporate governance provides a structure that defines the rights, roles and responsibilities of different groups through internal and external mechanisms. As Denis (2001; 197) depicted, Jensen (1993) divides corporate governance mechanisms into four as follows:

1. Legal and regulatory mechanisms
2. Internal control mechanisms
3. External control mechanisms
4. Product market competition

In this study, corporate governance mechanism is analyzed in two groups consisting internal and external mechanisms. Then, each one is divided into sub-groups. Internal mechanism comprises subjects related with board of directors and ownership structure whereas external mechanism comprises the market for corporate control, legal and regulatory structure, and product market competition as depicted in Figure 2.

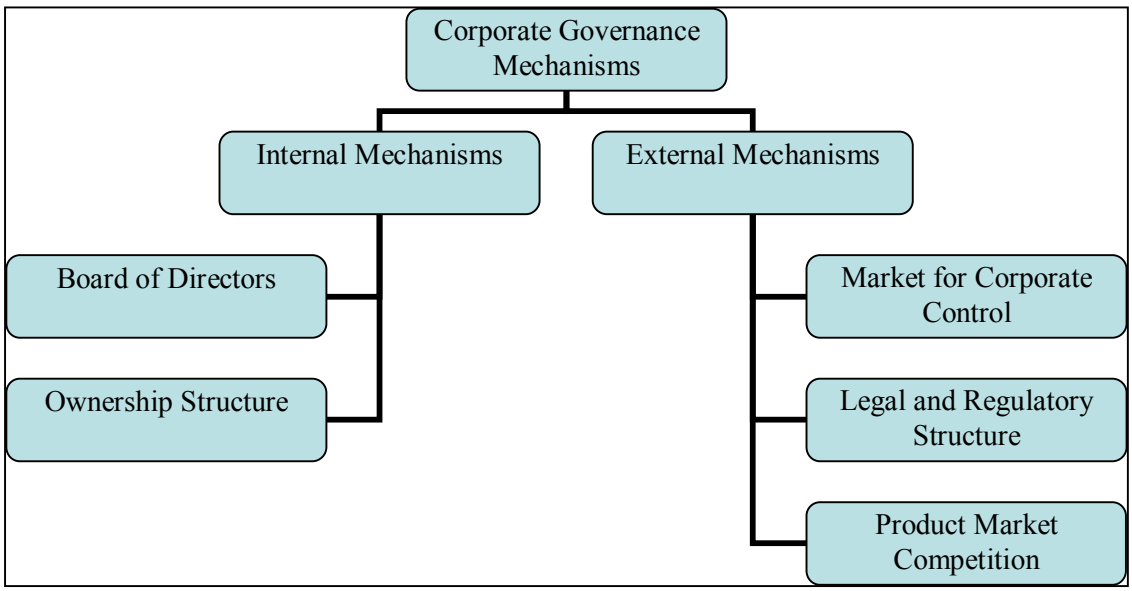


Figure 2: Corporate Governance Mechanisms

2.1.1. Internal Corporate Governance Mechanisms

Corporate governance can be seen as a set of provisions internal to the firm which defines the relationship between managers and shareholders. The board of directors is at the center of this system. Its responsibilities include maintaining the going concern of the firm and monitoring the actions of the management. A well governed corporation should balance the roles and the power of three groups of players including shareholders, the board of directors, and managers (Iskander and Chamlou, 2000; 20). Internal provisions are necessary for an efficient system. Moreover, governance problems that need to be addressed vary according to ownership types and then it is another issue of concern in the mechanism.

2.1.1.1. Board of Directors

The cornerstone of corporate governance mechanisms is the board of directors whose duty is to represent shareholders. Their role is to achieve and maintain business success and long term shareholder value while sustaining an effective governance framework. Board of directors is responsible for overseeing the conduct of the company's business and to act in the best interests of the company and shareholders. They oversee management's decisions regarding growth strategies and policies, and regularly evaluate its performance. In other words, the board of directors is the connection between management and owners and other stakeholders.

A board is selected by shareholders and acts collectively, and exists to make key corporate decisions and supervise the management. There exist one-tiered and two-tiered systems among countries (Maessen, 2002; 15). One-tiered system includes only one board consisting executive, non-executive, and independent members. Members of the board operate together in one organizational layer. It can have a board leadership style such as Chief Executive Officer (CEO) and chairperson. The best examples are seen in the U.S. and U.K. On the other hand, certain European countries – Germany, Australia, Netherlands, and Denmark – have a two-tiered board system. This system has two separate boards – management and supervisory.

The management board is composed of executives of the corporation and the supervisory board is composed of non-executives elected by the shareholders. The supervisory board selects the members of the management board and assures their accountability to corporate goals and governance regulations (Maessen, 2002; 15).

Board size and composition affects the effectiveness of the board of director's role in monitoring and guiding. As depicted by Lasfer (2002; 7), it has been argued that large boards are less effective than small boards since it is more difficult for CEOs to dominate larger boards. On the other hand, there are also disadvantages associated with larger boards such as poorer communication, decision making, and processing of information.

To function most effectively, the governed corporation model requires independent, outside board of directors who are experts in the complexities of the company, in finance, in industry, and in financial structures. Accordingly, the Higgs Report (2003; 2) addresses more demanding and important role for non-executive directors and focuses on directly on the effectiveness of their role in promoting firm performance as well as accountability.

Qualitative evidence over the years also shows that ineffective monitoring by boards has been caused by the predominance of inside directors. With the recognition of this fact, more boards are becoming composed of a majority of independent directors in order to increase the board's effectiveness (Adams, 2003; 730). Hence, international institutional investors are increasingly require more independent non-executive directors on corporate boards by the globalization of financial markets (Iskander and Chamlou, 2000; 97).

The corporate governance requires committees formed from members specialized on special issues. In general, these are executive, audit, executive remuneration, and nomination committees. Executive committee is responsible for daily management supervision. Audit committee supervises a company's internal audit procedures and interacts with the external statutory auditor to ensure full

financial compliance. Executive remuneration committee decides the appropriate compensation package for the company's executive directors. Lastly, nomination committee conducts a systematic search appropriately qualified and non-executive directors. In addition, the independence of those committees are considered important and a base for an effective governance system (Iskander and Chamlou, 2000; 99).

So far, the board of directors which is at the center of corporate governance system is discussed. Understanding the criteria for effective board of directors will help to analyze its impact on firm value.

2.1.1.2. Ownership and Control Structure

The ownership structure of a firm and its financing resources have an impact on the design of corporate governance systems. Additionally, one of the most important ways through which a firm maximizes its value is through well-designed ownership structure of the firm's shares. Villalonga and Amit (2004; 29) provide that family ownership creates firm value only when it is combined with certain forms of family control and management. Moreover, Lins (2003) finds out that management ownership structures and large non-management blockholders are related to firm value.

Zheka (2003; 7) gives the definition of ownership structure as the distribution of equity with regard to votes and capital but also the identity of the equity owners. It includes inside as well as outside owners. Managers and employees can have shares as inside owners whereas individuals, organizations, and states can have shares as outside owners. Structure of ownership significantly influences the financial performance of the company through decision making procedures and performance-monitoring systems (Zheka, 2003; 7-8).

La Porta, Lopez-de-Silanes and Shleifer (1999; 19-28) provide the comparison of ownership of large and medium sized companies across countries.

They find that many firms in the world have a controlling shareholder, usually Family or State. Family business group refers that a single individual or families control a large number of firms. It is generally formed through pyramidal structures. Pyramidal business group or pyramid is a structure in which the main shareholder, usually a wealthy family, controls a single company, which may or may not be listed. Then, this company holds control blocks in other listed companies. Additionally, a comparison of countries with good and poor shareholder protection show that widely held firms are more common in countries with good protection.

Pedersen and Thompsen (1997) also analyze ownership structures among the hundred largest companies in twelve countries and observe large differences between nations. They also present the argument that these differences would influence corporate governance and business behavior. Furthermore, Peng et al (2004; 1125) suggest that ownership type can be an important variable that managers use to classify firms into different strategic groups. There are also studies in the literature indicating the effects of ownership types on firm value and profitability.

The conclusion is that ownership types vary between countries and all has different structures. Hence, the ownership type is an important variable leading to different corporate governance mechanism frameworks.

2.1.2. External Governance Mechanisms

Internal mechanisms of corporate governance are strengthened by external laws, rules, and institutions. External governance mechanisms consist of the market for control, legal and regulatory structure, and product market competition. Firms are mainly disciplined by the market for corporate control in economies in which market-based corporate governance exists. Legal and regulatory structure reduces agency costs and solves governance problems through greater transparency, compliance mechanisms, and monitoring by regulatory bodies. Competitive product market disciplines the corporations through being effective in operations.

2.1.2.1. The Market for Corporate Control

Takeovers are the primary mechanism to discipline managers through market for corporate control. The takeover market is seen in the U.K. and U.S. as a major mechanism for disciplining underperforming management in contrast to relationship-based systems of Germany and Japan (Short et al., 1999; 345). Similarly, the market for corporate control and proxy fights as corrective mechanism have a limited to no effect when ownership is strongly concentrated, especially in developing countries (Nenova, 2005; 202).

Jensen and Ruback (1983; 608) shows that shareholders in successful targets realize substantial wealth increases, indicating a potential for improved performance, which the previous management had failed to utilize. Meaning that, the management invests free cash flows in more efficient projects when they fear that they may lose their jobs through takeovers.

According to Pendleton (2005) dispersed ownership leads to outsider forms of governance. Therefore, the market for corporate control is a central element of market paradigm in which managers of under-performing firms may be replaced after a change of ownership.

Parallel to the above argument, Schleifer and Vishny (1997; 756) states that, in Britain and the U.S., two of the countries where large shareholders are less common, a particular mechanism for consolidating ownership has emerged, namely the hostile takeover. There is no need to the approval of the board of directors of the target firm. Hostile takeovers target poorly performing firms and replace their managers with rival manager teams. The underlying theory is that outside bidders monitor poorly managed firms since they can profit by buying them and installing better management teams. Then, bidders earn a risk-adjusted market rate of return.

In general, takeovers can occur through merger, tender offer, and proxy contests. The bidding firm makes offers to buy the common stock of the target at a price in excess of the target's previous market value in mergers or takeovers. In particular, mergers are directly negotiated with target managers and approved by the target's board of directors. Tender offers can be made to individual shareholders. Proxy contests involve attempts to gain controlling seats on the board of directors often led by dissatisfied former manager or large stockholder (Jensen and Ruback, 1983; 576).

Takeovers as the market for corporate control provide a tool for replacing the entire internal control system when the internal management imposes large costs on shareholders from dishonest and incompetent managers. Thus, takeovers limit the managerial inefficiencies in the maximization of wealth.

2.1.2.2. Legal and Regulatory Structure

The system of laws and regulations that govern the firm is the most basic corporate governance mechanism outside the firm. The mechanisms of effective corporate governance include the legal and regulatory system, mainly the securities and company laws, and other complementary legislation, including commercial law, contract law, laws on collective investment institutions, bankruptcy and insolvency legislation, competition law, banking and dispute resolution (Yener, 2001; 4).

Investors have certain rights protected through the enforcement of regulations and laws. Those protected rights include those to receive dividends on pro-rata terms, to vote for directors, to participate in shareholders' meetings, to subscribe to new issues of securities on the same terms as the insiders, to sue directors or the majority for suspected expropriation, to call extraordinary shareholders' meeting, etc. (La Porta et al., 2000, 7).

The rights attached to securities become important when managers of companies act in their own interest since these rights give investors the power to extract from managers the returns on their investment. However, those rights depend

on the legal rules of the jurisdictions where securities are issued. Thus, law and quality of its enforcement are important determinants of what rights of security holders have and how well these rights are protected (La Porta et al., 1998; 3).

Corporations also work within a governance framework. That framework is set by law, by regulations, by the corporation's own constitution, by those who own and fund them, and by the expectations of those they serve. The good structure efficiently addresses the entry, operations, and exit of firms. The framework will differ from country to country, since it owes much to history and culture and it involves both rules and institutions.

The adaptation of high quality international auditing and accounting standards by the corporate sector directly impacts transparency and disclosure quality of corporations. The World Bank in recent years improved its external support to international accounting and auditing institutions both public and private (Iskander and Chamlou, 2000; 171).

Company laws and bankruptcy/reorganization laws have provisions for investor protection. Those laws are part of commercial codes in civil law countries whereas they are separate laws in common law countries. Company laws in all countries are concerned with (La Porta et al., 1998; 11):

1. the legal relations between corporate insiders and the corporation itself,

2. the legal relations between the corporation and certain outsiders, particularly creditors.

In general, commercial codes are originated from two broad traditions as common and civil law. The common law derives from English law whereas the civil law derives from Roman law. Within the civil tradition, modern commercial laws are originated from French, German, and Scandinavian laws. In addition, the civil law legal tradition is the most influential and most widely distributed law around the

world. It is mainly based on statutes and comprehensive codes and legal scholars to ascertain and formulate its rules. In contrast, the common law is based on court decisions, on the doctrines implicit in those decisions, and on customs and usages rather than on codified written laws. The common law has spread to British colonies, including the United States, Canada, Australia, India and many other countries (La Porta et al., 1998; 5-10).

La Porta et al. (1998) analyzed the legal rules comprising the protection of corporate shareholders and creditors, the origin of these rules, and quality of their enforcement in 49 countries and addressed three conclusions. First, laws differ around the world. La Porta et al. (1998; 33-34) provide that countries whose legal rules originate in the common law tradition tend to protect investors considerably more than do the countries whose laws originate in the civil law, and especially the French civil law, tradition. Second, law enforcement differs around the world, too. Law enforcement is strong in common law countries whereas it is the weakest in the French civil law countries. Third, countries develop substitute mechanisms for poor investor protection. Substitute mechanisms for poor investor protection are remedial rules and ownership concentration. Remedial rules are mandatory and include rules such as mandatory dividends or legal reserve requirements. Ownership concentration is another substitute mechanism and high around the world. The study of La Porta et al. (1998; 34) indicates that close to half of equity in a publicly traded company is owned by the three largest shareholders.

The conclusion is that strong investor protection is associated with effective corporate governance as stated by La Porta et al. (2000; 24). In particular, the investor protection depends on the legal structure and laws of each country. Hence, corporate governance reforms related to the protection of outsiders has gained importance with the integration of financial markets.

2.1.2.3. Product Market Competition

The firm can be successful in the product market competition if only it produces products at a cost structure that enables it to sell its products at a price that the customers are willing to pay. Meaning, low cost of capital allows corporations to sell products at competitive prices.

As Guadalupe and Perez-Gonzalez (2005; 2) depicted, product market competition improves corporate governance since it would drive inefficient firms out of the market. They provide that product market competition can discipline insiders of publicly traded companies. Similar to this study, Aldrighi (2003; 489) provided that the competition in the product market ensures corporate efficiency since firms whose managers pursue private goals would be driven out of the market. Additionally, the competition may help decreasing companies' agency costs since those costs affect their market share, profitability, and the likelihood of bankruptcy.

As stated by Januszewski, Köke, and Winter (1999; 4), Hermalin (1992) identifies four mechanism of the influence of product market competition on management performance. These are: (1) an income effect of reduced profits in more competitive market, (2) a risk adjustment effect if profit risks vary with the degree of competition, (3) an effect of change in returns to managerial effort, and (4) the effect of improved information in the presence of more rival firms.

2.2. Corporate Governance in Turkey

Corporate governance has become a concern of Turkey with the increased interest in global markets. Turkey is a rapidly growing emerging market. The government and the Capital Market Board (CMB) have been taking strong and stable steps towards attaining international standards in its governance standards. In Turkey, there occurred a series of economic crises in 1994, 1999, and 2001. Since then, Turkey has been following structural reforms with the aim of the establishment

of a deep and strong market economy with all its institutions (Standard & Poor's, 2004; 1).

In Turkey, the state has been the major player since 1923 with the foundation of Turkish Republic, and supported the private sector. According to Global Institutional Investors surveyed by McKinsey the top seven factors for foreign investment decisions in Turkey which are similar to other countries as depicted in Standard & Poor's Country Governance Study (2004; 1, 3) are as follows:

- Accounting disclosure (73% of the investors votes it as the most important factor)
- Shareholder equality (64%)
- Market regulation and infrastructure (55%)
- Takeover markets (45%)
- Property rights (45%)
- Credit information (36%)
- Board independence (27%)

If the financial market is growing as in Turkey, corporate governance needs to be improved in order to give investors the protection required to encourage them to provide capital. Turkey, thus, has realized the importance of corporate governance and began structural changes to improve the existing corporate governance system.

Major institutions in Turkey's capital market are The Capital Market Board, The Istanbul Stock Exchange (ISE), and Takasbank (Settlement and Custody Bank). The Capital Market Law was enacted in 1981 and the CMB was established. Then, ISE was founded in 1986. CMB regulates the actions of ISE. Since 1980s, the number and the size of companies traded on exchange have been increasingly numerously. The number of corporations traded on ISE was 80 by the end of 1986, and it has reached 316 firms by 2006 (Istanbul Stock Exchange, 2006; 6).

The modern capital market of Turkey has only 20 years of history. Market transactions in ISE are highly concentrated with the 25 most actively traded companies. Table 4 indicates the number of companies listed through years. Meaning, ISE is also characterized by a few companies listed.

Table 4: The Number of Companies Listed

	Number of Companies
2000	315
2001	310
2002	288
2003	285
2004	297
2005	304
2006	316

(Source: Istanbul Stock Exchange (ISE), 2006)

Through the process of continuous change in Turkey, combination of laws and regulations has been set forth by governing authorities. The importance of corporate governance issues has been widely recognized and structural changes are still in progress and evolving.

2.2.1. Internal Corporate Governance Mechanisms

The board of directors in Turkey is unitary in its structure and consist at least three members appointed for three years. Under the Commercial Code, board members are elected and dismissed by shareholders in the general assembly. Commercial Code of Turkey does not set any experience and education related criteria. Every person over the age of 18 can be a board member. On the other hand, many companies set their own special laws and regulations for board membership. The duties and liabilities are also governed by the Commercial Code. This states that

members of the board have a general duty of due diligence, care, foresight, and good faith (Institute of International Finance Task Force, 2005; 13).

The board of directors in Turkey is under the control of families. Owner families dominate the boards of Turkish companies and boards are an internal mechanism of control affirming the owners' influence on the company (Yurtoğlu, 2003; 11). Generally, independent members are not included in the boards. Independent board members are seen in joint ventures with foreign companies. However, there is a trend toward the inclusion of independent members to the board.

Kula (2005; 274) investigates the impact of roles, structure and process of boards on performance of Turkish companies. According to this study, separation of chairman and general manager positions has significant positive impact on firm performance. Additionally, resource acquisition role of the board is found as positively related to firm performance.

Business groups in Turkey characterize the ownership types. Business groups are a collection of industrial and financial companies organized under the legal form of a holding company. Yurtoğlu (2003; 16) and Demirağ and Serter (2003; 48) conclude that Turkey can be classified as an "insider system" country, with the insiders being the country's richest families.

Ownership is highly concentrated in Turkey. As depicted by Ararat and Uğur (2003; 14), almost half of the listed companies are controlled by one shareholder who controls more than 50% of voting rights. In particular, individual family members who exercise control through pyramidal structures are ultimate owners of listed companies (Yurtoğlu, 2000; 204). Pyramidal structures are organized under a holding company in Turkey. This means that corporations are affiliated with each other around a holding company. Those companies may be exposed to risk associated with reduced transparency.

Demirağ and Serter (2003; 40-44) also provide that ownership of Turkish companies is highly concentrated and families are the dominant shareholders. The separation of ownership and control among Turkish companies is also achieved through pyramidal ownership structures and the presence of big business groups. Additionally, they provide that the most significant owners of Turkish companies are holding companies, families, non-financial companies, financial companies and foreign companies, respectively. Pyramids and dual class shares are the most common tools to separate cash flow from controlling rights.

2.2.2. External Corporate Governance Mechanisms

Legal and institutional framework for corporate governance in Turkey has improved, especially in the past few years, parallel to the structural reforms carried out in cooperation with the International Monetary Fund (Institute of International Finance Task Force, 2005; 2). According to Standard & Poor's country corporate governance study, Turkey is a civil law country in the French tradition. Commercial Code of Turkey, the main base of corporate governance legislative framework, was originally taken from France and revised with provisions taken from German, Swiss, and Italian Laws.

There is no active market for corporate control in Turkey due to the concentrated ownership types. It is almost impossible to acquire a traded company through a hostile takeover bid since the controlling owner must approve a control change (Yurtoğlu, 2003; 5).

The company's article of association is the main document including rights of shareholders to participate the general meeting, to vote and to acquire information. Significantly, Capital Market Law provides a legislative framework for market activities and CMB activities.

There are differences between Commercial Code, Capital Market Law and Banking Law. Therefore, listed and non-listed companies are subject to different

rules such as concerning public disclosure, dividend payments, and shareholders rights. There is an integration effort to harmonize those laws in order to achieve consistency.

Recently, the CMB made improvements to the regulatory framework. Most companies will have to rearrange their articles of association in order to incorporate new provisions. There is no active market for corporate control since there is high ownership concentration.

2.2.3. Outlook, Future Trends and Recommendations

According to Ararat and Uğur (2003; 11), the corporate governance debate in Turkey revolves around 3 issues: (i) minority shareholders' and creditor rights; (ii) enforcement of law and regulations; and (iii) ambiguities and weaknesses in legal / regulatory framework. Since the Turkish corporate governance is characterized by concentrated ownership structure through pyramidal structures, minority shareholder rights need special thorough improvements in provisions of transparency and minority protection rights.

The Institute of International Finance (IIF) recommends the following changes to overcome the deficiencies and to add momentum and support for improved corporate governance in Turkey (2005; 2):

- To eliminate multiple voting rights, such as requiring elimination over a set period of time,
- To eliminate privileges held by majority shareholders to nominate directors and limit director nominations to those selected by corporate governance nomination committees and grant nomination rights to shareholders controlling a minimum percentage of voting power,
- Arbitration as a means to resolve shareholder conflicts,

- Creation of a subset of key, objective governance rules based on IIF Guidelines to be used for a separate ISE listing reflecting adherence to good corporate governance,
- To empower CMB to disqualify directors in case of wrongful acts,
- To convert CMB Principles to legally binding rules, regulations, or listing requirements as appropriate.

To sum up, Turkey's corporate governance framework and company practices have evolved significantly in recent years. The recent Corporate Governance Principles developed by the CMB have requirements for listed companies. Commitment of the government, the CMB, the ISE, and private institutions to improve corporate governance framework aims to result in an effective system.

CHAPTER III

CORPORATE GOVERNANCE AND FIRM PERFORMANCE

The importance of corporate governance has been widely accepted by academics, investors, regulators and corporations. In recent years, there is a growing need and interest for the insights and concepts of corporate governance. One of the main questions in this area considers the relationship between corporate governance and firm performance. From a theoretical point of view, good governed firms have better firm performance.

The majority of empirical research prior to 2000 is concerned with understanding the relationships of specific corporate governance mechanisms to firm performance. On the other hand, recent studies have focused on the relationship with firm performance and corporate governance as a whole measured by a composite score, a rating, or a ranking. Effective corporate governance practices have gained speed to improve firm performance and shareholder returns. There have been a number of empirical studies, mostly academic journal articles, on the relationship between good corporate governance in general and firm performance. In this chapter, the relationship between corporate governance and firm value is discussed based on related studies. The formulation of a corporate governance index is then presented.

3.1. Empirical Studies on the Corporate Governance and Firm Performance

The majority of the empirical research prior to 2000 has focused on understanding the relationship of specific corporate governance mechanisms to firm performance. Significant among these variables include ownership concentration, market for corporate control and board composition. However, recently, researchers have begun to explore whether corporate governance as a whole measured by a composite score, a rating or a ranking, has any relationship to firm performance (Gupta, Kennedy and Weaver, 2006; 8). The main studies regarding the relationship between corporate governance and firm performance is summarized in Table 5.

Table 5: The Summary of Studies Using Corporate Governance Score

Author	Year	Market	Corporate Governance Score	Performance Variable	Result
Gupta, Kennedy, and Weaver (2006)	2002-2004	Canadian Capital Market	Globe and Mail Corporate Rankings	Tobin's Q Price-to-book ratio Return on assets Market reaction	There is no strong association between the composite corporate governance scores measured by Globe & Mail and various measures of firm performance.
Aggarwal and Williamson (2006)	2001-2005	The U.S. Market	Corporate Governance Quotient (CGQ) provided by ISS	Tobin's Q	Corporate governance is important for firm performance and supports prior work on the value of governance. Positive and significant relation between governance and firm performance. There are statistically significant cross-sectional differences in governance at the firm and the industry level.
Brown and Caylor (2004)	2002	The U.S. Market	Governance Score (Gov-Score)	Tobin's Q Return on equity	Better-governed firms are relatively more profitable, more valuable, and pay out more cash to their shareholders.
Black, Jang, and Kim (2003)	2001	Korea Stock Exchange	Corporate Governance Index	Tobin's Q Market / Book Market / Sales	Strong positive correlation between the overall corporate governance index and firm performance.
Gompers, Ishii, and Metrick (2003)	1990-1999	The U.S. Market	Governance Index (G-Index)	Tobin's Q Book-to-market ratio	Corporate governance is strongly correlated with stock returns during the 1990s.

Gompers, Ishiii and Metrick (2003) construct a "Governance Index" using the incidence of 24 governance rules derived from the Investor Responsibility Research Center for a sample of about 1,500 firms per year during the 1990s. Their study analyzes the correlation of the corporate governance index with returns, firm value, and operating performance. Their index construction is done through giving one point for every provision that satisfies the minimum character and giving zero for not satisfied provisions. Therefore, Governance Index is the sum of ones for the existence of each provision. Delay, Protection, Voting, and other sub-indices are also constructed in order to indicate correlations with each other. To perform their analyses, they use the following regression model:

$$Q'_{it} = a_t + b_t X_{it} + c_t W_{it} + e_{it},$$

where Q'_{it} is industry-adjusted Tobin's Q (firm Q minus industry-median Q), X_{it} is a vector of governance variables and W_{it} is a vector of firm characteristics consisting the log of the book value of assets and the log of firm age. The study finds that corporate governance is strongly correlated with stock returns during the 1990s in the U.S.

Black, Jang, and Kim (2003) provide empirical evidence that corporate governance is an important factor in explaining the market value of Korean public companies. They construct a corporate governance index for 526 companies based on responses to a Spring 2001 survey of all listed companies by the Korean Stock Exchange. They regress Tobin's q on a corporate governance index (CG1) and the six subindices that comprise CG1. Each regression uses the control variables – the log of assets, log of firm age, debt/equity ratio, industry as dummy variable, sales growth, firm's market share, share turnover and other dummy variables. They find that moderate 10 point increase in the corporate governance index predicts a 5% increase in Tobin's Q and 14% increase in market / book ratio in ordinary least square regressions.

Brown and Caylor (2004) construct a governance score based on a data set provided by Institutional Shareholder Services (ISS). Gov-Score is a composite measure of 51 governance attributes in eight sub-categories: audit, board of directors, charter/by-laws, director education, executive and director compensation, ownership, progressive practices, and state of incorporation. The research provides evidence on whether Gov-Score relates to operation performance, valuation, and shareholder payout for 2,327 firms. They correlate Gov-Score with each industry adjusted variable using Pearson and Spearman correlations. They also order Gov-Scores from highest to lowest and analyze if firm performance differs in the extreme governance deciles.

Brown and Caylor (2004) find that better-governed firms are relatively more profitable, more valuable, and pay more cash to their shareholders. They also show that good governance as measured by using executive and director compensation is most highly associated with bad performance.

Gupta, Kennedy, and Weaver (2006) present evidence on whether there is any association between the publicly disclosed corporate governance scores and firm performance. In this study, corporate governance is measured by the Globe & Mail ratings which are published for the companies represented on the TSX/S&P index for the period of 2002-2004 in Canada. Board composition, board and CEO compensation, shareholder rights and board governance disclosure are dimensions of that composite score and ranking. The study also measures firm performance in three subcategories including relative market valuation as measured by the Tobin's Q and price-to-book ratio, financial performance as measured by return on assets, and market reaction as measured by 11-day and 2-day reaction.

Gupta et al. (2006) used three econometric models. First regression model regresses Tobin's Q and price-to-book ratio against the composite governance scores as well as against each one of the four sub-categories to investigate whether any one sub-component of the overall corporate governance scores is more value relevant than others.

Related regressions are as follows:

$$Tobin's\ Q = \alpha + \beta\ Composite\ Governance\ Score + \gamma\ ln(Sales) + \delta\ Return\ on\ Assets + \zeta\ Cross\text{-}listing\ status + \varepsilon$$

$$Price\text{-}to\text{-}book\ ratio = \alpha + \beta\ Composite\ Governance\ Score + \gamma\ ln(Sales) + \delta\ Return\ on\ Assets + \zeta\ Cross\text{-}listing\ status + \varepsilon$$

Second economic model regresses return on assets against the composite governance scores as well as each one of the four sub-categories.

$$Return\ on\ Assets = \alpha + \beta\ Composite\ Governance\ Score + \gamma\ ln(Book\text{-}to\text{-}Market) + \delta\ ln(Sales) + \zeta\ Cross\text{-}listing\ status + \varepsilon$$

The third and the final regression model tests whether there is any stock market reaction around the announcement date of the Globe & Mail rankings.

$$Rit = \alpha + \beta\ Governance\ Score + \gamma\ ln(Sales) + \delta\ Cross\text{-}listing\ Status + \varepsilon$$

$$R_{it} = \alpha + \beta Governance\ Category\ sub\text{-}Scores + \gamma\ ln(Sales) + \delta Cross\text{-}listing\ Status + \varepsilon$$

Where, R_{it} is the aggregate excess returns over period t of individual firm i for each one of the three years. Consequently, Findings of this research indicate that there is no strong association between the composite corporate governance scores measured by Globe and Mail and various measures of firm performance.

Aggarwal and Williamson (2006) analyze a comprehensive set of 64 governance attributes for more than 5,200 firms during 2001-2005 in the U.S. Those governance attributes are obtained from Institutional Shareholder Services (ISS) and eight sub categories are analyzed including board of directors, audit, charter/by-laws, anti-takeover provisions, ownership, executive and director compensation,

progressive practices, and director education. They divide their sample according to firm size and industry in order to examine differences across size and industry.

They use Tobin's Q as the measure of valuation. The following model is used:

$$Q_i = \alpha + \beta G_i + \gamma F_i + e_i$$

where, G_i is a proxy for firm-specific governance, and F_i are a set of firm characteristics. The firm characteristics included for control purposes are log of book value of assets, inclusion in the S&P 500 index, dividend yield, and sales growth.

The study shows that corporate governance is important for firm value and supports prior work on the value of governance and concludes that firm value is positively associated with firm-specific corporate governance.

In conclusion, the relation between corporate governance and firm performance is analyzed in several ways in the empirical literature. An overview of the literature summarizes only some of the studies mainly using composite corporate governance score as independent variable since this study uses a composite governance score in the analysis.

3.2. Corporate Governance Score

There is no global consensus on the definition and elements of what constitutes good governance and a recognizable entity that consistently measures corporate governance in a "composite" sense provided to all capital market participants in a fair and equitable manner. Consequently, academic researchers have attempted to deal with these issues by creating their own indexes, scores or ratings as proxies for the overall level of corporate governance in a company either by collecting data from the various regulatory filings or through a set of self report surveys (Gupta, Kennedy and Weaver, 2006; 8-9).

Institutional Shareholder Services (ISS), the leading provider of proxy voting and corporate governance data services, provides global corporate governance rating and information through *Corporate Governance Quotient* (CGQ®). Investment managers and researchers use such governance ratings and data to meet their research and modeling needs. The database provides corporate governance rankings on 8,000+ companies across 31 countries, with underlying data points for up to 63 individual corporate governance variables. Ratings are calculated on the basis of eight categories: 1) Board of directors, 2) Audit, 3) Charter and bylaw provisions, 4) Anti-takeover provisions, 5) Executive and director compensation, 6) Progressive practices, 7) Ownership, and 8) Director education (ISS, 2006; 6). Table 6 provides the criteria of rating:

Table 6: Corporate Governance Quotient Rating Criteria

Board of Directors	**Charter/Bylaws**	**Qualitative Factors**
Board Composition	Features of Poison Pills	Retirement Age for Directors
Nominating Committee	Vote Requirements	Board Performance Reviews
Governance Committee	Special Meetings	Meeting of Outside Directors
Board Structure	**State of Incorporation**	CEO Succession Plan
Board Size	Takeover provisions applicable under Law	Outside Advisors Available to Board
Changes in Board Size	**Executive and Director Compensation**	Directors resign upon job change
Cumulative Voting	Cost of Option Plans	**Ownership**
Boards Served On - CEO	Option Re-pricing	Director Ownership
Boards Served On – Other Than CEO	Shareholder Approval of Option Plans	Executive Stock Ownership Guidelines
Former CEO's	Compensation Committee Interlocks	Director Stock Ownership Guidelines
Chairman/CEO Separation	Director Compensation	Officer and Director Stock Ownership
Board Guidelines	Pension Plans for Non-Employee Directors	**Director Education**
Response to Shareholder Proposals	Option Expensing	Director Education
Board Attendance	Option Burn Rate	**Audit**
Board Vacancies	Corporate Loans	Audit Committee
Related Party Transactions		Audit Fees
		Auditor Rotation
		Auditor Ratification

(Source: Institutional Shareholder Services, 2006; 7)

ISS employs a "bottom up" approach in collecting and analyzing the data used to determine a CGQ® score. Data is derived from public disclosure documents, press releases and corporate websites. Then, points are awarded and the company's raw score is determined. The raw score is used to determine the company's relative scores and category sub-scores, based on index and industry groups (ISS, 2006; 6).

Furthermore, there are other different models of corporate governance around the world that reflect the nature of legal and regulatory systems. Mainly, Standard and Poor's Corporate Governance Score, G-Index developed by Gompers, Ishii, and Metrick (2003), a Corporate Governance Index developed by Black, Jang, and Kim (2003), the Gov-Score developed by Brown and Caylor (2004) offer a composite index for corporate governance.

Standard and Poor's *Company Corporate Governance Score* (CGS) reflects the assessment of a company's corporate governance practices and policies and the extent to which these serve the interests of the company's financial stakeholders, with an emphasis on shareholders' interests (Standard and Poor's, 2002; 4). A Corporate Governance Score is assigned on a scale from CGS-10 (highest) to CGS-1 (lowest). There are four individual components that contribute to the overall CGS include the following:

Component 1 - Ownership Structure
Sub-categories:

- Transparency of ownership structure
- Concentration and influence of ownership

Component 2 - Financial Stakeholder Relations
Sub-categories:

- Regularity of, access to, and information on shareholder meetings.
- Voting and shareholder meeting procedures.
- Ownership rights

Component 3 - Financial Transparency and Information Disclosure

Sub-categories:

- Quality and content of public disclosure.
- Timing of, and access to, public disclosure.
- Independence and standing of the company's auditor.

Component 4 - Board Structure & Process

Sub-categories:

- Board structure and composition.
- Role and effectiveness of board.
- Role and independence of outside directors.
- Directors and executives compensation, evaluation and succession policies.

Each of these sub-categories forms the overall score. Standard & Poor's analyzes ach of those categories to evaluate the governance standards of individual companies.

Gompers, Ishii, and Metrick (2003) construct a "Governance Index" as a proxy for the balance of power between shareholder and managers. Their index construction is straightforward: for every firm they add one point for every provision that reduces shareholder rights. They obtain data from the publications of the Investor Responsibility Center which provides 24 distinct corporate governance provisions. For each firm, they record the identifying information and the presence of each provision. They make no strength distinctions and code all provisions as simply "present" or "not present".

Firms in the highest deciles of the index are placed in the "Dictatorship Portfolio" and referred as having the "highest management power" or "the weakest shareholder rights". Firms in the lowest deciles of the index are placed in the "Democracy Portfolio" and are described as having "the lowest management power or the strongest shareholder rights (Gompers et al., 2003; 3). They also construct sub-indices for each five categories including Delay, Protection, Voting, Other, and State.

Thus, the Governance Index ("G") is just the sum of the points for the provisions which receive 1 point if exist.

Brown and Caylor (2004) created a broad measure of corporate governance, Gov-Score, based on a new dataset provided by Institutional Shareholder Services. Gov-Score is a composite measure of 51 factors encompassing eight corporate governance categories: audit, board of directors, charter / bylaws, director education, executive and director compensation, ownership, progressive practices, and state of incorporation. They code 51 factors as either 1 or 0 depending on whether the firm's governance standards are minimally acceptable. They, then, sum each firm's 51 binary variables to derive Gov-Score. The following include examples of factors minimally acceptable governance from each category given in the study (Brown and Caylor, 2004; 12):

"Audit: Consulting fees paid to auditors are less than audit fees paid to auditors
Board of directors: Board is controlled by more than 50% independent outside directors
Charter/bylaws: Company either has no poison pill or a pill that was shareholder approved
Director education: At least one member of the board has participated in an ISS-accredited director education program
Executive and director compensation: Directors receive all or a portion of their fees in a stock
Ownership: All directors with more than one year of service own stock
Progressive practices: Mandatory retirement age for directors exist
State of incorporation: Firm is incorporated in a state without any anti-takeover provisions"

As a result, they construct a governance index from minimum governance standards and obtain the composite corporate governance score.

Black, Jang and Kim (2004) also construct a corporate governance index including six subindices – shareholder rights (subindex A); board of directors in general (subindex B); outside directors (subindex C); audit committee and internal auditor (subindex D), disclosure to investors (subindex E) and ownership parity (subindex P). They construct 123 variables from the survey questions from 2001

survey by the Korea Stock Exchange (Black, Jang, and Kim, 2004, 6). They standardize each subindex to have a value between 0 and 20.

$$CG1 = A + (B+C)/2 + D + E + P$$

Furthermore, corporate governance index is constructed to have a value between 0 and 100. Each subindex is computed through a sum over of value between 0 and 1 for each element in subindex and then divided by the number of "non-missing" elements. Lastly, this ratio is multiplied by 20 to have a value between 0 and 20.

In a few words, a composite corporate governance index or score is used to measure to what extent a firm adopts codes and guidelines of corporate governance.

3.3. Firm Performance Measures

As discussed, better corporate governance performance is supposed to lead to better firm performance. In order to support the link between the quality of corporate governance and firm performance, quantitative evidence is needed assessed by firm performance measures.

A business that operates in such a way as to maximize its owners' wealth allocates its own resources efficiently, which results in an efficient allocation of resources for society as a whole. Owners, employees, customers, and anyone else who has a stake in the business enterprise are all better off when its managers make decisions that maximize the value of firm. Therefore, evaluating a firm's management on the basis of whether it maximizes the owners' wealth is a reasonable approach (Peterson and Peterson, 1996; 1)

Performance measures indicate the effectiveness of the control systems in the realizing organizational goals. According to Otley (2002; 3), there are three different major functions for financial performance. Firstly, financial performance measures

serves as a tool for financial management, as a major objective of a business organization, and as mechanisms for motivation and control.

Similarly, to examine relationship between corporate governance and firm performance, three firm performance measures are used in this study – Tobin's Q, return on assets and return on equity. Those measures also grouped into two as market based and accounting based measures.

3.3.1. Market Based Measures

Tobin's Q (Q) is often used a measure of the real value created by a firm's management. The higher the q, the more value is added. The attractiveness of this measure is derived from its estimation of the firm's intangible assets (Peterson and Peterson, 1996; 9). Firms with high q, or q is greater than 1, have been found to be better investment opportunities as depicted by Wolfe and Sauaia (2003; 157).

Tobin's Q is used as a proxy for the firm's value from investors' perspective (Wolfe and Sauaia, 2003; 156). It is defined as the market value of assets divided by the replacement value of assets:

$$q = \frac{market.value.of.assets}{replacement.value.of.assets}$$

The market value of assets is represented by the sum of the book value of assets and the market value of common stock outstanding. From this, the sum of book value of common stock and balance sheet deferred taxes is subtracted. And the replacement value of assets is the book value of total assets. Hence, it can be expresses as follows:

$$q = \frac{MVS + MVD}{RVA}$$

where:

MVS: Market value of all outstanding stocks

MVD: Market value of all debt

RVA: Replacement value of assets

Recently, two additional measures of market-based firm performance are used in the studies. Value added measures of Economic Value Added (EVA) and Market Value Added (MVA) evaluate a firm's performance (Peterson and Peterson, 1996; 4). Those provide an estimate of the variation in the value of firm. Economic value added refers the firm's economic profit which is the difference between the operating profit and the cost of capital. The related formula is:

Economic profit = (Return on capital – Cost of capital)*Capital

Similarly, market value added is the difference between the market value of capital and the amount of capital invested. The formula is:

Market Value Added = Market value of firm – Capital

3.3.2. Accounting Based Measures

Accounting measures of performance is the traditional quantitative approach to firm performance measurement. Financial measure of performance is one of the mechanisms of control. Every firm has to live in financial constraints and to deliver value to shareholders. There is no certain set of financial ratios that can be said to measure the performance of a business. Rather, there are set of measures to assess different aspects of financial performance. Those measures can be derived from annual financial statements (Otley, 2002; 8).

Financial ratios include 3 main groups as: (1) Liquidity ratios, (2) Operating performance ratios and (3) Price and dividend ratios (Civelek and Durukan, 2003; 156). Liquidity ratios are related to the firm's ability to meet its fixed obligation as they come due consisting short-term and debt utilization ratios. Operating

performance ratios shows the operating success of the management including asset utilization and profitability ratios. Price and dividend ratios are concerned with how the market perceives the firm's performance.

There are many operating performance ratios measuring firm performance. Two of them are most widely used – return on asset and return on equity. Return on asset measures the firm's overall effectiveness in generating profits. Return on equity measures the return earned on the owners' investment in the firm.

Return on assets (ROA) is one of accounting based performance measure and computed from firm's financial statements. It is one of operating performance measure. Return on assets is useful in management evaluation, profitability analysis, earnings forecasting, planning and control. It is calculated from firm's annual earnings before interest, taxes and depreciation divided by the book value of total assets. Return on assets uses net income in comparison to total assets:

$$\text{Return on assets} = \frac{net.income}{total.assets}$$

Return on assets ratio shows the return available to owners from the investment of capital from both creditors and owners (Peterson and Peterson, 1996; 7).

Return on equity is simply return on equity computed from firm's annual earnings before interest, taxes and depreciation divided by the book value of equity. It indicates the return the firm can generate on their investment. The formula is:

$$\text{Return on equity} = \frac{net.income}{book.value.of.equity}$$

In general, higher return ratios are associated with better performance. Peterson and Peterson (1996; 8) indicates that an advantage of using return ratios in evaluating firm performance is the ease of calculation. All information for the calculation can be achieved easily from financial statements or from market data.

CHAPTER IV

AN EMPIRICAL ANALYSIS OF THE RELATIONSHIP BETWEEN CORPORATE GOVERNANCE AND FIRM PERFORMANCE AT ISTANBUL STOCK EXCHANGE

Corporate governance literature analyzes the relationship between corporate governance and firm performance in recent years. It is argued that better governed firms have higher firm performance. According to Bauer, Guenster, and Otten (2003; 100), there are two reasons why corporate governance increases firm value. First, good governance increases investor trust. Investors might perceive well-governed firms as less risky and apply a lower expected rate of return, which leads to a higher firm performance. Secondly, better governed firms might have more efficient operations, resulting in a higher expected future cash-flow stream.

The major purpose of this study is to analyze the relationship between corporate governance and firm performance at Istanbul Stock Exchange (ISE) empirically. Hypothesis testing is used to analyze whether there is association between corporate governance and firm performance or not. In addition, it is aimed to answer the question of whether better governed firms measured by high corporate governance score have higher firm performance or not.

This chapter is structured as follows. Firstly, it describes the study's research design under four sections which are sample selection, data description, measuring firm performance and the construction of a corporate governance score. Additionally, the related methodology is discussed with the related hypothesis, definition of variables and the empirical model. Descriptive statistics and regression results from ordinary least squares (OLS) are provided in the part of empirical results. Finally, conclusions are drawn and the implications of the results are discussed.

4.1. Research Design

This study aims to self-construct a corporate governance score for firms listed at ISE 100 index based on the Corporate Governance Principles issued by Turkish Capital Market Board (CMB) and then test whether there is a relationship between corporate governance and firm performance. It also aims to determine the direction of this relationship by attempting to answer the question of whether better governed firms as measured by high corporate governance score have higher firm performance as measured by Tobin's Q.

In the overall research design, the firm performance is the dependent variable whereas a composite corporate governance score is the independent variable. Research design is structured in four sections including the data description, the sample selection, measuring firm performance and the construction of corporate governance score denoted as Gov-S.

4.1.1. Sample Selection

The population of this study consists of all firms quoted at ISE 100 index for the year ended 2006. Then, financial firms including insurance companies and banks and non-manufacturing firms are excluded from the study since those have specific characteristics of corporate governance structure and financial ratios. Additionally, non-manufacturing firms are excluded because of their limited sample in their industry. Therefore, there is a sample of 45 manufacturing firms to be analyzed. To sum up, this study is focused manufacturing firms.

4.1.2. Data Description

This study utilizes the data on corporate governance score and performance measures and other related variables in the model.

Data for the composite governance score is obtained from all publicly available information and from web-site of each firm. In general, web-sites include "*investor relations*" section and all corporate governance related and financial information is stated under this section. The followings are mainly used;

- Corporate Governance Compliance Reports
- Annual Reports
- Articles of Association
- General Meeting Agenda and Minutes
- Disclosed Policies (such as ethical policy and information policy)
- Other publicly available information

Balance sheets and income statements for the year ended 2006 and 2005 are obtained from ISE web-site database and used in the calculation of Tobin's Q and other variables. Annual Factbook of ISE for 2006 is also utilized in determining market value of selected firms.

4.1.3. Measuring Firm Performance

Tobin's Q is used as a measure of firm performance following the studies of Gupta, Kennedy and Weaver (2006), Aggarwal and Williamson (2006), Brown and Caylor (2004), and Black, Jang, and Kim (2003). All those studies use Tobin's Q as one of the performance measures. Tobin's Q is selected since not only other studies mainly use this variable as a performance measure but also it indicates the firm effectiveness from an investor's perspectives.

Tobin's Q is calculated as follows:

Tobin's Q= (MVS+MVD)/RVA

MVS: market value of all outstanding stock

MVD: market value of debt

RVA: replacement value of all production capacity

Market value of all outstanding stock is calculated by multiplying the firm's stock price with outstanding shares following Brown and Caylor (2004). For the market value of all outstanding stock, Annual Factbook of 2006 is used from ISE database. It provides closing price and market value of all listed companies. Market value of debt is assumed to equal to book value of debts following Jong et al. (2002). The replacement value of assets is represented by the book value of assets following Brown and Caylor, Black, Jang, and Kim (2003), Gompers, Ishii and Metrick (2003), Jong et al. (2002). To sum up, Tobin's q is measured by dividing the sum of the market value of equity and the book value of debt by the book value of total assets.

Return on Asset (ROA) is also used as a control variable which is calculated from the firm's annual earnings before interest, taxes and depreciation divided by the book value of total assets. Addition of this variable is based on the empirical model used by Gupta, Kennedy and Weaver (2006).

4.1.4. Construction of Corporate Governance Score

A summary metric "Governance Score" (Gov-S) to measure corporate governance framework of firms is constructed similar to Gov-Score developed by Brown and Caylor (2004), G-Index developed by Gompers, Ishii, and Metrick (2003) and G-Index developed by Black, Jang, and Kim (2003). Governance score denoted as Gov- S in this study is a broad measure of corporate governance.

Based on CMB Corporate Governance Standards, I identified minimum corporate governance criteria in four main sections similar to Institutional Shareholder Services (ISS) report for Vestel and SAHA Kurumsal Yönetim Derecelendirme Hizmetleri A.Ş. for Tofaş Türk Otomobil Fabrikası A.Ş. Those sections are:

1. Shareholders
2. Public Disclosure and Transparency
3. Stakeholders
4. Board of Directors

Relative weights of each section are also stated in Vestel and Tofaş report – 25% for Shareholders; 35% for Public disclosure and transparency; 15% for stakeholders; 25% for Board of Directors. In addition, sub-weighting in each section is assumed equally important and assigned equal weights in this study.

Individual attributes are utilized to create a composite governance score, Gov-S for selected sample of firms. Gov-S assigns 1 point for each governance attribute if the firm meets minimally acceptable standard on this attribute and 0 otherwise. In addition, an attribute gets a score of 0.5 points in some cases for a partial fulfillment by the firms in the same way as done by ISS in their report for Vestel.

The minimum criteria are set based on Turkish Corporate Governance Principles and a score card is constructed based on corporate governance compliance reports, articles of association, annual reports, general meeting agenda and minutes, and other publicly available information. The corporate governance score card used in the study is provided in Table 7. Headings of each section and sub-section are based on corporate governance principles of CMB.

Table 7: Corporate Governance Score Card

	GOVERNANCE SCORE CARD		
	TOTAL SCORE	**0**	**100%**
1.	**SHAREHOLDERS**	**0**	**25%**
1.1.	Facilitating the Exercise of Shareholders' Statutory Rights	0	
1.2.	Shareholders Right to Obtain and Evaluate Information	0	
1.3.	The Right to Participate in the General Shareholders' Meeting	0	
1.4.	Voting Rights	0	
1.5.	Minority Rights	0	
1.6.	Dividend Rights	0	
1.7.	Transfer of Shares	0	
1.8.	Equal Treatment of Shareholders	0	
2.	**PUBLIC DISCLOSURE AND TRANSPARENCY**	**0**	**35%**
2.1.	Principles and Means for Public Disclosure	0	
2.2.	Public Disclosure of Relations between the Company and Its Shareholders, The Board of Directors and Executives	0	
2.3.	Periodical Financial Statement and Reports in Public Disclosure	0	
2.4.	Functions of External Audit	0	
2.5.	The Concept of Trade Secret and Insider Trading	0	
2.6.	Significant Events and Developments That Must Be Disclosed to the Public	0	
3.	**STAKEHOLDERS**	**0**	**15%**
3.1.	Company Policy Regarding Stakeholders	0	
3.2.	Stakeholders' Participation in the Company Management	0	
3.3.	Protection of Company Assets	0	
3.4.	Company Policy on Human Resources	0	
3.5.	Relations with Customers and Suppliers	0	
3.6.	Ethical Rules	0	
3.7.	Social Responsibility	0	
4.	**BOARD OF DIRECTORS**	**0**	**25%**
4.1.	Fundamental Functions of the Board of Directors	0	
4.2.	Principles of Activity and Duties and Responsibilities of the Board of Directors	0	
4.3.	Formation and Election of the Board of Directors	0	
4.4.	Remuneration of the Board of Directors	0	
4.5.	Number, Structure and Independence of the Committees Established by the Board of Directors	0	
4.6.	Executives	0	

Total governance score is calculated from four main sub-sections. In theory, the score (Gov-S) changes between 0 and 100. Four main sections of the score are denoted as follows:

Total Corporate Governance Score : Gov-S

Shareholders : Gov-S_1

Public Disclosure and Transparency : Gov-S_2

Stakeholders : Gov-S_3

Board of Directors : Gov-S_4

Total score is calculated as follows:

$$\text{Gov-S} = (\text{Gov-S}_1 * 25\%) + (\text{Gov-S}_2 * 35\%) + (\text{Gov-S}_1 * 15\%) + (\text{Gov-S}_1 * 25\%)$$

And, each sub-score is calculated as follows:

$$\text{Gov-S}_i = (\text{Sum of Given Scores} / \text{Total Score in related section}) * 100$$

For example, one firm gets 6 points from shareholder section which is computed as the sum of its sub-sections. Total maximum score for this section is 8 since there are 8 sub-sections. If all criteria are met, the company gets 8 points from the shareholder section in total. Then, governance score for shareholders is: Gov-S_1 = (6/8)*100 = 75.

The maximum points for each section are as follows:

Gov-S_1 : 8

Gov-S_2 : 6

Gov-S_3 : 7

Gov-S_4 : 6

Furthermore, each sub-score has sub-sections, too. When deciding whether to give 0 or 0.5 or 1 point to each minimum attribute, the following decision criterion as shown in Figure 5 is used.

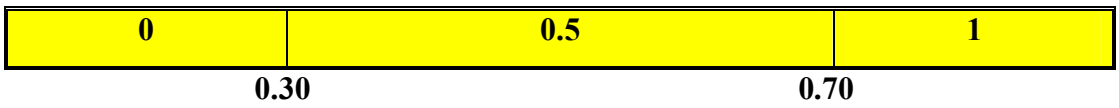


Figure 3: Decision Criteria for Scoring

Providing that, the relative ratio of the sum of the scores of each sub-attribute to the total is between 0,70 and 1, it gets 1 point whereas the ratio is between 0.30 and 0.69 it gets 0.5 point, and otherwise it gets 0 point.

By using the explained methods, every firm in the sample gets a governance score. Vestel gets 78 points when this method is followed whereas it got 75 point at the ISS reports. There is only a slight difference between the ISS ratings and the calculated score in this study. Therefore, it can be assumed that the constructed governance score explains the quality of corporate governance of firms well. The Appendix includes the detailed score card for Vestel. Sub-sections consist of sub-principles of corporate governance. Thus, the score card is the summary of the requirement of principles. Some requirements are omitted since either they are based on subjective or unavailable information through publicly available data. In conclusion, corporate governance scores for 45 firms at ISE are calculated based on publicly available information.

4.2. Methodology and Hypotheses

Multiple regression analysis is used in this study to analyze the relationship between corporate governance and firm performance. In this study, Ordinary Least Square (OLS) model is used as a multivariate test to investigate the effect of each independent variable on firm performance. The following basic regression model is used:

Firm Performance = f (corporate governance variables, control variables)

Firm performance is a dependent variable and measured by Tobin's Q.

Corporate governance variables refer the overall corporate governance score denoted as Gov-S and other 4 sub-scores of corporate governance as the independent variable. Those sub-scores are: (1) Shareholders denoted as Gov-S_1, (2) Public Disclosure and Transparency denoted as Gov-S_2, (3) Stakeholders denoted as Gov-S_3, and (4) Board of Directors Gov-S_4.

Moreover, two control variables are included in the regression model based on the model developed by Gupta, Kennedy and Weaver (2006). Those are the logarithm of total sales and return on assets.

4.2.1. Hypotheses

This study develops the following hypotheses:

H_0: There is no relationship between corporate governance and firm performance

H_1: There is a relationship between corporate governance and firm performance

As discussed so far, the study aims to test whether there is a relationship between corporate governance and firm performance under the assumption that better governed firms have better firm performance. Therefore, the study also attempts to determine the direction of the relationship if any.

4.2.2. Definition of Variables

All variables of this study are observed for the year 2006.

a) Independent Variables

1. Corporate governance score (Gov-S): A composite score of corporate governance.

2. Shareholder score (Gov-S_1): Total score of shareholders sub-category in corporate governance score

3. Public disclosure and transparency (Gov-S_2): Total score of public disclosure and transparency sub-category in corporate governance score

4. Stakeholders (Gov-S_3): Total score of stakeholders sub-category in corporate governance score

5. Board of Directors (Gov-S_4): Total score of board of directors sub-category in corporate governance score

b) Dependent Variable

The explanatory variable measuring firm performance is: Tobin's Q (Gupta, Kennedy, and Weaver, 2006; Aggarwal and Williamson, 2006; Brown and Caylor, 2004; Black, Jang, and Kim, 2003; Gompers, Ishii and Metrick, 2003).

Tobin's Q (TQ): calculated as the sum of market value of equity and book value of total debt, divided by the book value of assets.

c) Control Variables

1. ln (sales) as a control variable to control for firm size

2. Return on asset (ROA) to control other firm performance related variables

The log of sales denoted as ln(sales) is included as a control variable for firm size in the analysis because it has been found to be associated with various firm performance measures as stated by Gupta, Kennedy and Weaver (2006; 18). In addition, ROA is added to the model based on the model suggested by Gupta et al. Only, the variable of cross-listing status is omitted since cross listing condition is rare for the selected firms.

Tobin's Q = α + β Composite Governance Score + γ ln(Sales) + δ Return on Assets + ζ Cross-listing status+ ε

4.2.3. Specification of the Empirical Models

In equation form, the empirical model can be expressed as follows:

$$\text{Tobin's Q} = \alpha_0 + \beta_1 * \text{Gov-S} + \beta_2 * \ln(\text{Sales}) + \beta_3 * \text{ROA} + \varepsilon \qquad (1)$$

where,

Tobin's Q : firm performance measure as dependent variable

α_0 : constant term

Gov-S : corporate governance score as independent variable

Ln (Sales) : logarithm of sales, as a control variable

ROA : Return on assets, as a control variable

α_0 : error term

The other models are as follows:

$$\text{Tobin's Q} = \alpha_0 + \beta_1 * \text{Gov-S}_1 + \beta_2 * \ln(\text{Sales}) + \beta_3 * \text{ROA} + \varepsilon \quad (2)$$

$$\text{Tobin's Q} = \alpha_0 + \beta_1 * \text{Gov-S}_2 + \beta_2 * \ln(\text{Sales}) + \beta_3 * \text{ROA} + \varepsilon \quad (3)$$

$$\text{Tobin's Q} = \alpha_0 + \beta_1 * \text{Gov-S}_3 + \beta_2 * \ln(\text{Sales}) + \beta_3 * \text{ROA} + \varepsilon \quad (4)$$

$$\text{Tobin's Q} = \alpha_0 + \beta_1 * \text{Gov-S}_4 + \beta_2 * \ln(\text{Sales}) + \beta_3 * \text{ROA} + \varepsilon \quad (5)$$

Where,

Gov-S_1 : Sub-score of Shareholders

Gov-S_2 : Sub-score of Public Disclosure and Transparency

Gov-S_3 : Sub-score of Stakeholders

Gov-S_4 : Sub-score of Board of Directors

A positive coefficient ($\beta_1 > 0$) on governance score will indicate that better governed companies have better future operating performance.

4.3. Empirical Results: Corporate Governance and Firm Performance

This part is discussed under two sections. In the first section, the descriptive statistics of the sample is provided based on the corporate governance scores and firm performance measures. In the second section, the empirical results and hypothesis testing is discussed in detail.

4.3.1. Descriptive Statistics

The sample includes 45 non-manufacturing firms quoted at ISE 100 index. Figure 4 summarizes the descriptive statistics of the overall corporate governance score. In theory, the corporate governance score changes between 0 and 100. On the other hand, it is observed that maximum score is 84 whereas minimum one is 55 for the sample of the study. The mean score is 69 where the standard deviation is 7.053.

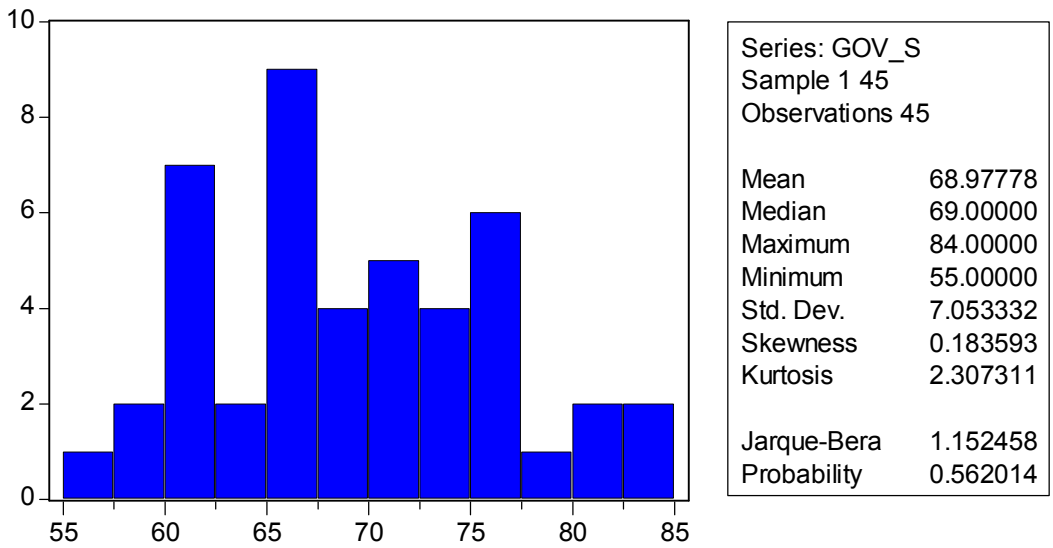


Figure 4: Descriptive Statistics and Histogram of Corporate Governance Score

Figure 5 refers to descriptive statistics and histogram of corporate governance sub-score of shareholders denoted as Gov-S_1. The minimum score in this sub-score is 56 points when the maximum is 94 with the standard deviation of 8.1508. It is observed that Gov-S_2 is mainly grouped into 4 main scores. This is related to similar extent of compliance to corporate governance principles by firms. In general, firms has limited or no minority rights, and some of them has the privileges on voting rights and partially meets principles of general shareholders' meeting. Moreover, shareholders are not able to request an external auditor and there is no cumulative voting among sample firms.

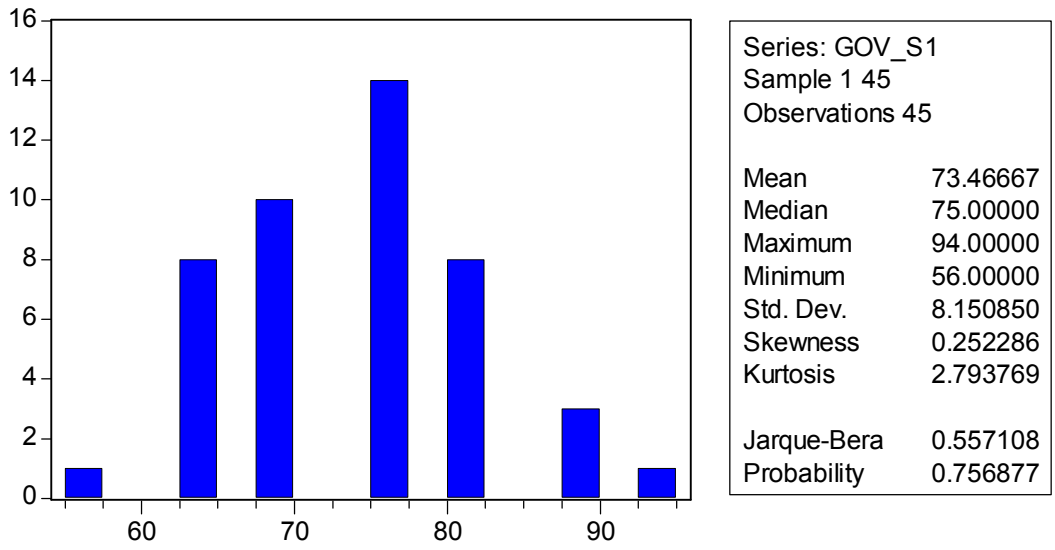


Figure 5: Descriptive Statistics and Histogram of Corporate Governance Sub-Score of Shareholders

As stated in Figure 6, the sub-score of public disclosure and transparency (Gov-S_2) has a mean of 70 where the standard deviation is 9.0242. Again, it is observed that there is a similar extent of compliance to corporate governance principles under this section. Accordingly, the score is mainly grouped around three scores. The information policy describing the form, frequency and methods of disclosure as required under the section of principles and means of public disclosure are not prepared and disclosed to the public by most of the firms. In addition, periodical financial reports can be improved and signed by the responsible persons.

There are no written independence documents and the disclosed declaration of all public disclosure principles are kept by the board of directors.

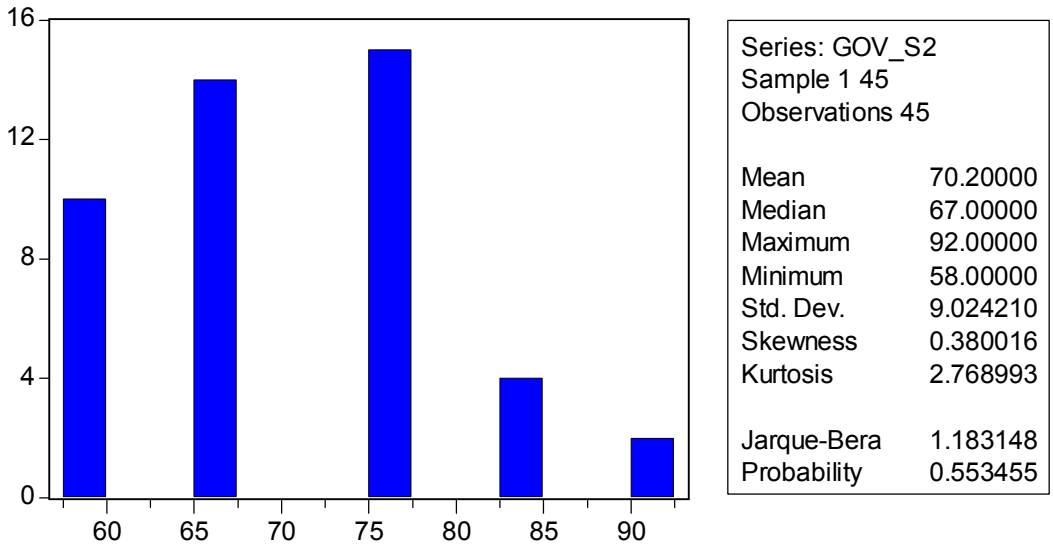


Figure 6: Descriptive Statistics and Histogram of Corporate Governance Sub-Score of Public Disclosure and Transparency

Figure 7 indicates that the sub-score of stakeholders (Gov-S_3) has a mean of 70 with the standard deviation of 12.1436.

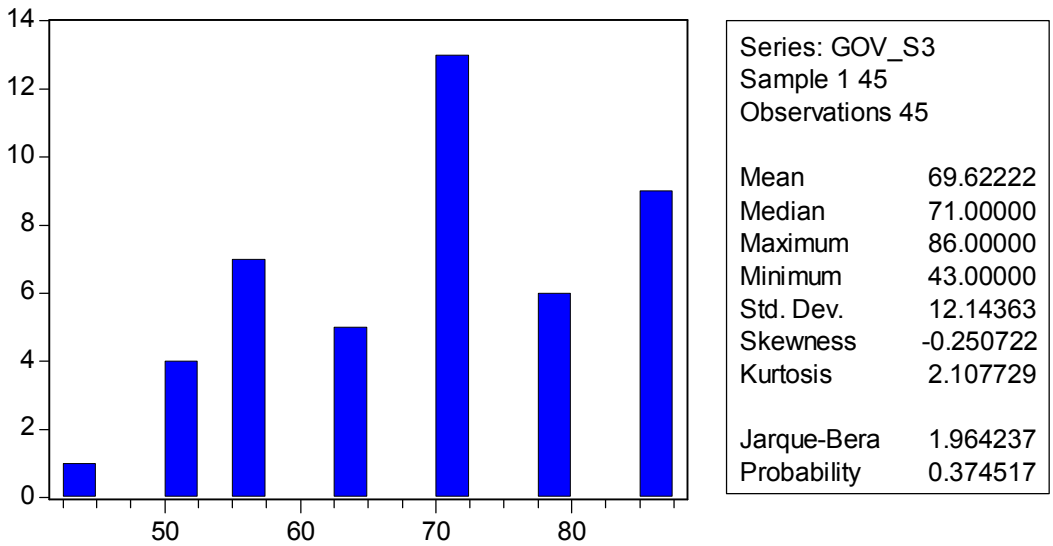


Figure 7: Descriptive Statistics and Histogram of Corporate Governance Sub-Score of Stakeholders

It is observed that Gov-S_3 has the highest standard deviation. It can be said that the extent of applications of firms at this section is quite different from each other. In general, it is observed that firms have not or partially established mechanisms to encourage the participation of stakeholders in the management. And a code of ethics is occasionally prepared and disclosed to the public.

Figure 8 indicates the descriptive statistics and histogram of corporate governance sub-score of board of directors (Gov-S_4). The mean is 63 when the standard deviation is 9.4081. Gov-S_4 has the lowest mean among all sub-scores. Meaning that, the extent of the compliance of principles related to the board of directors is low compared to the principles of other sections throughout the sample firms. Again, it is observed that there is a similar extent of compliance to corporate governance principles under this section. In common, the independent members and non-executives are stated rarely. The compensation of board of directors is not explained in detail and there is no performance based payments. In addition, most of the firms have not established corporate governance committees, yet.

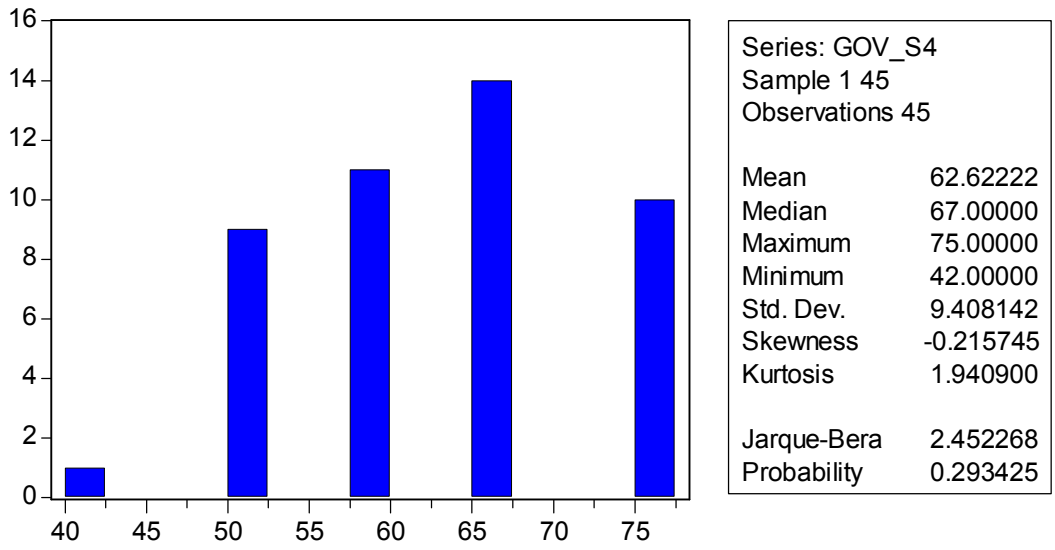


Figure 8: Descriptive Statistics and Histogram of Corporate Governance Sub-Score of Board of Directors

Furthermore, Table 8 presents descriptive statistics of all variables used in the analysis for sample firms.

Table 8: Variables Used in the Analysis

Variable	Description	Mean	Standard Deviation
Corporate Governance Score (Gov-S)	Overall corporate governance score	68.98	7.05
Gov-S_1	Governance score of shareholders section	73.47	8.15
Gov-S_2	Governance score of public disclosure and transparency section	70.20	9.02
Gov-S_3	Governance score of stakeholders section	69.62	12.14
Gov-S_4	Governance score of board of directors section	62.62	9.41
Tobin's Q (Q)	Tobin's Q equals the market value of assets divided by the book value of assets	1.40	0.61
Return on assets (ROA)	Return on assets equals net income before interest, depreciation and tax over the book value total assets	0.18	0.25
Sales (YTL million)	Logarithm of total sales in 2006	2,032	3,711

4.3.2. Empirical Results

The empirical findings for the regression analysis of corporate governance score and firm performance are given in Tables 9, 10, 11, 12 and 13 for each corporate governance score.

Table 8 summarizes regression results of the overall corporate governance score as the independent variable and Tobin's Q as the dependent variable. The related regression is as follows:

$$Q = 1.295808 + 0.021872*\text{Gov-S} - 0.085466*\ \text{Ln (Sales)} + 1.925779*\text{ROA} + \varepsilon$$

Since the p values of all coefficients are above α at the 5% and 10% confidence level, all variables are statistically significant. In other words, the coefficient estimates of variables are greater than 1 and statistically significant. Moreover, R^2 of regression is 73% and the adjusted R^2 is 71% meaning that 73% of the change in Tobin's Q is explained by the independent variables. Since the F-statistic is also significant at 1% level, the model is statistically significant, too.

Table 9: Regression Results: Gov-S as the Independent Variable

Dependent Variable: Q
Method: Least Squares
Included observations: 45

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	1.295808	0.860783	1.505383	0.1399
GOV_S	0.021872	0.007551	2.896532	0.0060
LOG(SALES)	-0.085466	0.042683	-2.002327	0.0519
ROA	1.925779	0.205522	9.370166	0.0000

R-squared	0.726195	Mean dependent var	1.397254
Adjusted R-squared	0.706160	S.D. dependent var	0.604565
S.E. of regression	0.327717	Akaike info criterion	0.691352
Sum squared res	4.403323	Schwarz criterion	0.851944
Log likelihood	-11.55542	F-statistic	36.24719
Durbin-Watson stat	2.455415	Prob(F-statistic)	0.000000

In addition, the coefficient estimate of the corporate governance score variable is positive and statistically significant since the p value (0.0060) is less than α at the 1% confidence level which is in the rejection region. Therefore, the null hypothesis of this study is rejected. Meaning, there is a statistically significant relationship between corporate governance and firm performance for sample firms. The direction of the relationship is positive. This suggests that better governed firms measured by high corporate governance score have better performance.

Table 10: Regression Results: Gov-S_1 as the Independent Variable

Dependent Variable: Q
Method: Least Squares
Included observations: 45

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	1.471999	1.021733	1.440689	0.1573
GOV_S1	0.006395	0.006727	0.950670	0.3473
LOG(SALES)	-0.043546	0.043445	-1.002318	0.3221
ROA	1.941797	0.227042	8.552603	0.0000

R-squared	0.677280	Mean dependent var	1.397254
Adjusted R-squared	0.653666	S.D. dependent var	0.604565
S.E. of regression	0.355788	Akaike info criterion	0.855722
Sum squared resid	5.189978	Schwarz criterion	1.016314
Log likelihood	-15.25374	F-statistic	28.68164
Durbin-Watson stat	2.663383	Prob(F-statistic)	0.000000

Table 10 provides the regression results of Tobin's q against Gov-S_1. The related regression is as follows:

$$Q = 1.471999 + 0.006395*\text{Gov-}S_1 - 0.043546*\text{ Ln (Sales)} + 1.941797*\text{ROA} + \varepsilon$$

Since the p value of the coefficient estimate of Gov-S_1 is above α at the 10% confidence level, it is in the non-rejection area. It refers that the hypothesis of $\beta_2 = 0$ is not rejected. Therefore, the coefficient estimate of Gov-S_1 is statistically not significant and is not related to firm performance. In other words, there is no relationship between the sub-score of Shareholders and firm performance. On the other hand, the model is statistically significant since F-statistic is significant at 1% level.

Similarly, Table 11 presents the regression results of Tobin's Q against the independent variable of Gov-S_2. The regression result is:

$$Q = 1.417933 + 0.018294*\text{Gov-}S_2 - 0.079416*\text{ Ln (Sales)} + 1.804694*\text{ROA} + \varepsilon$$

Table 11: Regression Results: Gov-S_2 as the Independent Variable

Dependent Variable: Q
Method: Least Squares
Included observations: 45

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	1.417933	0.828316	1.711826	0.0945
GOV_S2	0.018294	0.005580	3.278525	0.0021
LOG(SALES)	-0.079416	0.040683	-1.952090	0.0578
ROA	1.804694	0.202744	8.901340	0.0000

R-squared	0.738676	Mean dependent var	1.397254
Adjusted R-squared	0.719554	S.D. dependent var	0.604565
S.E. of regression	0.320160	Akaike info criterion	0.644698
Sum squared resid	4.202609	Schwarz criterion	0.805290
Log likelihood	-10.50570	F-statistic	38.63104
Durbin-Watson stat	2.470575	Prob(F-statistic)	0.000000

The p value of the coefficient estimate of Gov-S_2 is less than α at the 1% confidence level, it is in the rejection area. It can be said that there is significant relationship between sub-score of public disclosure and transparency and firm performance. The relationship direction is positive regarding that the variations in firm performance is explained by the variations in Gov-S_2. Furthermore, R^2 of the model is 74% and adjusted R^2 is 72% referring that the model is statistically significant since 74% of variation in the Tobin's Q is explained by the variations in the independent variables. The model is also statistically significant since F-statistic is significant at 1% level.

Table 12 indicates the results of regression Gov-S3 as the independent variable. The regression is:

$$Q = 2.063080 + 0.011720*\text{Gov-}S_3 - 0.089210*\text{ Ln (Sales)} + 1.938344*\text{ROA} + \varepsilon$$

The p value of the coefficient estimate of Gov-S_3 is less than α at the 1% confidence levels, it is in the rejection area. It can be said that there is significant relationship between sub-score of stakeholders and firm performance. The relationship direction is positive. 71% variation in the Tobin's Q is explained by the variation in the independent variables. The model is also statistically significant since F-statistic is significant at 1% level.

Table 12: Regression Results: Gov-S_3 as the Independent Variable

Dependent Variable: Q
Method: Least Squares
Included observations: 45

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	2.063080	0.852413	2.420282	0.0200
GOV_S3	0.011720	0.004645	2.522995	0.0156
LOG(SALES)	-0.089210	0.044875	-1.987966	0.0535
ROA	1.938344	0.210209	9.221012	0.0000

R-squared	0.714493	Mean dependent var	1.397254
Adjusted R-squared	0.693602	S.D. dependent var	0.604565
S.E. of regression	0.334647	Akaike info criterion	0.733203
Sum squared resid	4.591520	Schwarz criterion	0.893796
Log likelihood	-12.49708	F-statistic	34.20132
Durbin-Watson stat	2.488008	Prob(F-statistic)	0.000000

Table 13 shows the regression results of Tobin's Q against Gov-S_4. The regression is:

$$Q = 1.852666 + 0.006584*\text{Gov-}S_3 - 0.059167*\text{ Ln (Sales)} + 1.926512*\text{ROA} + \varepsilon$$

The p value of the coefficient estimate of Gov-S_3 is greater than α at the 5% and 10% confidence levels, it is in the non-rejection area. It can be said that there is no relationship between sub-score of stakeholders and firm performance. The model is statistically significant since F-statistic is significant at 1% level.

Table 13: Regression Results: Gov-S_4 as the Independent Variable

Dependent Variable: Q
Method: Least Squares
Included observations: 45

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	1.852666	0.904369	2.048573	0.0469
GOV_S4	0.006584	0.006181	1.065167	0.2930
LOG(SALES)	-0.059167	0.046105	-1.283320	0.2066
ROA	1.926512	0.223616	8.615286	0.0000

R-squared	0.679047	Mean dependent var	1.397254
Adjusted R-squared	0.655563	S.D. dependent var	0.604565
S.E. of regression	0.354812	Akaike info criterion	0.850229
Sum squared resid	5.161548	Schwarz criterion	1.010821
Log likelihood	-15.13015	F-statistic	28.91490
Durbin-Watson stat	2.527134	Prob(F-statistic)	0.000000

To sum up, Table 10, 11, 12 and 13 summarizes regression results of the governance category sub-scores as the independent variables and Tobin's Q as the dependent variable. Except for the sub-scores of shareholders (Gov-S_1) and the board of directors (Gov-S_4), other sub-scores are statistically significant in the model. It can be argued that scores of public disclosure and transparency (Gov-S_2), stakeholders (Gov-S_3) influence the firm performance in the positive direction.

The coefficient of the sales variable was negative in all models as expected. ROA was also positive and statistically significant at 1% confidence level in all models as expected.

4.4. Findings

The findings of this study suggest that corporate governance is an important factor in explaining the variations in firm performance. A Governance score is constructed for 45 manufacturing firms listed in ISE 100 index. Sub-scores for the

sections of (1) Shareholders, (2) Public Disclosure and Transparency, (3) Stakeholders, (4) Board of Directors are also constructed.

The result of the regressing Tobin's Q against overall corporate governance sore indicates that there is a statistically significant relationship between corporate governance and firm performance for manufacturing firms at ISE. The relationship direction is positive meaning that an increase in corporate governance score will lead to an increase in firm performance. These findings are consistent with the results of Aggarwal and Williamson (2006), Brown and Caylor (2004), Black, Jang, and Kim (2003), Gompers, Ishii and Metrick (2003) whereas they are inconsistent with Gupta, Kennedy, and Weaver (2006).

The sub-scores of shareholders denoted as Gov-S_1 and board of directors denoted as Gov-S_4 and has no effect on firm performance. On the other hand, other sub-scores including public disclosure and transparency and stakeholders have significant effects on firm performance according to regression results against Tobin's Q. The relationship direction is positive.

For further studies, sample size can be increased and thus more relevant results can be obtained. In addition, all companies quoted at ISE will get a corporate governance score report in a few years. By using those disclosed scores, there will be no need for self-construct corporate governance score. Investors and other interested parties will easily obtain corporate governance scores from ration reports of firms. Then, more firm performance measures can be used to analyze the relationship between corporate governance and firm performance for further studies.

Overall, it can be argued that corporate governance has a positive effect on firm performance of manufacturing firms at Istanbul Stock Exchange.

CONCLUSION

In recent years, corporate governance has become a very important topic to investors, firms and governments. The importance of effective corporate governance has been realized and regulatory bodies began to improve and maintain governance frameworks of firms through codes, principles, and regulations. An effective corporate governance system is important for sustainable economic growth and investor confidence through promoting efficient use of resources.

There is no one model of corporate governance system for every firm and country. Therefore, there are many codes and principles related to good corporate governance practices around the world. On the other hand, OECD standards define the basis for a corporate governance framework and set of principles. Similarly, Turkish CMB issued its own corporate governance practices in 2003 and amended them in 2005. Those principles are mainly based on OECD principles.

The main purpose of this study is to self construct a composite corporate governance score based on the CMB corporate governance principles and then to investigate the relationship between such a score and firm performance measured by Tobin's Q. It also attempts to determine whether better governed firms measured by high corporate governance score have better firm performance.

In the first chapter, corporate governance is defined with its importance and evolution through years. Governance systems including market-based and relationship-based are presented and the convergence between these systems is also discussed with reasons. The principles of corporate governance are discussed under the sections of OECD principles, CMB principles in Turkey, and the comparison between those two principles.

In the second chapter, corporate governance mechanisms including internal and external forming the structures and rules of the system are discussed. Internal governance mechanisms are divided into sub-sections – board of directors and

ownership structure. In similar, external mechanism includes market for corporate control, legal and regulatory structure, and product market competition. Within this structure, governance mechanisms in Turkey are discussed based on the empirical studies on Turkish corporate governance.

A review of corporate governance and firm performance is given in the third chapter. Empirical studies on the corporate governance using a composite corporate governance score or index against firm performance measures are reviewed and discussed in detail. In addition, firm performance measures as accounting-based and market-based are defined and given.

The empirical analyses are provided in the fourth chapter. The population of this study is every firm quoted at ISE 100. The sample includes 45 manufacturing included in the index. The data for the governance score is collected from the web-site of each firm and balance sheets and income statements are obtained from the ISE data-base. The data is obtained and the study is conducted only for 2006. A composite corporate governance score is constructed based on corporate governance principles issued by Turkish CMB. The governance score card is used in giving a score to each firm. Then, four sub-scores are formulated including shareholders, public disclosure and transparency, stakeholders, and board of directors. As a firm performance measure Tobin's Q is used similar to other studies in the literature.

The regression analysis is conducted for hypothesis testing. Tobin's Q is regressed against overall corporate governance score and the sub-scores of shareholders, public disclosure and transparency, stakeholders and the board of directors. The results of the analysis show that there is a significant relationship between corporate governance measure by a composite corporate governance score denoted as Gov-S and firm performance measured by Tobin's Q. The direction of the relationship is positive. It can be argued that better governed firms have better firm performance.

In addition, the sub-scores of shareholders denoted as Gov-S_1 and board of directors denoted as Gov-S_4 have no effect on firm performance. By contrast, the sub-scores of public disclosure and transparency denoted as Gov-S_2 and stakeholders denoted as Gov-S_3 have significant effect on firm performance. The relationship direction is positive.

There are few limitations in the study. First, the sample is restricted to only manufacturing firms. Therefore, these results are highly tentative because of the small sample size. Second, only one firm performance measure is used. With the addition of more firm performance measures to the model, more accurate results can be obtained. Third, the corporate governance score is self-constructed through CMB principles. Some subjective and non-obtainable items are omitted from the score. Scores may be tentative since the sample firms are self-scored.

For further studies:

- It can be better to conduct the analysis with greater sample sizes which are gathered throughout many years,
- A composite corporate governance score can be obtained directly from corporate governance rating reports of firms,
- More firm performance measures can be used in the analysis,
- The analysis can be conducted within several industries.

In the light of this study, it can be said that the importance of corporate governance is realized by Turkish investors, regulators, and other stakeholders. Additionally, the evolution of corporate governance is still continuing and the existing system is improving through more effective framework.

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APPENDIX

	GOVERNANCE SCORE CARD				
	TOTAL SCORE - VESTEL		**100%**	**78**	
1.	**SHAREHOLDERS**	**6.5**	**25%**	20	81
1.1.	Facilitating the Exercise of Shareholders' Statutory Rights	0.5			
1.2.	Shareholders Right to Obtain and Evaluate Information	1			
1.3.	The Right to Participate in the General Shareholders' Meeting	0.5			
1.4.	Voting Rights	1			
1.5.	Minority Rights	0.5			
1.6.	Dividend Rights	1			
1.7.	Transfer of Shares	1			
1.8.	Equal Treatment of Shareholders	1			
2.	**PUBLIC DISCLOSURE AND TRANSPARENCY**	**5**	**35%**	29	83
2.1.	Principles and Means for Public Disclosure	1			
2.2.	Public Disclosure of Relations between the Company and Its Shareholders. The Board of Directors and Executives	1			
2.3.	Periodical Financial Statement and Reports in Public Diclosure	0.5			
2.4.	Functions of External Audit	0.5			
2.5.	The Concept of Trade Secret and Insider Trading	1			
2.6.	Significant Events and Developments That Must Be Disclosed to the Public	1			
3.	**STAKEHOLDERS**	**5.5**	**15%**	12	79
3.1.	Company Policy Regarding Stakeholders	0.5			
3.2.	Stakeholders' Participation in the Company Management	0			
3.3.	Protection of Company Assets	1			
3.4.	Company Policy on Human Resources	1			
3.5.	Relations with Customers and Suppliers	1			
3.6.	Ethical Rules	1			
3.7.	Social Responsibility	1			
4.	**BOARD OF DIRECTORS**	**4**	**25%**	17	67
4.1.	Fundamental Functions of the Board of Directors	1			
4.2.	Principles of Activity and Duties and Responsibilities of the Board of Directors	0.5			
4.3.	Formation and Election of the Board of Directors	0.5			
4.4.	Remuneration of the Board of Directors	0.5			
4.5.	Number. Structure and Independence of the Committees Established by the Board of Directors	0.5			
4.6.	Executives	1			

The scores for all sections are based on the calculations provided in the next tables. In these tables, the signs used denote:

✓ **: The firm meets the minimum criteria**

☒ **: The firm does not meet the minimum criteria**

na : Not Applicable. Non-obtainable data through publicly available information

DETAILS OF SCORES

1.	**SHAREHOLDERS**			
1.1.	***Facilitating the Exercise of Shareholders' Statutory Rights***			**0,5**
	1.1.1.	In exercising shareholders' rights, legislation, articles of association and other in-house regulations should be applied and necessary precautions to ensure use of such rights should be adopted.		0,5
		1	*established investor relations department consisting an adequate number of staff and an authorized staff*	☒
		2	*defined responsibilities of shareholder relations department*	✓
1.2.	***Shareholders Right to Obtain and Evaluate Information***			**1**
	1.2.1.	There should be no discrimination among shareholders when exercising their right to obtain and evaluate information.		0,5
		1	*All information required to exercise shareholders' rights should be made available to all shareholders*	✓
		2	*when not receiving the information in that quality, a shareholder has a right to refuse financials and suing for cancellation.*	**na**
		3	*informations about legal and commercial relationships wtih other enterprises or individuals*	**na**
		4	*right to obtain information simultaneously*	✓
		5	*not providing information when it is trade secret and when protecting the company's assets*	**na**
		6	*right to obtain to reqest an appoinment of a special auditor -a provision in the articles of association*	☒
	1.2.2.	In order to broaden the scope of shareholders right to obtain and evaluate information, any type of information that may affect the way in which shareholder exercise such rights, must be updated on a regular basis in an electronic form.		1
		1	*updates in web-sites*	✓
1.3.	***The Right to Participate In the General Shareholders' Meeting***			**0,5**
	1.3.1.	Within a reasonable period prior to the general shareholders' meeting, holders of registered shares should be recorded in the company's share ledger by also taking into consideration the records of institutions operating for the record keeping and safekeeping of shares in order to ensure attendance of real shareholders at the general shareholders' meeting.		0
		1	*booking of registered shares to company's share ledger prior to general shareholder's meeting*	☒
	1.3.2.	The procedure, content and timing of invitation to the general shareholders' meeting, should allow shareholdesrs to acquire adequate information about the agenda items to be discussed prior to the meeting and enables preparations thereto. The board of directors should prepare and disclose to public an informative document regarding the agenda items.		1
		1	*announcement through all means of communication including electronic means in three weeks advance*	✓
		2	*including:date and time of meeting; exact location of meeting; agenda items with informative documents; old and new versions of the related provisions of articles, the place where annual report, financial statements and other meeting documents can be examined*	✓
		3	*made all informations for meeting to shareholders for examination purposes (electronic form-through branches)*	✓
		4	*declaring all changes which were realized in the previous accounting period - if any reasons for changes in the organizational structure of the company*	✓

		5	*easily associated information attached to agenda items-consisting references*	✓
		6	*separete heading for agenda items and clearly expressed*	✓
		7	*announced proxy forms for the meeting - electronic forms*	✓
		8	*voting procedure should be announced prior to the meeting and shareholders should be duly informed in electronic media*	☒
		9	*attention to issues raised within shareholders relation department and request of minority shareholders*	☒
	1.3.3.	The general shareholders' meeitng should be conducted in a manner to ensure the highest level of participation.		1
		1	*helding meetig at the shortest time period - not exceeding three months following the end of each accounting period*	☒
		2	*not leading any discrimination among shareholders - least cost and complex mannner*	✓
		3	*placing meeting at headquarter or where majority of shareholders are located*	✓
		4	*location should be easily accepted*	✓
	1.3.4.	Agenda items should be expressed in an unbiased and detailed manner with, clear and concise method in the general shareholders' meeting. Shareholders should be provided with equal opportunities to express their opinions, and raise any questions and a sound discussion environment should be created.		0,5
		1	*total number of votes and privileges are determined and classified and shareholders are informed at the start of meeting*	✓
		2	*meeting should serve as a forum in which annual report and company's performance indicators are discussed*	✓
		3	*inform about the transactions and competitive activities that board members have been involved*	☒
		4	*information about controversial news and analysis regarding the company issues as exposed in the media*	☒
		5	*answer questions raised by the shareholders - auditors and board of directors*	✓
		6	*chairman of the meeting should conduct meeting on fair grounds*	**na**
		7	*questions should answered directly or provided in writing within one week following the date of meeting*	**na**
		8	*informers about agenda items should attend the meeting, or explain reasons for absences*	**na**
		9	*each agenda item should be voted separetely. Votes must be counted and results be announced before the end of meeting*	✓
		10	*the minutes of the meeting should be made available to the shareholders in writing or in electronic media*	✓
		11	*a provision could be inserted in the articles of association to allow meeting open to public, stakeholders and the press*	☒
		12	*all candidates should be present during the election of the board members of the board of directors and shareholders are provided with information concerning the candidates -Shareholders should be informed about the other companies on which each candidate fulfils a duty as a board member and exclusively on whether or not in-house regulations in that respect are observed. -Minimum requirements for disclosure of information about the candidates should be stated in the articles of association. Shareholders are informed about any information that the candidates refrain to disclose. - The information that candidates are required to disclose may be outlined as follows: identification information of the candidate; level of education; current and previously held positions within the past five years and reasons for departure from each position; the characteristics and level of relations with the company; board membership experience; official tasks; the characteristics and level of relations with the individuals related to the company; the characteristics and level of relations with main institutions with whom the company deals with; financial status and/or declaration of property; whether or not independence criteria is meet and will*	✓

			be maintained at the time of general shareholders' meeting and other similar matters that may affect the company's operations in case of board membership.	
		13	*If a person, who was previously employed in the public sector, is employed within the management, enforcement, and/or consultancy departments of the company, then the shareholders must be informed of the reasoning of such appointment.*	**na**
		14	*Shareholders should be given the opportunity to express their views and suggestions in relation to the remuneration policy that is applicable to board members and key executives.*	**na**
	1.3.5.	During the general shareholders' meeting, the audit firm must explain in writing whether or not the financial statements and other financial reports such as capital adequacy table comply with the current Principles and standards; the statements and reports truly and completely reflect the real status of the company; whether or not there are any issues hindering the independence of the external auditor company; and services provided to the companyand to its subsidaries / affiliates by the external auditor company and its subsidaries.		1
	1.3.6.	Articles of association of the company includes a provision to maintain that decisions, regarding the division and allocation of shares which changes the capital and management structure of the company and the composition of the company's assets; the sale, purchase or lease of tangible/intangible assets or grants in significant amounts; the issuance guarantees like pledges and mortgages in favour of a third person are in general shareholders' meeting and the shreholders are encouraged to participate in the decision-making process thereby.		0
1.4.	***Voting Rights***			**1**
	1.4.1.	The right to vote is an indispensable right, which cannot be abolished in any way by the articles of association and its essence can not be interfered with in any way.		1
	1.4.2.	Any actions that may complicate the use of voting rights must be avoided.		1
	1.4.3.	Ceilings should not be applied on the number of votes that a shareholder may exercise during the general shareholders' meeting.		na
	1.4.4.	The right to vote is automatically granted once the share is acquired. Hence, under no conditions, arrangements that would postpone the exercise of the right to vote a certain period following the acquisition of share should be adopted.		1
	1.4.5.	Privileges regarding voting rights should be avoided.		1
		1	*Shareholders of preferred stock should not have the privilege to nominate in a way that would distort the fair representation of holders of publicly traded shares in the management of the company.*	✓
		2	*Priveleges on voting rights should be simple and allow shareholders to easily understand their rights*	✓

	1.4.6.	Provisions that may prevent voting by use of a proxy who is not a shareholder should not be included in the articles of association of the company.		1
		1	*a shareholder can vote either personally or by appointing a third person as his /her representative*	✓
		2	*each individual shareholder may only be represented by one person at the general meeting*	✓
		3	*legal repsentations if any should be documented in writing*	✓
		4	*the company should attach great significance to the institutional representatives*	✓
		5	*Should beneficial interests of shares are mentioned in the articles of association of the company, a provision may be inserted there in order to clarify that the voting right would belong to the shareholder whereas such shareholder would consider the interests of the beneficial owner when exercising his/her voting right*	✓
	1.4.7.	In case cross ownership is associated with a controlling relationship, the companies in such cross ownership should avoid exercising his/her voting right in the general shareholders' meeting and disclose the issue to the public, provided that there exist no compulsory cases, e.g. to form a quorum.		1
	1.4.8.	Save for the special provisions of the relevant legislation and articles of association, voting should be conducted through open ballot and by raising hands during the general shareholders' meeting. Upon request by shareholders, the voting procedure should be determined by the general shareholders' meeting.		1
	1.4.9.	Shareholders should be notified about the voting procedure prior to the start of the general shareholders' meeting.		0
1.5.	***Minority Rights***			**0,5**
	1.5.1.	Utmost care should be given to the exercise of minority rights. -The cumulative voting procedure should be adopted so as to as certain that minority shareholders send their representatives to the board of directors. -Minority rights are defined in the articles of association for shareholders' holding less than one twentieth of the company's capital. An enlargement of the scope of minority rights can be attained through the regulations in the articles of association of the company (R).		0,5
		1	*Cumulative voting procedure should be adopted so as to certain that minority shareholders send their representatives to the board of directors*	☒
		2	*minority rights are defined in the articles of association for shareholders' holding less than one twentieth of the company's capital*	✓
1.6.	***Dividend Rights***			**1**
	1.6.1.	The board of directors and executives of the company are prohibited from diminishing the profit through, collusive transactions, as defined in the related legislation.		1
	1.6.2.	The company should have a clearly defined and consistent dividend policy. This policy should be announced to the shareholders at the general shareholders' meeting and also included in the company's annual report, prospectus and circulars.		1
		1	*following issues should be incorporated in the dividend policy*	✓

			a-Annual profit, amount and sources of distributable profit, b-The criteria according to which the board of directors' prepare dividend distribution proposal, c-Dividend to be paid for each share, while indicating different groups of shares, d-Amount of dividend to be distributed to the board of directors, founders' benefit shares, and employees of the company and the method for its calculation, e-Location, time and terms of payment for dividends, f-Should interim dividends are to be paid in the following accounting period, the Principles and provisions relating to interim dividend payments, g-By taking into consideration any indirect shareholder relationships, the amount of dividends due to be paid to real persons who own a significant portion of distributable profit (for the small investors the amounts may be summed up), h-Information regarding past and planned donations/contributions to be performed by the company during the accounting period or at the end of the accounting period.	
	1.6.3.	In case the board of directors proposes not to distribute any dividends at the general shareholders' meeting, the basis for such proposal and information on the method of use of the profit should be announced to the shareholders and published in the annual report, prospectus and circulars.		1
	1.6.4.	Distribution of dividends should be performed within the period prescribed by the legislation and as soon as possible after each general shareholders' meeting.		1
	1.6.5.	Decision-making and implementation procedures for the interim dividend payments should be carried out with due diligence.		1
	1.6.6.	A consistent dividend distribution policy is constituted to balance the interests of the shareholders and the company (R).		1
1.7.	***Transfer of Shares***			**1**
	1.7.1.	Practices that would hinder shareholders to freely transfer their shares should be avoided. The articles of association should not contain provisions to impede the transfer of shares.		1
1.8.	***Equal Treatment of Shareholders***			**1**
	1.8.1.	All shareholders, including minority shareholders and foreign shareholders should be treated equally.		1
	1.8.2.	The board of directors, executives, shareholders who are controlling the management, or other person, who would have the privilege to retrieve various kinds of information, should disclose the activities performed on their own behalf but which coincide with the activities of the company.		1
	1.8.3.	Unless aimed at protecting his/her own justified interest, no shareholder may act with the intention of harming other shareholders and the company (R).		1

2.	**PUBLIC DISCLOSURE AND TRANSPARENCY**			
2.1	***Principles and Means for Public Disclosure***			**1**
	2.1.1	Disclosed information should be accurate, complete, comprehensible, interpretable and easily accessible at low cost and be prepared to aid the individuals and institutions in their decision-making and presented equally.		1
		1	*there should be two executives responsible for public disclosures with signing authority*	✓
		2	*a member of personnel employed at the company's shareholder relations department should be assigned solely to monitor and supervise all issues pertaining to public disclosure*	✓
		3	*information to be disclosed to the public should not be announced to specific investors or concerned parties prior to the public diclosure*	**na**
		4	*the company must accurately disclose its accounting policy and operational results to the public*	✓
	2.1.2	The company should established its information policy and disclose it to the public.		1
		1	*the board of directors should prepare collective Principles to be used in the information policy of the company*	✓
		2	*information policy should cover category of information to be disclosed to the public:form, frequency and methods of disclosure; etc.*	✓
		3	*information policy should define the type of information to be discussed at meeting*	✓
		4	*any amendments in the information policy should be presented at meeting and to the public*	✓
	2.1.3	Any developments that may affect the value of the company's capital market instruments should be disclosed to the public without any delay and within the time period required by the current legislation.		na
	2.1.4	Should there be a significant change in the financial status and/or operations of the company, or in case of an expectation of such a significant change in the financial status and/or operations in the future, the information should be disclosed to the public, save for the relevant provisions of legislation.		na
	2.1.5	Any changes or new developments in the already disclosed information should be regularly updated and disclosed to the public.		na
	2.1.6	Unilateral declaration of the board of directors, which covers information about whether or not the Principles are being properly applied, if the Principles are not being applied, the reasons for such non-application and all possible conflicts of interest due to the improper adoption of the Principles, should be included in the annual report and disclosed to public, together with pertinent harmonization report, if any.		1
	2.1.7	The dividend policy of a company should also be included in the annual report of the company and be publicly announced within the framework of the public information policy.		1
	2.1.8	The company should disclose its ethical rules within the scope of its public information policy.		1
	2.1.9	A company, whose capital market instruments are listed in a foreign securities exchange, is required to simultaneously disclose the information in its home country that is disclosed abroad, together with any additional notes that would make the information disclosed easier to understand, even if such information does not need to be disclosed in its home country.		1

	2.1.10	Forward looking information to be disclosed, e.g. pro forma financial statements and reports should be disclosed together with underlying statistical data and evidence. This information should not consist of any exaggerated provisions or misleading information that would lead to false interpretations about the company's financial status and operational results.		0
		1	*review predictions and assumptions regarding the company's performance*	☒
		2	*preparation of financial statements should be subject to a compliance audit*	☒
		3	*principles applicable to disclose forward looking information should be included in the information policy of the company*	☒
	2.1.11	The company's website should be actively used as a means of public disclosure.		1
		1	*website should be easily accessible*	✓
		2	*website should also be made available in English*	✓
		3	*explanations in website should not be considered as a substitute for disclosure of special events*	✓
		4	*information disclosed to the public is also available on its website*	✓
		5	*including information about company, trade registry, form of proxy voting etc.*	✓
		6	*announcement of the planned meeting and agenda items*	✓
		7	*the company's web adress should be printed in the company's letterhead*	✓
		8	*the criteria regarding the use of the company's website should be included in the company's information policy*	✓
	2.1.12	In addition to disclosing information as required by the legislation, the company should also publicly disclose any information that may affect decisions of shareholders and investors (R).		0
			disclosed declaration of the board stating that all disclosure principles are duly kept	☒
2.2	***Public Disclosure of Relations between the Company and Its Shareholders, The Board of Directors and Executives***			**1**
	2.2.1	In case shareholding or voting right percentage of an individual or group reaches, exceeds or falls below the thresholds of 5%, 10%, 25%, 33%, 50% and 66,67% of total share capital or voting rights, the company is required to disclose such information immediately upon being informed thereof, except otherwise required under relevant legislation.		1
	2.2.2	The company's ultimate controlling individual shareholder or shareholders should be disclosed to the public, as identified after being released from indirect or cross ownership relationships between co-owners. The company's capital structure should be presented in a table format that would include the names of the ultimate controlling individual shareholder/s (names of the real personalities), amount and proportion of their shares and their share class and such table should also be incorporated into the annual report and financial statement footnotes2.		0,5
		1	*the company's capital structure should be presented in a table format*	✓
		2	*amount and proportion of their shares should be incorporated into the annual report and financial statement footnotes 2*	☒
	2.2.3	Board members, executives and shareholders, who directly or indirectly own 5% of the company's capital, should disclose all transactions performed on the company's capital market instruments.		1
		1	*board members, executives and shareholders who directly or indirectly own 5% of the company's capital, buys or sells capital market instruments of the company should disclose transactions on web-site.*	✓

		2	*board members, executives and shareholders who directly or indirectly own at least 5% of the company's capital, should disclose their net positions of derivative products if their share either directly or indirectly exceeds 1% of the company's capital.*	✓
	2.2.4	Board members, executives and shareholders, who directly or indirectly own at least 5% of the company's capital, should immediately disclose information about the purchase and sales of capital market instruments of other group companies or any other company with whom the company maintains a material commercial relationship.		na
	2.2.5	Commercial and non-commercial transactions between the company and companies, where board members, executives and shareholders, who either directly or indirectly own at least 5% of the company's capital, possess at least 5% and more of shareholding or having the control of the latter are disclosed to public.		na
	2.2.6	Shareholders can engage in voting agreements in order to be effective within the company's management. The company should disclose information about the voting agreement to the public once being informed of such agreement.		na
2.3	***Periodical Financial Statement and Reports in Public Diclosure***			**0,5**
	2.3.1	The company's periodical financial statements and their footnotes should be prepared in order to reflect actual financial situation of the company and disclosed to public.		1
		1	*periodical financial statements and footnotes should be prepared in accordance with the current legislation and international accounting standards abd applied accounting policies should also be included in the footnotes of financial statements.*	✓
		2	*periodical financial statements should be amended in accordance with the comments mentioned in the audit report.*	✓
		3	*the footnotes of the periodical financial statements should include all off-balance sheet transactions.*	✓
		4	*periodical financial statements should comprise all forms of incentives that is designed to grant shares to employees.*	✓
	2.3.2	The annual report should be prepared in a manner to ensure public access to all kinds of information regarding the company's activities.		0
		1	*the annual report should be signed by the board chairman, chief executive officer and department manager responsible for the preparation of periodical financial statements and reports.*	☒

		2	*The below listed issues should be incorporated in the company's annual report;* *a-Scope of activities of the company,* *b-Information about the sector in which the company operates and the company's status within this sector,* *c-Board of directors' evaluation and analysis of financial status and operation results; level of achievement of the planned operations; the company's position with respect to the defined strategic objectives,* *d-Board of directors' statement about the status of internal control system,* *e-Audit firm's opinion about the internal control system,* *f-Rating agency's opinion about the company,* *g-Detailed explanation about the foreseeable risk factors regarding future operations,* *h-Analysis of significant transactions carried out during the preceding year with the group companies and other related persons and institutions,* *i-Commercial and non-commercial transactions between the company and companies, where board members, executives and shareholders, who either directly or indirectly own at least 5% of the company's capital, possess at least 5% and more of shareholding or having the control of the latter,* *j-The curriculum vitae of the company's board members and executives; their duties and responsibilities within the company; positions held outside the company and compliance with the internally established company rules in that respect; independence statements by the independent board members; remuneration, bonuses and other benefits offered and performance evaluation of the corporate governance committee; proportion of shares and amounts invested in the company's capital; transactions made between the mentioned persons and the company, possessions in the company's capital market instruments; lawsuit filed against them on company operations,* *k-Changes in the organization, capital, ownership and management structure of the company.*	☒
		3	*statistical data and graphics should be also incorporated in the annual report.*	✓
		4	*additional explanations may be provided to ease the understanding of the reports*	☒
		5	*employees' social rights, professional training and environment protection rights may also be incorporated in the annual report*	☒
2.4	***Functions of External Audit***			**0,5**
	2.4.1		The audit firm and auditors employed by such audit firm must be independent. Independence principle indicates that the independent audit activities should be conducted without being influenced by any relationship, benefit or other factors that may impede the auditor's professional discretion and impartiality.	0
		1	*written independence documents*	☒
	2.4.2		Audit firms should be subject to regular rotation.	1
		1	*bod should appoint an audit firm for a maximum period of 5 years*	✓
		2	*only after 2 accounting periods following the termination of audit contract should the company appoint the same audit firm*	✓
	2.4.3		Audit and consultancy services should be clearly separated.	1
		1	*audit firm are not permitted to provide consultancy services to companies*	✓
		2	*the consultancy firm and its members and staff should be independent*	✓
2.5	***The Concept of Trade Secret and Insider Trading***			**1**
	2.5.1		When identifying information within the scope of trade secret, a balance should be maintained between providing transparency and protecting the interests of the company (R).	1

		1	*information bearing commercial value should be classified as trade secret*	✓
		2	*security and protection of trade secrets of the company are essential*	✓
	2.5.2	In order to prevent insider trading all the necessary measures and precautions should be taken. A list of the names of executives and other persons/institutions who provide services to the company, and who can potentially possess price-sensitive information should be prepared and disclosed to public in accordance with the information policy.		1
		1	*published list of names*	✓
2.6.	***Significant Events and Developments That Must Be Disclosed to the Public***			**1**
	2.6.1	The conditions listed below and their possible implications on the financial status and operational results of the company should be disclosed immediately to the public.		1
		1	*published list of significant events on web-site and on ISE*	✓

3.	**STAKEHOLDERS**			
3.1.	***Company Policy Regarding Stakeholders***			**0,5**
	3.1.1	The corporate governance framework should recognise the rights of stakeholders established by law or through any other mutual agreement.		1
		1	*effective and swift compensation should be offered in case the stakeholders' rights, that are governed under the relavant legislation and protected by contracts are violated*	☒
		2	*company should preserve the interest of stakeholders under good faith principles and within the capabilities of the company*	✓
		3	*stakeholders should be sufficiently informed about the company's policies and procedures*	✓
		4	*the company should act as a pioneer in overcoming and solving any possible conflicts and disputes that may arise between the company and its stakeholders*	✓
		5	*stakeholders should be able to freely communicate their concerns about illegal or unethical practices.*	✓
	3.1.2	When a conflict of interest arises among the stakeholders or when a stakeholder belongs to more than one interest group, the company should seek to adopt a well-balanced policy aimed at protecting the rights of stakeholders. Moreover, each particular right of the stakeholder should be protected independent from each other (R).		0
		1	*well balanced written policy amied at protecting the rights of shareholders*	☒
3.2.	***Stakeholders' Participation in the Company Management***			**0**
	3.2.1	The company should establish mechanisms and models to encourage participation of the stakeholders in the management of the company while giving priority to employees and not hindering company operations (R).		0
			Any planned mechanism or model that the company will adopt should be acknowledged in the internal regulations or in the articles of association of the company as much as possible. -In means of such mechanisms, representation of employees at the board of directors and obtaining opinions of stakeholders on company related material issues should be given priority. -Should incentives regarding the review of the management and operations of the company be granted to a particular group of stakeholders, any information which is classified as trade secret and obtained as a result of this privilege, may not be used so as to violate the equal opportunity among different groups of stakeholders.	☒
3.3.	***Protection of Company Assets***			**1**
	3.3.1	Neither the board of directors nor any of the executives may take actions that would cause the company assets loose value and that would lead to the deliberate loss for stakeholders.		1
3.4.	***Company Policy on Human Resources***			**1**
	3.4.1	When establishing employment policies and preparing career plans, the company should adopt employment policies that would provide equal opportunities to individuals who have similar specifications.		1
		1	*the employment criteria should be in written form and be applied in applications*	✓

		2	*each employee should be treated on equal grounds in education and promotion and training plans*	✓
	3.4.2	In order to establish a collaborative working environment, the company should conduct regular informative meetings that would enable the company's personnel to be informed of and to discuss issues such as company's financial capabilites, remuneration, career planning, training and health.		1
	3.4.3	Employees or their representatives should be acknowledged of any significant development or decision taken by the company that clearly affects them.		1
	3.4.4	Definitions of tasks and their distribution and performance related reward mechanisms and other issues that are vital to the productivity of the employees should be determined and disclosed by the executives to the employees. While determining compensation and other benefits, productivity and other factors that are deemed material should be prioritized.		0
	3.4.5	Working conditions of the company's personnel should be safe and secure and should be maintained and improved in time.		na
	3.4.6	The opinions of relevant trade unions regarding the rights of the employees and changes in the working conditions should be taken into careful consideration.		na
	3.4.7	Measures should be taken in order to prevent race, religion, language and sex discrimination among the employees and to protect the employees against any physical, spiritual and emotional mistreatments in the company.		na
3.5.	***Relations with Customers and Suppliers***			**1**
	3.5.1	The company should take all measures in order to ensure that its customers are fully satisfied with its goods and/or services it offers.		1
		1	*the requests of customers should be handled in a quick and efficient manner*	✓
		2	*the company should adhere to the norms of quality standards in the production of its services*	✓
	3.5.2	Within the scope of trade secret, confidentiality of information relevant to customers and suppliers should be respected.		na
	3.5.3	The company should take all the necessary measures and precautions in order to establish good relations with its customers and suppliers free from any unfair advantage and to comply with the provisions of the agreements among the parties (R).		na
3.6.	***Ethical Rules***			**1**
	3.6.1	The ethical rules of the company should be prepared by the board of directors, submitted to the general shareholders' meeting for information and disclosed to the public. The operations of the company should be carried out in accordance with the company's ethical rules.		1
		1	*written and published ethical rules*	✓
3.7.	***Social Responsibility***			**1**
	3.7.1	The company should be considerate of its social responsibilities; should act in accordance with the company's ethical rules and rules with respect to the environment, the consumers and the public health .		1

4.	**BOARD OF DIRECTORS**			
4.1.	***Fundamental Functions of the Board of Directors***			**1**
	4.1.1	The board of directors is the strategic decision-making, executive (management) and representation body of the company. The board of directors should define the mission/vision of the company and should disclose this to the public.		1
	4.1.2	The board of directors should approve the strategic goals constituted by the executives.		1
	4.1.3	The board of directors should constantly and effectively revise the company's level of success in achieving its goals, operations and past performance. In doing so, the board of directors endeavors to abide by international standards in all respect. In case any difficulties or problems are encountered, the board of directors should take all the necessary means and measures without any delay or prior to occurrence thereof.		1
		1	*Effective revision shall mean revealing degree of achievement of the company's operations, approved annual financial and business plans; compliance with current legislation and international accounting standards in the accountancy of operational results of the company and identification of the degree of accuracy of the company related financial information.*	✓
		2	*BOD should establish an internal control and risk management mechanisms*	✓
		3	*BOD should form committees to perform tasks in a sound manner*	✓
		4	*BOD should assess whether the executives are well qualified to suit the demands of their positions*	**na**
	4.1.4	The board of directors should closely monitor and supervise whether or not the company's operations comply with the relevant legislation, articles of association, in-house regulations and policies.		na
	4.1.5	The board of directors should act as a pioneer in resolving and settling disputes that may arise between the company and shareholders.		na
4.2.	***Principles of Activity and Duties and Responsibilities of the Board of Directors***			**0,5**
	4.2.1	The board of directors should conduct its activities in a fair, transparent, accountable and reliable manner.		1
	4.2.2	The board of directors' duties and responsibilities should be clearly defined in the articles of association of the company in consistence with its functions and beyond any doubt so as to distinguish from the authorities and responsibilities of individual board members, executives and general assembly. Authority and responsibility for each board member and executive should also be clearly defined, included in the annual report of the company and disclosed to public thereby.		0
		1	*The board of directors' duties and responsibilities should be clearly defined in the articles of association*	☒
		2	*Authority and responsibility for each board member and executive should also be clearly defined, included in the annual report of the company and disclosed to public thereby.*	☒
	4.2.3	Each board member should perform his/her duty prudent and in good faith. Performance of duties in a prudent manner and in good faith requires demonstrating minimal care and diligence as will be required for similar events under similar conditions.		na
	4.2.4	In order to ensure that the board members perform their duties fully, they should be provided with easy access to all kinds of information in a timely manner.		na

		1	*mechanisms to enable timely and accurate information for the board members about significant developments should be adopted*	**na**
		2	*if deemed necessary, all executives should attend the board of directors meetings*	**na**
		3	*any behaviour by the company employees that would obstruct flow of the information to the board of directors should be subject to sanctions including warnings and termination of employees*	**na**
		4	*non-executive directors of the board cannot escape from responsibility*	**na**
	4.2.5	Members of the board members will be jointly liable should they intentionally or unintentionally fail to properly perform their duties assigned to them by legislation, the articles of association and the general shareholders' meeting.		0
	4.2.6	Members of the board should not indulge in pressures that would serve against the interests of the shareholders and not accept any material gains. Board of directors should include these matters in the ethical rules of the company and take measures to ensure that all employees abide thereby.		1
			ethical rules include this matter	✓
	4.2.7	Each member of the board should devote sufficient time for the company's business. Within this scope, any duty that the board member may accept outside the company should be subject to certain rules and be limited.		na
	4.2.8	As a rule, each member of the board should be strictly prohibited from engaging in transactions and from competing with the company.		1
			Upon occurrence or being informed of such case, the board member should immediately notify the board of directors and the company's internal audit committee in writing. Moreover, this incident should be explained to the shareholders in the next revailing general shareholders' meeting, be disclosed to public and included in the annual report. For a board member, in order to engage in transactions and compete with the company, ¾ (three-fourths) of the company's shareholders should grant approval thereto. The issue should be regulated under the company's articles of association.	✓
	4.2.9	Members of the board can under no circumstances disclose company information that is confidential and/or trade secret. This matter of confidentiality should be incorporated in the ethical rules of the company. Board members should also adopt requisite measures in order to ensure that confidential information does not flow out of the company by other company employees as well.		1
			Matter of confidentiality should be incorporated in the ethical rules of the company	✓
	4.2.10	Members of the board are prohibited from exploiting confidential and publicly unavailable information in favor of himself/herself or others; providing information or extending news or making comments that are false, untrue, misleading, and unfounded information about the company.		1
	4.2.11	In case the company faces bankruptcy, executives should restore to the company any excessive portion of material benefits which they may have received as allowances and which may be significantly different from the imputed allowances within last three years before bankruptcy (R).		na
	4.2.12	Before commencing work, members of the board should declare in writing that they will comply with the legislation, articles of association, in-house regulations and policies, and in case of incompliance, that they would be jointly liable to compensate the loss accrued to the shareholders and stakeholders (R).		0

	4.2.13	The board of directors shall be held responsible for the preparation and presentation of the company's periodical financial statements in accordance with the current legislation and international accounting standards and the reliability and accuracy thereof. The board of directors should adopt a separate decision to approve the periodical financial statements and annual report of the company.		0
		1	*at the time of announcement and notification of periodical financial statements with footnotes and annual report, all responsible persons should be obligated to prepare and sign an official declaration in writing*	☒
		2	*BOD should take all measures to ensure that responsible persons can access to information about the company*	☒
		3	*authorized signatures should inform the board, audit commitee, and external auditor about any critism or suggestions*	☒
	4.2.14	Beyond basic functions of the board of directors and in accordance with opinions and suggestions of the committees, the board of directors should undertake the following responsibilities; a-To approve the annual budget and business plans of the company, b-To prepare the annual report and to finalize the same for presentation at the general shareholders' meeting; c-To ensure that the general shareholders' meeting is conducted in accordance with the legislation and the company's articles of association; to fulfill the general shareholders' meeting decisions, d-To control the company's material expenditures exceeding 10% of the total assets value in the most recent balance sheet of the company, e-To approve the career plans and remuneration of executives, f-To determine policies for shareholders, stakeholders and the public relations , g-To determine the information policy of the company, h-To determine the ethical rules, i-To determine the working principles of the committees; to ensure them to work effectively and efficiently; j-To take all required measures to assure that the organization of the company meets environmental conditions, k-To inspect operations of the preceding board of directors.		0,5
	4.2.15	The chairman should consult other members of the board and chief executive officer/general director to determine the agenda of the board of directors' meetings.		1
	4.2.16	The agenda items should be discussed openly and thoroughly at the board meetings. Should a member of the board has a dissenting opinion, he/she should append the reasonable and detailed dissenting opinion to the records of the meeting and inform the company's auditors in writing.		1
		1	*under no condition can a member of the board submit deficient or biased information on the issues discussed at meetings.*	✓
		2	*all questions raised by the members of the board during the meeting should be answered immediately and incorporated in the minutes of meeting*	✓
	4.2.17	The meetings of the board of directors should be planned and conducted in an effective and efficient manner.		0,5
		1	*First meeting of the board of directors should be held within one month following the election. Decisions regarding election of the chairman and the deputy chairman as well as distribution of duties and composition of committees should be adopted at such first meeting.*	☒
		2	*In principle each member of the board should attend all meetings.*	✓
		3	*Remote access should be made available in order to maximize the level of attendance at the board of directors meetings*	**na**
		4	*All members of the board are obliged to attend the meetings in person if important agenda items regarding the company's operations are to be discussed therein.*	✓
		5	*The board of directors should convene on regular basis at least once a month, as planned in advance, and if necessary more often without any delay.*	✓
		6	*Procedures for invitation of the members of the board to the meeting and organization thereto should be designed so as to allow the board members to be properly prepared for such meeting.*	☒
		7	*Documents and information about the agenda items of the meeting should be submitted to the members of the board for inspection at least seven days in advance.*	☒

		8	*A member of the board is entitled to propose any amendments on the agenda to the board chairman prior to the start of the meeting. The opinions of members, who are unable to attend the meeting, should be presented to the other members of the board, provided that the opinions are delivered in writing to the board of directors.*	**na**
		9	*Each member is entitled to a single vote at the board of directors meeting. Board members cannot be granted with weighted voting rights or positive/negative veto rights.*	✓
		10	*Provisions regarding the procedures for invitation of the members of the board for a meeting by shareholders and stakeholders should be incorporated in the articles of association.*	✓
		11	*The manner in which the board of directors' meetings are to be conducted should be incorporated in the company's internal regulations.*	**na**
	4.12.18		The board of directors meeting and decision quorum should be included in the articles of association.	1
	4.2.19		A secretariat should be established under the responsibility of the board chairman in order to serve the board of directors and to keep documents related to the board meetings in order.	1
		1	*The secretariat should basically engage in communication between members of the board; make preparations for the board meetings and committee meetings; keeps the minutes of the meetings; records and archives all communications made by the board of directors, including announcements*	✓
		2	*Records kept by the secretariat should be made available for inspection by the board of directors.*	✓
	4.2.20		A members of the board is not permitted to attend the board meeting that may concern his/her own interests or the interests of his/her spouse and his/her blood or affinity relatives up to the third degree.	na
	4.2.21		Should any opposition is raised by the independent board member on a particular issue at the board meeting such dissenting vote is disclosed to public together with a reasonable and detailed reasoning.	1
	4.2.22		The board of directors should have a budget to reimburse travel/meeting expenses, costs pertaining to special working requests and similar expenses.	na
4.3.	***Formation and Election of the Board of Directors***			**0,5**
	4.3.1		The board of directors should be structured so as to optimize effect and efficiency thereof.	1
		1	*In principle, candidates with high level of knowledge and skills and a qualified, specific experience and background should be considered as eligible and from among such candidates, members of the board should be appointed. General rules in this respect should be incorporated in the articles of association of the company.*	✓
		2	*Those, who have been convicted of non-conformity with the capital markets legislation, insurance legislation, banking legislation, legislation on prevention of money laundering and legislation on lending money; or sentenced with heavy imprisonment or imprisoned for more than five years, excluding negligent offences, even if they have enjoyed amnesty, or infamous crimes like embezzlement, qualified embezzlement, extortion, bribe, theft, swindling, forgery, abuse of trust, deceptive bankruptcy, and smuggling crimes other than employment and consumption smuggling; any fraudulent act to render official tenders; revealing state secrets; tax evasion; attempting or participating in tax evasion shall not be eligible to become a board member.*	**na**

		3	*Members of the board should be elected from among qualified persons, who are proficient about the subject of activity and management of the company and who have acquired experience as a result of working in the private/public sector, and who preferably have obtained a university degree (R).*	**na**
		4	*The number of the members for the board should be determined to facilitate producing efficient and constructive works by the board of directors, adopting rapid and rational decisions and effectively organizing formation and working of committees.*	**na**
		5	*minimum requirements required for candidates for board membership positions are defined below:* *a-To be capable of analyzing and interpreting financial statements and reports,* *b-To have basic knowledge about the legal regulations applicable to the company for daily or long term business as well as dispositions,* *c-To be able to participate in all board of directors' meetings in the relevant budget year.*	✓
		6	*Candidates who do not have the above-mentioned qualifications but elected to the board of the directors should be provided with the necessary training within the shortest period of time. Once the members of the board of directors are appointed, the corporate governance committee should commence its adaptation program. The adaptation program should be completed in a rapid and efficient manner and address the below mentioned issues:* *a-Meeting the executives and visits to the production units of the company,* *b-Evaluations of the executives' CVs and performances,* *c-Strategic goals of the company, current situation and problems,* *d-Indicators of market share of the company and its financial performance.*	**na**
	4.3.2	The board of directors comprises of both executive and non-executive members.		1
		1	*it should be maintained that the board chaiman and chief executive members are not the same person and majority of the board of directors should consist of non-executive members*	✓
		2	*non-executive members of the board of directors should regularly conduct internal meetings*	✓
				□
	4.3.3	The board should be composed to comprise independent members who have the ability to execute their duties without being influenced under any circumstances.		0
		1	*Independent board members should comprise at least one third of the board of directors and in any case two members of the board should be independent. While calculating the number of independent members, fractions should be considered as the next whole number.*	☒
		2	*Remunerations including compensations and attendance fees offered to the independent board members should be provided at a level to sustain independence and in accordance with suggestions of the board of directors and upon approval by the general shareholders' meeting. Remunerations targeted on such aim do not hinder independence.*	**na**
		3	*Professionals who have previously worked in regulatory authorities and self-regulatory institutions can be elected as members to the board provided that the other independence criteria are met (R).*	**na**
		4	*A person who has been a member of the company's board of directors for seven years cannot be appointed as an independent member to the board of directors.*	**na**

		5	*A member of the board who fulfill the below mentioned requirements may be qualified as an "independent member": a-Not to have any direct or indirect relationship of interest in terms of employment, capital or trade and commerce between the company, its subsidiaries, affiliates or any other group company and himself/herself, his/her spouse and his/her blood or affinity relatives by up to the third degree within the last two years, b-Not to be previously elected to the board of directors as a representative of a certain group of shareholders, c-Not to be employed in a company, primarily for the audit and consultant firm, which undertakes full or partial activity or organization of the company under a contract and not to be have a managing position therein within the last two years, d-Not to be previously employed by the external auditor of the company or not to have been included in the external audit process within the last two years, e- Not to be previously employed by a firm providing significant amounts of services and products to the company and not to have a managing position therein within the last two years, f-For his/her spouse or any of his/her relatives by blood and affinity up to the third degree, not to have a managing position or be a shareholder holding more than 5% of the total capital or the controlling shareholder by all means, or not to hold a managerial position or not to be effective in the control of the company, g-not to receive any compensation other than the board membership compensation and attendance fee; to hold shares of less than 1% if he/she is a shareholder due to his/her duty, provided that such shares are not preferred shares.*	☒
		6	*Independent member of the board of directors should provide a written declaration to the board of directors, stating that he/she is independent within the framework of the legislation, articles of association and the criteria stated above.*	☒
		7	*In case the independence is jeopardized in any way, any change in the independence status should immediately be reported to the board of directors by the independent member to be disclosed to public.*	**na**
	4.3.4		Priority should be given to the use of cumulative voting in the election of the board of directors. Within the framework of the legislation, the procedure for the adoption of cumulative voting should be incorporated in the articles of association of the company. The board of directors should inform the shareholders about the cumulative voting system. The cumulative voting system should be used in line with its objective and members of the board should act duly sensitively in this subject.	0
4.4.	***Remuneration of the Board of Directors***			**0,5**
	4.4.1		Attendance fee should be paid to members of the board of directors, provided that it does not exceed a certain rate of his/her compensation.	1
	4.4.2		In principle, compensation for the members of the board of directors should be determined by the general shareholders' meeting so as to counterweigh the time invested and performance of membership duties as a minimum.The compensation of the members of the board of directors should be close to the fixed wage per hour provided to the chief executive officer/general director, as a general principle. The level of the compensation should be calculated by taking into consideration the amount of time which a member has to spend for the company in the meeting, and pre and post-meeting preparations and special projects.	0,5
	4.4.3		Incentive remunerations of the board of directors should be based upon the performance of the members of the board in connection with the performance of the company. The corporate governance committee may propose any suggestions on this issue together with the reasoning thereof.	0

			The board of directors will be held liable for the company's level of achieving its predetermined operational and financial goals. Should those goals not be accomplished, the reasons thereof are clearly explained in the annual report. Thus, the board should conduct a self-assessment and performance evaluations of both the board and the members thereof, in line with the Principles established by the authorized committee. The board of directors will be provided with incentive remunerations or be dismissed under such Principles.	☒
	4.4.4		The company is not entitled in any way to lend money, to extend any credits, to prolong the terms of existing loans and credits, to improve the conditions thereof, and to extend credit under the name of any personal credit means through a third person or to provide warranties to a member of the board or the executives.Only those institutions which offer personal credits to individuals may be entitled to offer loans to above-mentioned persons via credits credit cards and other means.	1
4.5.	***Number, Structure and Independence of the Committees Established by the Board of Directors***			**0,5**
	4.5.1		In accordance with the conditions and necessities of the company, an adequate number of committees should be formed so as to enable the board to execute its tasks in an efficient manner.	0,5
	4.5.2		Chairman for each committee should be elected from among independent members of the board.	0
	4.5.3		Each committee should comprise of at least two members. If there are two members, both of them should be non-executive members. If there are more than two members in a committee, the majority of its members should be non-executive members.	1
	4.5.4		In principle, members of the board of directors cannot be assigned to more than two committees. If necessary, experts in specific areas may be eligible to be commissioned at a committee, even if they are not board members.	1
	4.5.5		Each committee should act within the limits of their own authority and duties and may present advices to the board of directors whereas the final decision should be reached by the board.	na
	4.5.6		An audit committee in charge of supervision of the financial and operational activities of the committee should be established.	1
	4.5.7		A corporate governance committee should be established in order to monitor the company's compliance with the corporate governance Principles and perform improvement studies and offer any possible suggestions to the board.	0,5
4.6.	***Executives***			**1**
	4.6.1		The executives should perform their duties in a fair, transparent, accountable and reliable manner.	1
	4.6.2		The executives should ensure that the company conducts its business within the framework of its mission, vision, goals, strategies and policies.	1
				☐
	4.6.3		The executives should act in accordance with the financial and operational plans of the company as approved by the board of directors each year.	1
	4.6.4		The executives should be authorized to perform their duties.	1
	4.6.5		An executive should have the required professional qualifications in order to perform the assigned duties.	1

		1	*the person who is appointed to the position of chief executive officer/general director, must be an expert in his/her area and have adequate managerial experience*	✓
		2	*the chief executive officer / general director should not accept any duties outside the company.*	✓
	4.6.6	The executives should obey the legislation, articles of association, in-house regulations and policies while performing their duties; and submit a report regarding the conformity of the performed works with the Principles to the board of directors each month.		0
	4.6.7	The executives cannot exploit company related confidential and publicly unavailable information in favor of himself/herself or others, and cannot provide information or extend news or make comments that are false, untrue, misleading or unfounded about the company.		na
	4.6.8	Executives should not accept direct or indirect gifts offered to them in return for the conduct of their business in the company and may not obtain unjust benefits.		na
	4.6.9	The executives should compensate the losses incurred by the company and third persons as a result of not performing their duties duly (R).		0
	4.6.10	The compensation to be paid to the executives should be compatible with their qualifications and their contributions in the success of the company. The compensation to be paid to executives should be determined in accordance with market conditions.		na
	4.6.11	A person who has been convicted of non-conformity with the capital markets legislation, insurance legislation, banking legislation, legislation on prevention of money laundering and legislation on lending money; and/or sentenced with heavy imprisonment or imprisoned for more than five years, excluding negligent offences, even if they have enjoyed amnesty, or infamous crimes like embezzlement, qualified embezzlement, extortion, bribe, theft, swindling, forgery, abuse of trust, deceptive bankruptcy, and smuggling crimes other than employment and consumption smuggling; any fraudulent act to render official tenders; revealing state secrets; tax evasion; attempting or participating in tax evasion may not be eligible to become a manager.		na
	4.6.12	Employment agreement should clearly indicate that the executive may not be permitted to work for a competitor of the company in case the executive renounces from his/her duty to protect the interests of the company for a certain period of time and describe the sanctions to be implemented in case of violation of such provision (R).		na
	4.6.13	The chief executive officer/general director should ensure that a communication method is established among the executives of the company, and between the executives of the company and third persons(R).		na