

**The Relationship Between Corporate Governance and Stock Market; Does
"more corporate governance" mean "more foreign investment"?
An Analysis In The Base of Turkey**

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Introduction

The financial liberalisation policies have started to be applied in Turkey after 1980. New institutions has been established and become independent from the government policies in Turkey for the recents 26 years. As a result Turkey, not only become an attractive and confident capital market for foreign capitals but also its place in the world corruption and transperency lists has risen¹

In this study, the absence of debate on the relationship between corporate governance and foreign direct investment in Turkey can be seen as an important shortcoming for this analysis. Nevertheless, the literature review showed that, especially for Turkey there is a poor relationship between corporate governance and foreign direct investment as only in the form of contract law.² Therefore, in our study only the capital market dimension of this argument was delineated.

In the the first part of the study, the term ‘corporate governance’ will be defined and different approaches to corporate governance will be evaluated, briefly.

In the second part, the public adjustments dealing with corporate governance in Turkey and the new institutions which can support the corporate governance after decrees of 1980 will be discussed .Additionally, corporate governance principles declared by Capital Market Board (CMB) in 2003 will be examined, briefly.

In the third part, the movement in stock markets before the CMB principles and the changes following them will be investigated through the national index information which was generated by a questionnaire made by Istanbul Stock Exchange

¹ <http://www.sabah.com.tr/2006/08/18/eko97.html>, (03.10.2006)

² For a detailed master thesis see Melis Atamer, “Halka Acik Anonim Sirketlerde Kurumsal Yonetim ve Dogrudan Yabancı Yatirimlar Acisindan Degerlendirilmesi”, **Uzmanlik Tezi**, Turkish Treasury, 2006

1. Corporate Governance; Conceptual Definition

It is not easy to give an exact definition on this concept that has a very short history. Corporate governance that focuses on management of the companies, control of the management and performances, in narrow sense examines the system between ownership of the company and management of it.

According to OECD Corporate Governance Committee; Corporate Governance can be defined as a system in which companies are directed, controlled and fundamentally, furthermore it contains the relationships between management of the company, administrative board of the company, share holders and stakeholders. Corporate Governance builds a structure in which the firm's purposes, targets and the tools in order to track the performance showing how the firm is closer these aims are all determined.³

In other words, the management of the firm, the control of the management, and the performance oriented corporate governance represent the relations system between the owners and management of the firm.

Turkish Industrialists' and Businessmens' Association takes this subject from Turkey's point of view, defines the code of corporate governance in its report called "The Structure of Board of Directors and Work" as follows ;

*"Corporate Governance can be defined in several ways, but from the widest perspective, it is a code that represents how attractive it can be to get financial resources, how efficient it works, and thus it is a code which while showing respect to values of the society it operates in, creates economic value in long term."*⁴

Monsky and Minow also define corporate governance as follows ; *"Corporate Governance is relationship among various participants in determining the direction and performance of corporations. The primary participants are;*

- *the shareholders,*
- *the management (led by the chief executive officer)*

³ Osman Gurbuz, Yakup Ergincan, **Kurumsal Yonetim: Turkiye'deki Durumu ve Gelistirilmesine Yonelik Onerileri**, Literatur Yayıncılık, Mart 2004, Istanbul

⁴ TUSIAD, **Kurumsal Yonetim En İyi Uygulama Kodu: Yonetim Kurulunun Yapisi ve Isleyisi**, Aralık 2002, page 3

- *the board of directions*⁵.”

And in their famous article Vishny ve Shleifer wrote ;” *corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment*⁶.

All over these definitions it can be said that corporate governance concept is a mechanism not only saves firms and shareholders' benefit in micro perspective; but also contribute economical improvement of country in macro perspective in all management businesses.

2) Institutions and Principles of Turkey in Corporate Governance Framework

After January,24th 1980 in which the financial liberalization decisions started to be applied, four basic institutions were established to coordinate and regulate the operation of capital market.

2.1. Capital Market Board and “Principles”

Capital Markets Board of Turkey (CMB) is the regulatory and supervisory authority in charge of the securities markets in Turkey. Empowered by the Capital Markets Law (CML), which was enacted in 1981.

Main mission of the Board is to make innovative regulations, and perform supervision with the aim of ensuring fairness, efficiency and transparency in Turkish capital markets, and improving their international competitiveness.

CMB declared ‘The Principles’ in 2003 in order to reach its aims more efficiently and to create a basic source in this area for Turkey in light of world institutional corporate governance application codes.

In the preface of Coprorate Governance Principals of Turkey the chairman of Capital Market Board of Turkey Dr.Dogan Cansizlar said;

”Here, at the Capital Markets Board (CMB) of Turkey, we are conscious of the fact that a country’s capital market can positively contribute to the economic develeopment of a country if the capital market of that particular country is able to compete within the global financial markets. Therefore, the CMB has defined corporate governance principles, which can be used

⁵ Robert A.G. Monsks and Nell Minow, **Corporate Governance**, Blackwell Business Publish, 2nd edition, 2001, page 1

⁶ Andrei Shleifer and Robert W. Vishny, “A Survey Of Corporate Governance”, **The Journal of Finance**, Vol 52, No.2, June 1997, page.737

*primarily by listed companies as well as by joint stock companies in both the private and public sector.*⁷”

This quotation, which also represents the Board’s approach to the corporate governance and attitude toward the application of it ,shows that the main target of ‘The Principals’ is the stock market which has an important role in a country’s economic development.

Corporate governance principles is based on four main headline⁸;

- Shareholders
- Public Disclosure and Transparency
- Stakeholders
- Board of Directors

And these headlines also show many similarities with OECD principals and on the other hand they indicate some differences of Turkey’s local problems.

2.2. Istanbul Stock Exchange

The Istanbul Stock Exchange (ISE) was established in 26 December 1985. The ISE is the only Stock Exchange in Turkey established to provide exchange in equities, bonds and bills, revenue-sharing certificates, private sector bonds, foreign stocks and real estate certificates.⁹ ISE has administrative autonomy and its decisions about market regulations have to be approved by CMB.

ISE had a department in 1988 called Takasban which provides ISE members with a range of banking services including securities lending and borrowing, while also providing foreign institutions with domestic custody and settlement service.¹⁰ After re-organisation in ISE, Takasbank was called Settlement and Custody Bank Inc and started to work in January 1992.

2.3. Banking Supervision and Regulation Agency

Banking and Regulation Agency (BSRA) was established in 31 August 2000 after negotiations with IMF and Stand-by agreements.

The mission of BRSA is *“to ensure confidence and stability in financial markets, to create an environment that will improve competitiveness of the financial system, to enable effective*

⁷ Dogan Cansizlar, “Corporate Governance Principles”, CMB, June 2003

⁸ For a detailed scope see Corporate Governance Principles, www.cmb.gov.tr, CMB, June 2003

⁹ See for detail, <http://www.ise.org/about/organize.htm>

¹⁰ See, www.takasbank.com.tr

operating of loan system, to protect the rights and benefits of the depositors, to take necessary measures for enabling institutions subject to supervision to operate in a sound and well-organized manner in market discipline.¹¹

2.4. Central Registry Agency

By a change in Capital Market Law in 18 December 1999, it was decided to establish a new institution which will register and monitor the stock exchanges in ISE. Duties of Central Registry Agency (CRA) are monitoring the capital market instruments that belongs to domestic and foreign investors for the rights of stakeholders and shareholders in a computer based system, checking the consistency of members and if realized any inconsistency informed CMB, to control and reorganize the system if necessary.

3. An Example From Istanbul Stock Exchange; Is “More Governance” Does Also Mean “More Foreign Investment”?

In this part of this study, under the light of Istanbul Stock Exchange data, the differences between the foreign investment entering into the stock market before and after condition the Corporate Governance Principles of Capital Market Board will be analyzed.

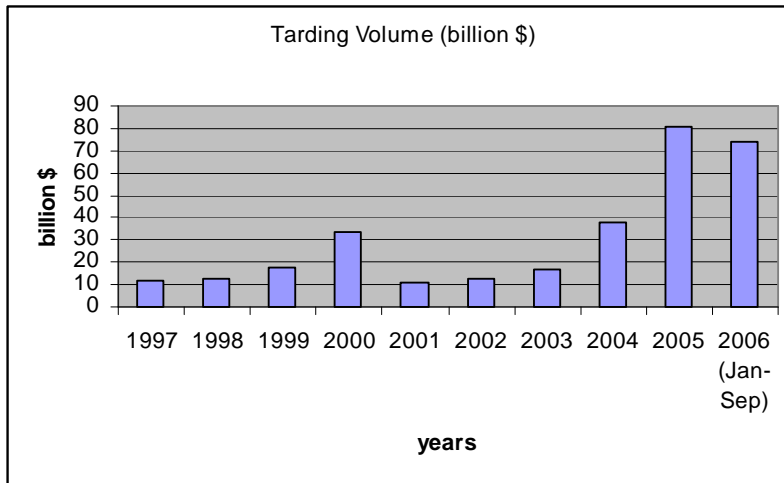
Corporate governance, gets wellcomed by the investors with increasing desire especially in developing countries. According to McKinsey Emerging Market Investor Opinion Survey 2001, the most important institutional factors for investors are “enforceability of legal rights” and “quality of economic management¹².”

After the financial crises that Turkey lived in 1994 and 2001, it became a country that investors are more posed and selective. At this stage in order to understand the effects of these Principles, it will be a good start to analyze the following table.

¹¹ See, www.bsra.org.tr

¹² McKinsey Emerging Market Investor Opinion Survey, 2001

Figure 1: Trading Volumes of Foreign Banks/Borekage



This table¹³ prepared by using the data Stock Market Transactions Realized on Behalf and Account of Foreign Banks/Brokerage Houses or Individuals 1997-2006 that is kept by Istanbul Stock Exchange shows the 10 years transaction volumes of foreign investors in dollars. The increasing trend that can be seen until 2000 lived a breakage with the crisis of 2001. The foreign investors that had stagnant motion in the years of 2002 and 2003 ,increased their investments rapidly, after the elections in 2003 with the effect of positive growth in the economy at the time of one-party cabinet government. And again the year of 2003 which is the year that Capital Market Board published the Principles. After this year the shares that purchased in the name of foreigners have an increasing trend.

It is not much convincing that to accept these data as a result of solely Principles. However, the reaction coming from investors to the domestic arbitruments taken during the globalization progress-in which communication speed enhances and the zones become much closer-emerges instantaneously.

Thereto in this period a study done on foreign investors who act in Istanbul Stock Exchange showed that, after Principles the time period that foreign investors keep their shares has increased.

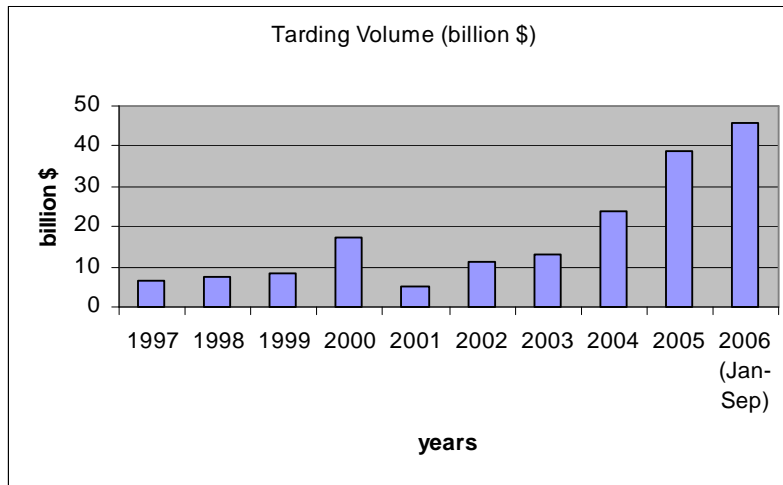
One of the most important problems of developing countries is “hot money”. On this subject, even there are lots of application suggestions, including Tobin Tax, the developing countries which need high external finance has no power to resist this. There are not any restrictions against foreign capital entrance or entrance in Turkey also.

¹³ These datas are re-organized from montly based national market datas.For detailed view see, <http://www.ise.org/data.htm>

On the other hand, in spite of having an important crisis in a closer period in Turkey it is an indication of trust that the investors have been keeping their shares for longer time periods¹⁴.

Despite of these results, applications of Corporate governance's effects can not be seen in Figure 1. Data are rearranged and this table is obtained to reduce the errors that can appear.

Figure 2: Trading Volumes of Foreign Banks/Borekage for Selected Frims¹⁵



On the table above, trading volumes of the companies' which attended the study of 'The Application of the Principles of Companies that Traded in the Stock Market'¹⁶ that is made by Istanbul Stock Exchange are taken into consideration. With the rearranging of the data, the esteems that showed by foreign investors to the companies can be seen clearly before and after 2003 Principles. Before principles, also as an indicator of coming closer to the crisis some increase can be seen in the market but Credit Rating Institutions'¹⁷ reports showed that a secure investment atmosphere in Turkey was not strictly formed during the year of 2001. Considering these two periods the firms that apply Principles has increased their transaction volumes.

¹⁴ See, <http://www.tkyd.org/ayinkonugu.asp?ID=56>

¹⁵ During these years lots of firms enter and exit the stock market. To avoid biases only the firms which have traded their stocks between 1997-2006 are selected

¹⁶ Meral Varis, Ali Erdogan and Levent Ozer, "Sermaye Piyasalarında Kurumsal Yönetim İlkeleri", **IMKB Özel Sayısı**, Yıl.5, sayı 19

¹⁷ Melsa Ararat, Mehmet Ugur, "Corporate Governance In Turkey; An Overview And Some Policy Recommendations", **Corporate Governance**, Vol 3., No1., 2003

it can be seen that international investors gave positive reaction to Corporate governance applications.

Conclusion

By choosing free capital markets after 1980, Turkey continued its liberalization policies which started with custom union in this period, in order to prepare a trustful environment, where foreign capital can invest, Turkey founded several institutions. Turkey made management independence in order to get management decisions least affected by the political changes. These institutions helped out the following cases: founding a capital markets in short run, informing the national organizations, convincing the firms to go to the stock exchange as well as solving the savings problems which is a main problem in developing countries.

Turkey is such a country that easily gets affected directly from the world economic developments and probably can't articulate to the world economy with its most ways. Because of this, it injured heavily after 1994 Asia Crisis and 2001 crisis and chose the way to go on its life with Stand By agreements with IMF and different currency policies.

The development of financial markets ,which are the most important determining factors of economic development, certainly depends on the firms that traded in the stock market and moreover it depends on the trust to the country. In this period Turkey has followed the corporate governance literature intimately and in 2003 with the Principles that is published by Capital Markets Board, Turkey has presented its rules -some of them were carrying advice characteristics- for criticism.

Especially after the failure of corporate governance of USA, concern to applications of corporate governance in developing countries multiplied. And Turkey became interrogated primarily with its adjective of "developing", in the decisions of investors with its applicability of Corporate Governance Principles.

This study shows that especially in developing countries that apply the corporate governace principles as a part of their national economic policy, investments that are made to capital markets show positive trend.

This situation makes such inferences;

- Firstly, the need of finance for the firm in long and medium term can be provided by stock exchange market,

- The shares that are hold in hand during long periods as a result of the trust against companies, decreases the rate of the speculative capital movements that lean against lack of confidence in the stock exchange market,
- In medium and long term, to outstand the company's market value enables new investments, and on the other hand that helps to get 'low-interest – long-dated' credits for the companies.

Since the data submitted in this paper belong to 3 years after the Principals, it is not possible to have a unique and certain idea here. In order to understand the effects of the Principals more detailed, actually both the effects of the stock market of companies in future and the foreigner investors to this situation should be considered in following years.

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