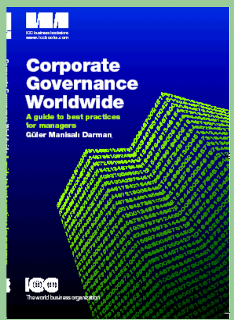
CORPORATE GOVERNANCE FINANCIAL MARKETS
CASE TURKEY – THE BRIDGE BETWEEN EAST & WEST

Güler Manisali Darman
Principal, GMD Global Advisors Ltd.

IIFF September 2005, Istanbul



Author, ICC Publication
"Corporate Governance
Worldwide"

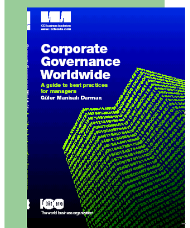
Corporate Governance Worldwide

"The proper governance of companies will become as crucial to the world economy as the proper governing of countries"

James Wolfenson, Past President of World Bank

"The hallmark of Islamic financial system lies in the high ethical values that underpins the governance and business opportunities of islamic finance"

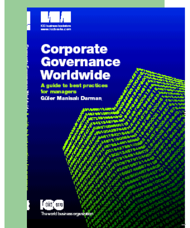
Dr. Zeti Akhtar Aziz, Governor Bank Negara Malaysia



Corporate Governance Worldwide
Factors that contribute to good governance

- **What are the factors that contribute to good governance**
  - –accountability
  - –financial disclosure and transparency
  - –independence of the board
  - –shareholders' and other stakeholders' rights, equal treatment of shareholders
  - –ethical behavaior and leadership

- **Why to urge for good governance – the constituents of corporate governance**

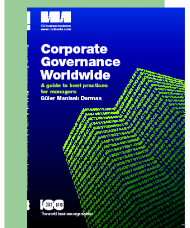


Corporate Governance Worldwide
The Board and the Shareowners

➢ Effective and robust boards - the importance of human element, a chemistry that cannot be qualified

➢ The ownership and control structure of a corporation should be fully transparent to all shareholders under all circumstances - the capacity to exercise their rights must not be abrogated by the management of the corporation

Welcome (my friend) aboard, but don't change a thing!



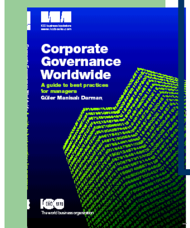
Corporate Governance Worldwide

- **Recent corporate scandals and failures** - Enron, WorldCom in USA, Parmalat in Italy , Ahold in the Netherlands, and Yanguangxia in China, Ihlas Finance House, in addition to others, in Turkey
- **The decline in public trust has to be restored**.

Companies and institutions cannot afford to have their reputations tarnished by inadequate oversight and unethical governance, nor can national economies continue to suffer from laxity and fraud in corporate activities

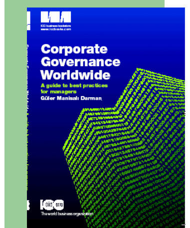
Regulatory Measures Worldwide

USA	Sarbanes-Oxley, *July 2002*
Europe	European Corporate Governance Forum, *October 2004*
China	Code of Corporate Governance of Listed Companies, *January 2002*
Russia	Corporate Governance Code, *April 2003*
Japan	Commercial Code, *April 2003*
Malaysia	Corporate Governance in listing requirements of KLSE, *January 2001*



Regulatory Measures - Turkey

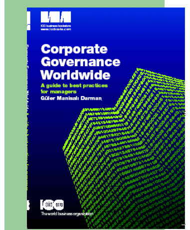
- Listed companies – Corporate Governance Principles, Comply or Explain, *June 2003,* amended *February 2005*
- Non-Listed Companies – Some provisions for Joint Stock Companies in the new (draft) Commercial Law
- Corporate Governance Index- Capital Markets Board of Turkey
- Corporate Governance Association of Turkey, In the new draft of Capital Markets Board Law
- OECD – Turkey as a pilot case



Driving Forces Behind Corporate Governance

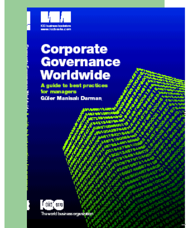
The major driving forces behind the evolving role of corporate governance worldwide are;

- Privatization,
- Listing requirements
- Company ratings
- Merger & Acquisitions as corporate control mechanisms
- The aging population
- Globalization

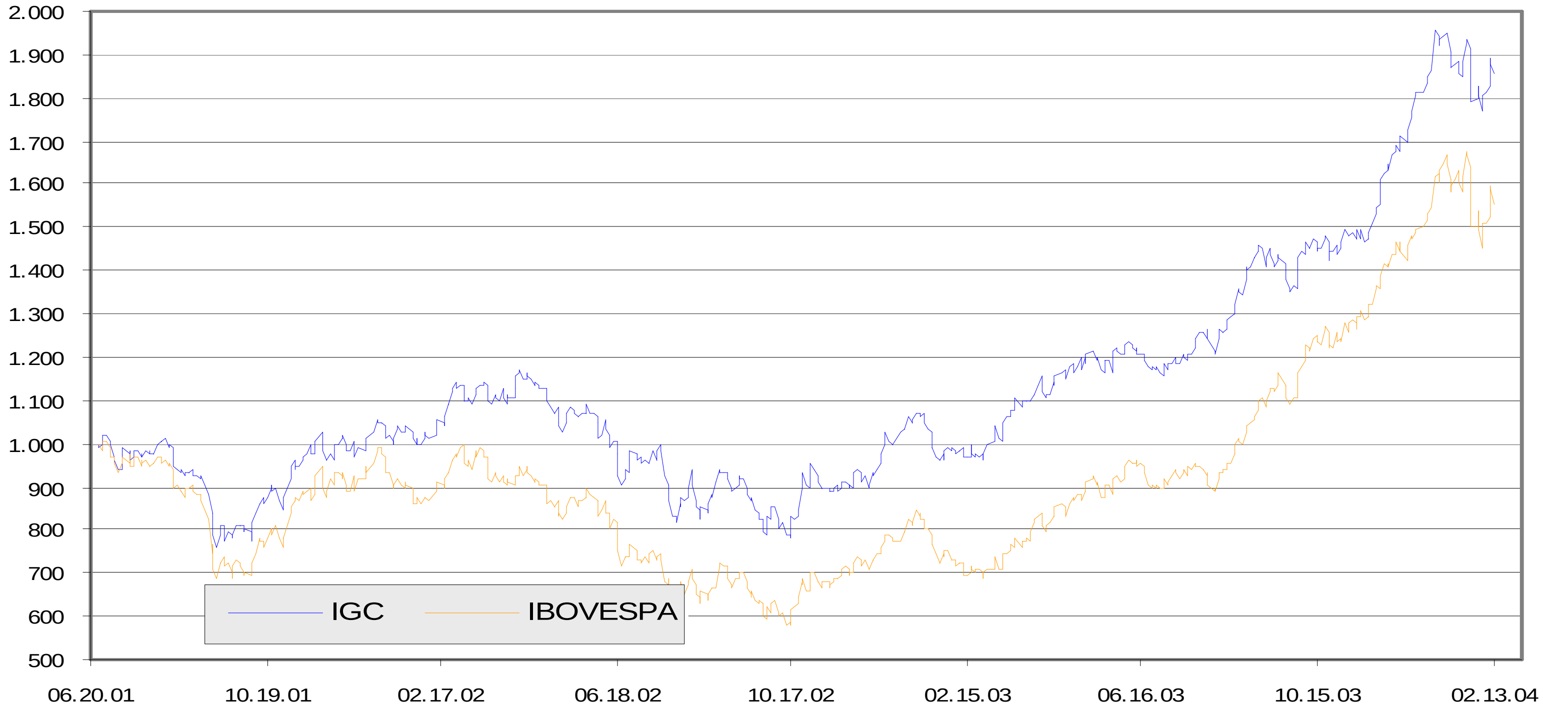


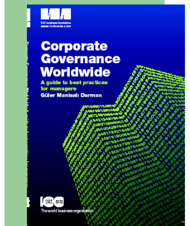
Listing Requirements

- New York Stock Exchange
- Nasdaq
- Hong Kong Stock Exchange
- London
- Brazil– Bovespa → Novo Mercado
- Borsa Italiana → Star
- FEAS (Federation of Euro Asia Stock Exchanges)



IGC – IBOVESPA 26/6/2001 – 16/2/2004





STAR Index performance: overperformance vs Mibtel

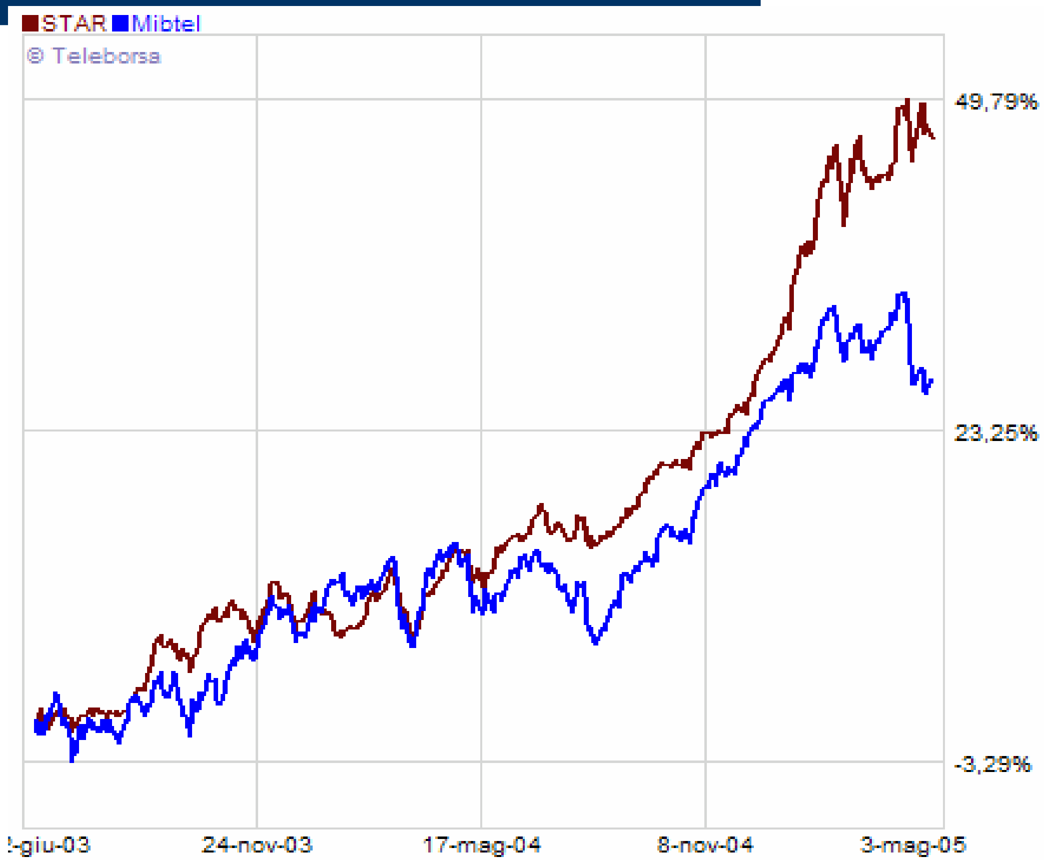
– STAR constituents as of today:
  - 45 listed companies

– Total STAR market capitalisation **(31/03/'05):**
  - Total: € 13.9 bn
  - Average: € 308 m

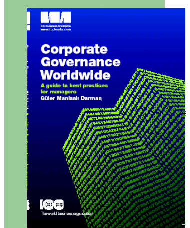
– Performance:
  - +50% from Jun '03
  - Overperformance vs Mibtel: + 27%

Source: Borsa Italiana

Chart update: 04/05/2005

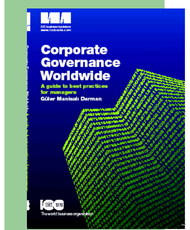


Federation of Euro-Asian Stock Exchanges



Corporate Governance of Non-listed companies

- The gap between corporate governance practices of the listed and non-listed companies
- Non-listed companies also have impact on the economy
- Public companies have business relations with their private counterparts.
- Besides today’s private companies can be the public companies of tomorrow and change in culture, policy and structure cannot be realized overnight



Corporate Governance of Non-listed companies – OECD & ICC Roundtables

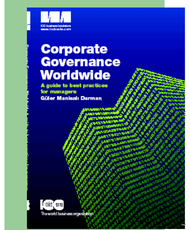
OECD organized a meeting on the corporate governance of non-listed companies in Istanbul in April 2005. ICC also held a rountable on how to improve corporate governance of family-owned companies.

In the OECD meeting issues such as;

- How is professional management monitored?
- What are the trasparency requirements of NLCs?
- Access to capital and implications for corporate governance?
- What are different ownership & control structures of NLCs? are discussed.

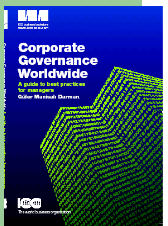
Future Prospects for Corporate Governance

- Convergence versus Divergence,
- Principles rather than Rules
- Cost of Regulation
- Judicial Enforcement
- Market Forces (civil enforcement)



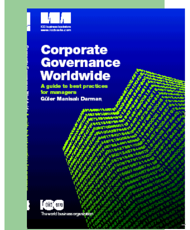
Role of Governmental and Non-Governmental Organizations

- Basel II
- WTO
- World Bank - IFC
- OECD
- ICC



Islamic Finance

- ➢Honesty, integrity, ethics and equitable treatment are the basics of islamic finance
- ➢Equity financing rather debt financing – to avoid dealing with interest
- ➢Profit-and-loss-sharing modes, Mudaraba (Trustee finance contract), and Musharaka (Equity participation contract) are comparable with the conventional investment management and joint ventures
- ➢Non-profit-and-loss-sharing modes, eg: leasing, leasing purchase (Ijara, Ijara wa iqtina')



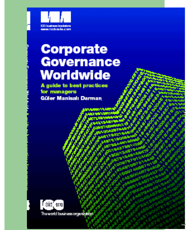
Source: HSBC Amanah, Euromoney Conference Sept. 2005 & IMF Paper

Islamic Finance

➢The Islamic financial services industry manages financial assets at an estimated size of US$250 billion, and consists of more than 200 financial institutions in and outside the Muslim world

➢It is a relatively young but rapidly growing industry. Estimated growth is 15-20% per year

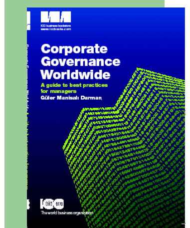
➢Highly important transactions are carried out; such as US$ 2.144 billion Etisalat Share Murabaha, or US$530 million Islamic project finance tranche Qatar Gas II as lease financing (*Ijara*)



Source: HSBC Amanah, Euromoney Conference Sept. 2005

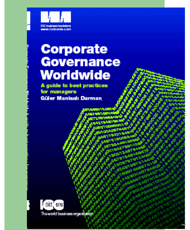
Islamic Corporate Governance

- Islam strongly advocates all forms of positive governance (Dr. Zeti Akhtar Aziz Governor of Bank Negara Malaysia),
- Information disclosure in Islamic finance is as important as it is in conventional system, because protection of investment depositors (especially in the case of unrestricted Mudaraba contracts) is the core of system
- Good governance and internal controls are crucial in risk monitoring and reducing moral hazard.
- Monitoring of management and senior staff is among most important tasks of Shariah Boards in addition to their responsibility on the financial issues (products and services)



Islamic Corporate Governance

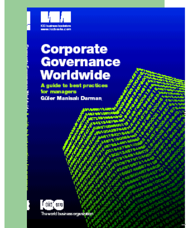
- AAOIFI has made significant contribution in formulating and issuing accounting & auditing standards for islamic financial institutions → There is no room for negligence
- Islamic Financial Services Board advocates effectiveness of corporate governance in the islamic financial services industry
- The challenge is to compete successfully with the conventional financial systems. Therefore the development of adequate instruments and a transparent market infrastructure backed by accountability will definetly facilitate risk management
- Globally accepted high standard governance practices can be translated into modes consistent with the injunctions of Shariah



Islamic Corporate Governance

➢Dr. Nader Mazlomi's research on the "Relationship Between Institutional Ownership and Corporate Performance: Evidence from Tehran Stock Exchange Market" (Published in "management studies" quarterly Journal of Management Accounting School Allameh Taba Tabai University)

The research covers a sample of 131 non-financial companies listed in the Stock Exchange of Tehran. Data were collected for a five year period (1996-2000). Results of his analysis indicate that the size of outside institutional stockholding have significant effect on the company's performance. This study also confirms the growing role of institutional shareholders in pushing for further convergence in good corporate governance practices in countries with different legislations and cultures.



Corporate Governance Worldwide-Enforcement

But how companies/financial institutions conform to these principles and put them into practice is as important as their acceptance. Good corporate governance practices are not merely a box-ticking exercise to comply with a form; they are also the substance – Enforcement is the critical issue-

Finally corporate governance is risk management under any framework either Islamic or conventional