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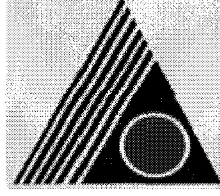

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CORPORATE GOVERNANCE
The Case for Turkey

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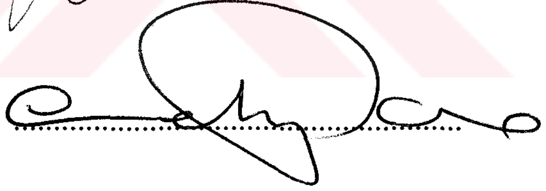

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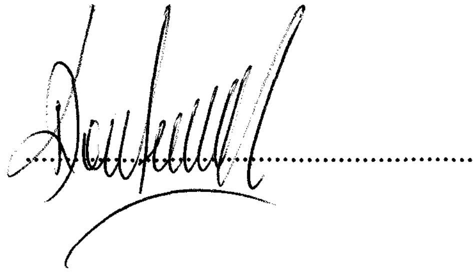

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LIST OF ABBREVIATONS

ADB	Asian Development Bank
BOD	Board of Directors
BRSA	Banking Regulation and Supervisory Agency
CB	Central Bank
CC	Commercial Code
CEO	Chief Executive Officer
CG	Corporate Governance
CMB	Capital Markets Board
CML	Capital Markets Law
EASD	European Association for the Study of Diabetes
FDI	Foreign Direct Investment
GAAP	Generally Accepted Accounting Principles
GFCF	Gross Fixed Capital Formation
IAS	International Accounting Standards
ICGN	International Corporate Governance Network
IMF	International Monetary Fund
ISE	Istanbul Stock Exchange
ISSA	Information Systems Security Association
MIS	Management Information Systems
NGO	Non-Government Organization
OECD	Organization for Economic Cooperation and Development
OEIC	Open-ended Investment Companies
SEC	Security Exchange Commission
SOE	State-owned Enterprise
TUSIAD	Turkish Industrialists' and Businessmen's Association
UK	United Kingdom
UN	United Nations
US	United States of America

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ABSTRACT

In light of recent corporate scandals, financial collapses, and growing awareness of the need for "good practice," the term "Corporate Governance" has been more prominent than ever. The new international environment, throughout the developed world with a larger private sector and globally-integrated financial and product markets, makes pressures on governments and companies to reform their governance arrangements.

Governments are concerned with Corporate Governance as they attempt to design legal and regulatory institutions that enable private sector to raise more domestic and foreign capital and attract foreign direct investment. Companies are concerned because Corporate Governance drives their competitiveness and reduces the cost of capital. Investors care about Corporate Governance, because it crucially shapes security returns. For all these reasons, governance has been occupying the time and attention of government officials, thinkers, practitioners and academicians in finance, accounting, management studies, business strategy, public policy, law, and economics.

The purpose of this study, based on a literature review, is (i) to define what Corporate Governance is and highlight its structure and framework (ii) to analyze its development in the world and especially in emerging economies (iii) to provide an overview of the Turkish Corporate Governance framework and its current practice, and (iv) to draw out conclusions and recommendations for the Corporate Governance reforms.

ÖZET

Son dönemlerde yaşanan şirket skandalları ve finansal krizler, "doğru kurumsal uygulama" ihtiyacı ile birlikte "Kurumsal Yönetim Kavramı"nı her zamankinden daha fazla ön plana çıkarmıştır. Gelişen dünya ile birlikte ortaya çıkan yeni uluslararası çevreler ve globalleşme ile büyüyen özel sektör, hükümetler ve kurumlar üzerinde yönetim reformları yapılması için baskı oluşturmaktadırlar.

Hükümetler özel sektöre dış yatırımı özendirmek amacıyla yapısal ve kurumsal düzenlemelere gitmektedirler ve bu nedenle Kurumsal Yönetim kavramı ile yakından ilgilenmektedirler. Kurumsal Yönetim, şirketler için rekabet gücünü artırıcı ve maliyetleri düşürücü, yatırımcılar için ise güvenli kazanç anlamı taşıyan bir unsurdur. Tüm bu nedenlerden dolayı Kurumsal Yönetim, hükümet yetkilileri ve finans, muhasebe, yönetim, strateji, kamu, hukuk ve ekonomi dallarından akademisyenlerin ilgisini çekmektedir.

Kaynak ve veri taraması ile yapılan bu çalışma (i) Kurumsal Yönetim'i, yapı ve formasyonu ile tanımlamak (ii) dünya ve özellikle de gelişmekte olan ülkelerdeki gelişimini analiz etmek (iii) Kurumsal Yönetim'in Türkiye'deki yapısı ve uygulamalarını incelemek (iv) Kurumsal Yönetim reformları ile ilgili önerilerde bulunmak amacı taşımaktadır.

1. INTRODUCTION

Fundamentally, the central theme of CG is how rights and responsibilities are shared and exercised by different stakeholder* groups to ensure common business objectives.

The "universal principles of corporate governance" are fairness, accountability, transparency and responsibility. CG aims at high performance, profitability, productivity and competitiveness.

CG is concerned with how powers are shared and exercised by different groups, to ensure that the objectives of the company are achieved. Aspects of CG are the rights of shareholders and other interest groups, how powers are shared and exercised by the directors, and how the holders of power in a company should be held accountable for what they do.

As a concept, CG has acquired unprecedented significance in the global policy debate on sustainable development and the role of business organizations in that process. Like many significant issues, however, agreement on what constitutes CG is still elusive; a broad definition captures the corporation's interaction with "internal" as well as "external" stakeholders.

Good CG is normally recognized as a major contributor to company performance. It is in investors' interests that CG structures ensure value creation and responsible business practices as well as the accountability of management to shareholders.

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* Individuals or institutions that have a direct or indirect interest or "stake" in a company are called the stakeholders.

2. WHAT IS CORPORATE GOVERNANCE?

"Governance" refers to the way in which something is governed and to the function of governing. The governance of a country, for example, refers to the powers and actions of the legislative assembly, the executive government and the judiciary.

CG refers to the way in which companies are governed, and to what purpose. It is concerned with practices and procedures for trying to ensure that a company is run in such a way that it achieves its objectives. This could be to maximize the wealth of its owners, subject to various guidelines and constraints and with regard to the other groups with an interest in what the company does.

Instead of a theoretical definition, CG can be stated narrowly as the relationship of a company to its owners or, more broadly, as its relationship to society. Theoretically, there is not a single or a standard definition of CG as the concept changes in its application depending upon the nature of the organization concerned. Some definitions from the reference literature are provided below:

- "Corporate governance is the system by which companies are directed and controlled." (Cadbury Report, 1992)
- "Corporate governance refers to the relationship among various participants in determining the direction and performance of corporations. The primary participants are the shareholders, management, and the board of directors." (Monks, Robert A.G. and Nell Minow, 1995)
- "Corporate governance is the body of the rules by which companies or institutions are managed internally and supervised by boards of directors. A narrower definition comprises all rules, regulations, codes and practices enabling long term economic value creation for shareholders, while respecting social values and attracting human and financial capital." (World Bank, Corporate Governance Manual, 1999)

- “Corporate governance is about promoting corporate fairness, transparency and accountability.” (J. Wolfensohn, 1999)
- “Corporate governance is a new system by which business corporations are directed and controlled." (OECD, 1999)
- “Corporate governance refers to the top management process that manages and mediates value creation for, and value transference among, various corporate claimants (including society at large), in a context that simultaneously ensures accountability towards these claimants.” (Sundaram, Bradley, Schipani, and Walsh, 2000)
- “Corporate governance deals with the ways in which the rights of outside suppliers of equity finance to corporations are protected and receive a fair return” (Fremond and Capaul, 2002).
- “Corporate governance is a system that outlines the steps for company restructuring. This system is based upon globally applicable principles like transparency, accountability, fairness and responsibility and is broadly defined; it is a system that gives direction to corporations and monitors their operational performance.” (Ozilhan, 2002)

It is anticipated from the definitions above that CG refers to a whole system of managing an organization and like every system, CG has structures and a framework that builds on these structures.

2.1 Corporate Governance Structures

- **Legislative structures**: legislation which regulates the activities of an organization and those within it.
- **Ethical structures**: these structures include codes of conduct, identifying and dealing with conflicts of interest and exercising appropriate integrity in the performance of official duties.

- **Internal accountability structures**: these structures are intended to ensure appropriate internal control and management of the organization, the planning and review of its operations and progress and ensure consultation and constructive feedback on activities. They incorporate structures for planning and reviewing the corporate plan, business plans, risk management plans, internal delegations, quality control systems, checks and balances, performance monitoring and the like.
- **External accountability and reporting structures**: these structures generally relate to the external operating context of an organization and the means by which it provides transparent and open decision making capable of review by members and others.
- **Financial management structures**: These include the establishment and maintenance of appropriate accounts and records, preparation of financial statements and the internal control framework for the expenditure of the organization's budget.
- **Resource management structures**: These include structures within the organization such as human resource policy and procedures, facilities, equipment and records and means for ensuring that any policies relating to these matters are implemented.

2.2 The Focus of Corporate Governance

The key debates on CG have focused primarily on public companies, and in particular on large companies whose shares are traded on a major stock market. In these companies separation of ownership from management is much wider than for small private companies.

Public companies raise capital on the stock markets, and institutional investors* hold vast portfolios of shares and other investments. Investors need to know that their money is reasonably safe. Should there be any doubts about the integrity or intentions of the individuals

* An organization or institution that invests funds of clients, savers or depositors. The main institutional investors are pension funds, insurance/life assurance companies, investment trust companies and organizations such as unit trusts and OEICs. Institutional investors are the main investors in shares in the leading stock markets of the world.

in charge of a company, the value of the company's shares will be affected and the company will have difficulty raising any new capital should it wish to do so.

Many of the issues of CG also apply to smaller companies and to non-corporate organizations, such as SOEs, government offices and bodies, institutes and associations, and charitable organizations. Such organizations also face the central dilemma of CG: how rights and responsibilities are shared and exercised by different groups to ensure common objectives. Increasingly, public sector and NGOs are acquiring their own regulatory guidelines and codes of best practice in this area.

Aspects of CG in the public sector have different set of external constraints and influences. Public sector entities regardless of governmental offices or SOEs have to satisfy a more complex range of political, social and economic objectives in one hand. These objectives are subject to forms of accountability to various stakeholders which are different to those that a company in a private sector owes to its shareholders.

CG was first adopted by private companies, since CG principles lie rather on a simply applicable and easy-going form to the private sector. Most of the public sector CG models, to a greater or lesser extent, create confusion and tensions in the roles, responsibilities and decision-making powers of the affiliated authority. Therefore and for the purposes of this study, the concentration is on the aspects of CG on private sector enterprises.

Nevertheless, there are primary distinctions between the models of CG, modern and on-going traditional practices adopted by companies that vary more considerably than between public and private companies, NGOs, SOEs or government offices. Therefore, governance system should form a package of overall corporate control in each company within the complete law jurisdiction applied and supervised by public entity. Also, it is vital to see the package as a whole. There has to be an integrated harmony between state legislation and regulatory infrastructure, stock market regulation and corporate self-regulation. Moreover, the overall

CG package has to be consistent with the way that business is done and the reality of relationships in that culture; this should require slow adaptation or transitive process.

2.3 Parties Involved in a Corporate Governance Framework

Although a company exists as a legal person, in reality it is the organized, collective effort of many different individuals. The stakeholders.

Stakeholders are affected by what the company does and therefore expect the company to behave or act in a particular way, with regard to their interests. A stakeholder can also expect to have some say in some of the decisions and actions a company takes. The balance of power between different stakeholder groups, and the way in which power is exercised, are key issues in CG.

A large company has a larger number of stakeholders and has to balance the demands and needs of each of them. Although some stakeholder groups have power to decide or influence actions by the company, others do not have much influence and rely on the "enlightenment" of the company's managers (primarily the directors) to take decisions that are in their interests. Stakeholders other than shareholders and creditors possess a powerful ability to influence corporate behavior and performance.

2.3.1 Shareholders

These are the equity holders and the owners of a company. The interests of the shareholders are likely to be focused on the value of their shares and dividend payments. However, the powers of shareholders in large public companies are usually fairly restricted and shareholders have to rely on the BOD to act in their best interests.

A different situation arises when there is a majority shareholder* or a significant shareholder. A shareholder with a controlling interest is able to influence decisions of the company through an ability to control the composition of the BOD. When there is a majority shareholder, the interests of minority shareholders** may be disregarded.

2.3.2 Board of directors

Board's role in governance is fundamental. An indication of an agency's effectiveness is the way in which the organization as a whole works together under the board's leadership. The board must have a collective ability to provide leadership, to communicate a coherent set of governance principles throughout the agency and to ensure the operation of the checks and balances which effective governance demands.

The BOD has the responsibility for giving direction to the company. It delegates most executive powers to the executive management, but reserves some decision-making powers to itself, such as decisions about raising finance, paying dividends and making major investments. Executive management is also held accountable to the board for their performance.

Booz Allen and Hamilton analysis depicted 12 questions that need to be answered by every director with a "yes" in the case of the first nine, and with a reasonably comprehensive explanation in the case of the latter three.

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* A shareholder holding a majority of the equity shares in a company and so having controlling interest in the company. (A majority shareholder has the voting power to remove directors from the board, and so can control the board.)

** Shareholders whose combined shareholdings are insufficient to affect resolutions by the company in general meeting. The term is often used when a majority of the shareholders (and possibly a single majority shareholder) favors one course of action whilst a minority opposes it. Company law provides some safeguards for minority shareholders, to protect them from unfair or discriminatory actions by the majority.

Table 2.1 "Diligent Dozen"

1. Strategic Direction	Does management have a comprehensive strategy and operating plan for the company to realize its performance potential?
2. Resource Allocation	Are the necessary human, financial, physical, and other supporting resources provided and properly allocated to achieve success?
3. Management Organization	Does the CEO provide the leadership required by the company and does the organization have a succession plan for this position?
4. Financial Accountability	Are the financial information systems, control processes, decision delegations, and reporting responsibilities established and audited?
5. Operational Controls	Does management utilize an effective system of key performance indicators to monitor and control operating performance?
6. Constituency Protection	Are mechanisms in place to ensure conformance with legislation and regulations protecting customers, employees and community?
7. Litigation and Disputation	Does management adequately report, control and provide for all material disputes of a legal, financial or regulatory nature?
8. Crisis and Contingencies	Are effective risk management processes in place to prevent or correct physical and financial crises?
9. Management Priorities	Does the board adequately understand and support resolution of the near-team, intermediate and long-term priorities of management?
10. Past and Present Performance	What has been the company's financial and market performance compared with its historical performance, projected performance and competitors' performance?
11. Underlying Causes	What specific competitive strengths and weaknesses, market forces or drivers of profit dynamics determined performance results?
12. Performance Potential	What are the reasonable objectives for and limits to the company's growth, profitability and appreciation of shareholder value?

(Source: Booz Allen and Hamilton, Corporate Governance: Hard Facts about Soft Behaviors, January 2003)

CG is mainly considered in the context of companies with a unitary board (one-tier)* structure, which is the traditional Anglo-American form of a company. A unitary board structure means that the organization is governed by a single decision-making body, which in the case of a company is a BOD who have a wide range of decision-making powers. In contrast to a unitary board structure, an organization can have a two-tier board** structure, in which key operational decisions are taken by a management board***, which is accountable to a senior supervisory board****. The supervisory board exercises powers for strategic decisions and non-operational decisions, such as financing and dividend policy.

A BOD is made up of both executives and non-executives. Executive directors are individuals who combine their role as director with their position within the executive management of the company. Non-executive directors perform the functions of director only, without any executive responsibilities. Executive directors combine their stake in the company as a director with their stake as a fully paid employee, and their interests are therefore likely to differ from those of the non-executives.

* A board structure where the organization has just a single board of directors. This consists of executive directors and (in the case of listed companies and also many other public companies and some private companies) non-executive directors.

** A board structure with two boards, a supervisory board of non-executive directors and beneath it a management board of executive directors. The CEO heads the management board and reports to the chairman of the supervisory board. Responsibilities for governance are divided between the two boards.

*** A board of executive managers, chaired by the chief executive officer, within a two-tier board structure. The chairman of the management board reports to the chairman of the supervisory board. The management board has responsibility for the operational performance of the business.

**** A board of non-executive directors, found in a company with a two-tier board structure. The supervisory board reserves some responsibilities to itself. These include oversight of the management board.

	Executive	Non-executive
Independent	———	Members having no relationship with the company except membership of the board of directors
Non-Independent	Chief Executive Officer	• Family members • Suppliers of goods and services • Professional directors working in one of the company affiliates • Executives employed in the company within the previous two years

Figure 2.1 Board Composition
(Source: OECD, 2002, http://oecd.gov.tr)

Today, companies are falling over themselves to institute visible and verifiable changes in board composition and structure; requiring that a certain proportion of directors be non-executives; appointing a lead director; requiring "outsider only" membership on board audit and nominating committees.

2.3.3 Management

Management sets in place the broad principles under which the company operates, including:

- Setting clear objectives and an appropriate ethical framework operating in the public interest.
- Establishing due process, providing for transparency and lines of responsibility and accountability.
- Implementing sound business planning.
- Encouraging business risk assessment.
- Having the right people and the right skills for the job.
- Having sound communication both internal and external
- Establishing clear boundaries for acceptable behavior.

- Evaluating performance and recognizing individual and group contributions.

Management is accountable to the BOD. (and more particularly to the CEO). Individual managers, like executive directors, may want power, status and a high remuneration. They may see their stake in the company in terms of the need for more power and authority, and a high remuneration package.

2.3.4 Employees

Employees have a stake in their company because it provides them with a job and an income. They also have expectations about what their company should do for them, and these could be security of employment, good pay and suitable working conditions. Some employee rights are protected by employment law, but the powers of employees are generally limited.

2.3.5 Creditors

Lenders and other creditors have an indirect interest in a company, because they expect to be paid what they are owed. If they deal with the company regularly, or over a long time, they will expect the company to do business with them in accordance with their contractual agreements. If the company becomes insolvent, unpaid creditors will take a more significant role in its governance, depending on the insolvency laws in the country, for example by taking legal action to take control of the business or its assets.

2.3.6 Institutional investors

Representatives of investment institutions have some influence over public companies whose shares are traded on a stock market. There are representative bodies (i.e. insurance associations, pension funds) that may try to coordinate the activities of their members, for example, by encouraging them to vote in a particular way on resolutions at the annual general

meetings of companies in which they are shareholders. These bodies represent the opinions of the investment community generally.

2.3.7 General public

The general public are also stakeholders in large companies, often because they rely on the goods or services provided by a company to carry on their life. Even sometimes, the general public try to influence the decisions of companies (i.e. pressure groups, such as environment protection groups).

3. CORPORATE GOVERNANCE FRAMEWORK

According to McKinsey, many factors contribute to good governance but some are difficult to quantify. Nevertheless, several used indicators of a well-governed company are available to shareholders. McKinsey identified the "Corporate Governance Top Ten" as below.

Table 3.1 "Corporate Governance Top 10"

Accountability	Independence
Transparent ownership: Identify major shareholders, director and management shareholdings, and cross-holdings. **Board size:** Establish an appropriate number of board seats, studies suggest that optimal number is 5-9. **Board accountability:** Define board's role and responsibilities in published guidelines, and make them basis for board compensation. **Ownership neutrality:** Eschew antitakover defenses that shield management from accountability. Notify shareholders at least 28 days before shareholder meetings and allow them to participate online.	**Dispersed ownership:** Deny any single shareholder or group privileged access to or excessive influence over decision making. **Independent audits and oversight:** Perform annual audit using independent and reputable auditor. Insist that independent committees oversee auditing, internal controls, and top-management compensation and development. **Independent directors:** Allow no more than half of directors to be executives of company, at least half of nonexecutive directors should have no other ties to company.
Disclosure and transparency	**Shareholder equality**
Broad, timely, and accurate disclosure: Fully disclose information on financial and operating performance, competitive position and relevant details (such as board member backgrounds) in timey manner. Offer multiple channels of access to information and full access to shareholders. **Accounting standards:** Use internatioanlly recognized accounting standards* for both annual and quarterly reporting.	**One share, one vote:** Assign all shares equal voting rights and equal rights to distributed profit.

* Generally accepted accounting principles (GAAP) such as US GAAP, UK GAAP or IAS.

(Source: McKinsey. A Premium for Good Governance, 2002)

Key issues in CG, for which codes of best practice have been developed, are financial reporting and auditing, disclosure of information, directors' remuneration, the balance of power on the BOD, risk management and communications between company and shareholders. Personal and business ethics underlie all these key issues. Several other issues continue to be central to CG research.

A few others occur with less frequency, but with no less importance. The dominant themes include the conflict of interest, principal-agent problem, director networks*, succession**, top management teams, ownership structure, and shareholder activism.

3.1 Financial Reporting and Auditing

A robust governance framework will build on existing accountability and reporting structures within the company. It will also review any anomalies such as unclear lines of authority or too many layers of authority, too complex reporting mechanisms, multiple objectives including policy or legal requirements with no direct connection to program objectives, the tension between central control, lack of clear-cut concepts of success or failure and constraints on applying positive or negative sanctions. Under governance principles responsible officers are required to signoff that they have discharged their responsibilities to an agreed standard.

Governance is ultimately concerned with the alignment of information, incentives and capacity to act (Monks and Minow, 1995). It involves the monitoring of the corporation's performance and ability to observe and respond to that performance. Insufficient and/or unclear information may hamper the ability of the markets to function, increase volatility and the cost of capital, and result in poor allocation of resources (La Porta et al, 2000).

It is apparent that market forces for transparency would be weaker where ownership is concentrated and related lending by banks form major source of finance. Deficiencies in standards of transparency and accountability allow corporate management (therefore major shareholders) to avoid disclosure and manipulate markets by misinformation. These weaknesses are conduit to asset transfers and asset stripping.

According to Gilson (2000), effective disclosure requires legally mandated disclosure requirements, good accounting standards, independent auditors, and enforcement. These

* Director's external network ties.

** Presence of an apparent heir for a position in the company.

standards are highly significant in ensuring that stakeholders have sufficient, timely, credible, comprehensible and cost-effective information to monitor the company's performance.

The directors may try to disguise the true financial performance of their company by dressing up the published accounts and giving less than honest statements. Window dressed accounts make it difficult for investors to reach a reasoned judgment about the financial position of the company.

When the annual financial statements of a company prove to have been misleading, questions are inevitably raised about the effectiveness of the external auditors. There are two main issues relating to the external audit of a company: one is whether it should be the job of the auditors to discover financial fraud and material errors. The second is the problem of the relationship between a client company and its auditors, and the extent to which the auditors are independent and free from the influence of the company's management. If auditors are subject to influence from a client company, they might be persuaded to agree with a controversial method of accounting for particular transactions, which shows the company's performance or financial position in a better light.

3.2 Dominant Personality* and Leadership Aspects

With some corporate collapses, the failure has been attributed to a dominant individual, acting as chairman and chief executive, running the company as a personal kingdom and with complete disregard to the interests of shareholders and other stakeholders.

* An individual who is able, through force of character or other means, to impose his way of thinking on others, so that the others will normally agree with him or accept his point of view. Where a board of directors has a dominant personality (for example, a forceful individual who is both chairman and CEO) there is a risk of poor corporate governance.

3.3 Directors' Remuneration

As stated, directors may reward themselves with huge salaries and other rewards, such as bonuses, a generous pension scheme, share options and other benefits. Institutional shareholders do not object to high remuneration for directors. However, they take the view that rewards should depend largely on the performance of the company and the benefits obtained for the shareholders. The main complaint about "fat cat" directors' remuneration is that when the company does well, the directors are rewarded well, which is fair enough, but when the company does badly, the directors continue to be paid just as well.

3.4 Decision-making Powers

Most decision-making powers in a company are held by the BOD. The CG debate has been about the extent to which professional managers, acting as board directors, exercise those powers in the interests of their shareholders and other stakeholders in the company, and whether the powers of directors should be restricted.

3.5 Disclosure of Information

Another issue in CG is communication between the BOD and the company's shareholders. Shareholders, particularly those with a large financial investment in the company, should be able to voice their concerns to the directors and expect to have their opinions listened to. Small shareholders should at least be informed about the company, its financial position and its intentions for the future, even if their opinions carry comparatively little weight.

The responsibility for improving communications rests with the companies themselves and their main institutional shareholders. Companies can make better use of the annual report and accounts to report to shareholders on a range of issues and the policies of the company for dealing with them. The annual report and accounts should not be simply a brief directors' report and a set of financial statements. The company should explain its operations and

financial position and report on a range of governance issues such as directors' remuneration, internal controls and risk management and policies on health, safety and the environment. A company can also try to encourage greater shareholder attendance and participation at annual general meetings as a method of improving communications and dialogue. On their part, institutional investors should develop voting policies, and apply these in general meetings. Where necessary, they can vote against the board to alert the directors to the strength of their views.

3.6 The Extent of Corporate Governance Legislation

Essentially, CG is related to complete legislative systems. As the OECD has commented:

"Corporate governance is of direct relevance to policy makers because laws, institutions and regulations, on which policy makers exert influence, have a direct bearing for corporate governance structures. Such policy levers include: company law, taxation, banking and securities regulation, prudential regulation of pension and insurance sectors, stock market regulation, and bankruptcy legislation."

Companies are constrained or limited by the law in what they can do. For example, laws regulate the way in which companies deal with other people, giving rights to creditors and customers, and provide some protection for employees and for society at large. They are also subject to various regulations and codes of practice from external bodies.

Issues to consider therefore are:

- The extent to which CG practices should be forced on companies by legislation.
- How much should be left to regulation by the stock market regulators.
- How much CG should be a matter for companies to decide for themselves, perhaps within a published framework of best practice guidelines.

In practice, however, CG is voluntary rather than compulsory, the risk of disrupting relations with shareholders is usually enough to persuade companies to comply with guidelines and codes of practice. Annex II is an example CG Guidelines of the consultancy company Accenture (http://www.accenture.com).

It should be noted here that as cultural values partly determine the types of legal regimes likely to be accepted as legitimate in a country, there is a culturally–induced path dependence in CG regimes for every country.

3.7 Ethical Issues

Ethical considerations are at the root of many perceived problems with CG in practice. Individuals are expected to behave in an ethical way. Companies may be aware of the need to maintain a culture of corporate ethics, providing a code of conduct that all directors and employees are expected to follow.

Irrespective of type of ownership and structure, the wider governance agenda advocates that all organizations should act ethically and in a socially responsible manner. The individuals controlling an organization should work for the objectives of the organization and should not allow self-interest to dominate their decisions and actions.

3.8 Monitoring and Risk Management

Monitoring assesses the quality of the control systems over time and identifies corrective action to improve them. Systems operating in a changing environment need close monitoring. Quality assurance, benchmarking and other continuous improvement tools can be effectively included as part of a monitoring process. Monitoring is most effective when it occurs in the course of normal operations, rather than focusing on detection of problems after they have occurred.

Risk management establishes a process of identifying, analyzing and mitigating risks which could prevent the company from achieving its business objectives. It includes making links between risks/returns and resource priorities.

Risk management includes putting control activities in place to manage risk throughout the organization by developing fraud and risk management plans which cover activities as diverse as review of operating performance, information technology and MIS, increased competition and contestability, contracting out and outsourcing performance management and information, professional development, staff appraisal including client surveys, reconciliations of accounts, approvals and segregation of duties.

As a general rule, investors expect higher rewards to compensate them for taking higher business risks. If a company makes decisions that increase the scale of the risks it faces, profits and dividends should be expected to go up. Another issue in CG is that the directors of companies might take decisions intended to increase profits, without giving due regard to the risks. In some cases, companies may continue to operate without regard to the changing risk profile of their existing businesses.

When investors buy shares in a company, they have an idea of the type of company they are buying into, the nature of its business, the probable returns it will provide for shareholders and the nature of its business and financial risks. To shareholders, investment risk is important, as well as high returns. Directors, on the other hand, are rewarded on the basis of the returns the company achieves, linked to profits or dividend growth, and their remuneration is not linked in any direct way to the risk aspects of their business.

A common denominator in past corporate failures has been a lack of effective control over the company and the absence of risk management procedures and systems. The problem with corporate collapse could be dishonest management finally being exposed, but is much more likely to be the consequence of a well-intentioned BOD failing to carry out its duties adequately. The duties of the BOD must include ensuring that there is an operative and

effective system of risk management. Shareholders should feel confident that the board is aware of the risks faced by the company, and that a system for monitoring and controlling them is in place.

When questions were asked about how the corporate collapse could happen to such well-established companies without warning, some common themes emerged. Investors were not kept informed about what was really going on in the company and the published financial statements were misleading. External auditors were accused of failing to spot the warning signs, but much of the blame was heaped on the self-seeking activities of powerful company chiefs, their apparent lack of personal and business ethics, and the inability of their colleagues on the board to restrain them from acting improperly. In addition, it was recognized that the risk of financial collapse can be prevented by adequate risk management, and that in the case of all the companies concerned, the financial controls had been inadequate or ineffective.

3.9 Ownership Structures

The debate on the impact of ownership structures on the quality of CG and whether one ownership structure is preferable to others has been ongoing. As early as in the 1950s, Berle suggested that some ownership concentration is required to improve agency problems[*]. That is because, in the presence of dispersed ownership, investors have little incentive to engage actively in monitoring and control of companies but prefer to free ride on the monitoring performed by others.

In the case of concentrated ownership, however, the owners have the incentive and means to monitor management closely. Furthermore, they support decisions to enhance companies' long term value creation capabilities. Supporting Berle's thesis, Gomes and Novaes (1999) argued that maximally efficient corporate structure consists of multiple large shareholders together with some minority shareholders.

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[*] Please refer to the next section for an explanation of the agency problem (e.g.principal-agent problem).

This wisdom, however, was questioned by the apparent performance of the US and the UK market against that of continental Europe. Fox and Heller (2000) suggest that their findings contradict the recent theoretical and empirical research which suggests that control by multiple large shareholders may improve firm performance. Carlsson (2001), based on his research on Scandinavian enterprises, concludes that "ownership matters, and it all depends on the owner" - pulling the debate to shareholder responsibility. The findings by Oman (2001) go a long way in explaining why issuing corporate equity may not be a major source of funding in countries where concentrated ownership is the norm. Yet, the permanent problem remains unresolved: ownership concentration goes together with weak investor protection. Himmelberg, Hubbard and Low (2002) add a new dimension to the problem. They predict that agency problems force insiders to retain a larger share than they would under a perfect risk diversification strategy.

4. CONFLICT OF INTEREST

CG issues are intrinsically linked to the principal-agent problem* (agency problem) and this originates the need for an effective CG framework; interests of those who have effective control over a firm can differ from interests of other parties.

"An effective CG framework is necessary to ensure a level playing field for corporations and discipline the behavior of the company insiders vis-à-vis stakeholders in general. These objectives can be achieved by putting in place standards, transparency requirements and monitoring and compliance mechanisms that corporations must adhere to." (World Bank Group, 1999).

4.1. Separation of Ownership and Control

At the heart of the debate about CG lie the conflicts of interest, or potential conflicts of interest, between shareholders and either the BOD as a whole or individual board members. The directors may be tempted to take risks and make decisions aimed at boosting short-term performance. Many shareholders are more concerned about the longer term, the continuing survival of their company and the value of their investment. If a company gets into financial difficulties, professional managers can move on to another company to start all over again, whereas shareholders suffer a financial loss.

Shareholders have to rely on the BOD to govern their company competently and in their best interests. They are able to monitor the performance of the company (and, by implication, its directors), primarily through the company's annual report and accounts. They make their decisions to invest in the company's shares and hold on to them, largely on the basis of information supplied by the directors in the company's name. Their only reassurance that the

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* The problem that arises because an agent takes decisions and acts on behalf of a principal. The principal has to accept the consequences of the agent's actions, but might want some redress against an agent acting outside his authority. This problem is comparable to the relationship between the equity shareholders and directors of a company.

information they are supplied is correct is the honesty of the directors and the assertion by the company's auditors that the published accounts give a true and fair view of the company's profitability and financial position.

The problem has been well expressed by the OECD, the international organization established to help governments deal with global economic, social and governance issues:

"The relationship between the shareholders and the board of directors is at the center of many of the problems that arise in CG. Many of the guidelines in the codes of conduct for CG and codes of best practice are directed towards reducing the potential for conflict, by seeking to put some restraints on individual directors, particularly the CEO and other executive directors, and by trying to reconcile the interests of the two stakeholder groups."

4.2 Other Stakeholder Groups

A major concern with CG is the conflict of interests between the BOD and other stakeholder groups. When the directors take decisions that are in their personal best interests, and regardless of the interests of other stakeholders, should this be allowed or how can it be prevented? The directors, particularly executive directors, have greater access to the information systems of their company and so know more about what is going on. They are also often in a position to control or manipulate the information that is released to the shareholders or employees.

4.3 Separation of Outsiders and Insiders

Investors and creditors that lack control over the corporation (absence of perfect information and effective sanctions) will find it risky and costly to protect themselves from the opportunistic behavior of managers and controlling shareholders in the absence of the protections that good CG supplies.

According to Booz Allen and Hamilton analysis, in order to minimize the conflict of interest and enhance the board performance, every board needs to evaluate its practice and redefine the future requirements of the company in coordination with other stakeholders, primarily the shareholders.

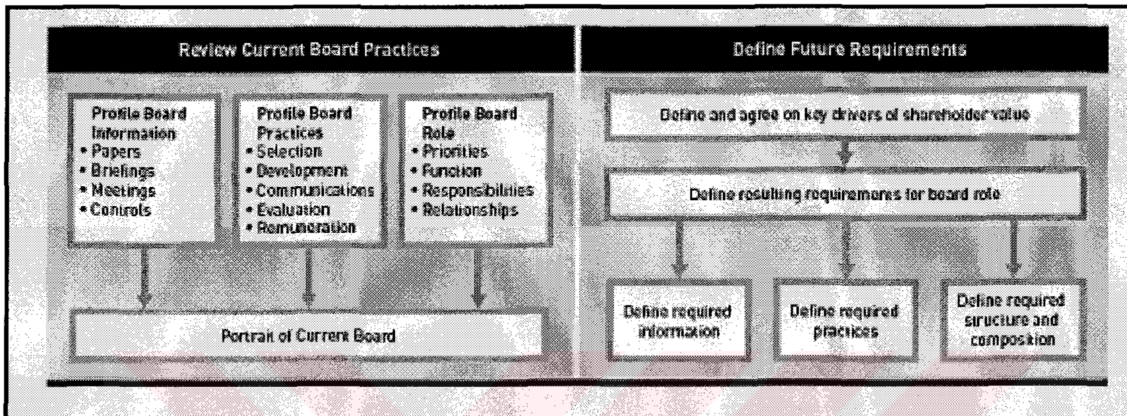

Figure 4.1 Checklist
(Source: Booz Allen and Hamilton, Corporate Governance: Hard Facts about Soft Behaviors, January 2003)

5. APPROACHES TO CORPORATE GOVERNANCE

There has been considerable debate about what the objectives of sound CG should be. The different views can be divided into three broad approaches:

- The shareholder value approach
- The enlightened shareholder approach
- The stakeholder or pluralist approach

The most well-established approach to CG is the shareholder value concept. A move to an enlightened shareholder approach or a stakeholder approach would require changes in the law to be effective. However, there is growing awareness of the need for companies to act in a socially responsible way.

5.1 Shareholder Value Approach

A well-established view, supported by company law in advanced economies, is that the BOD should govern their company in the best interests of its owners, the shareholders. This could mean that the main objective of a company should be to maximize the wealth of its shareholders, in the form of share price growth and dividend payments, subject to conforming with the rules of society as embodied in laws and customs.

The directors should be accountable to their shareholders, who should have the power to remove them from office if their performance is inadequate. The OECD, in the introduction to its principles of CG, states that from a company's perspective, CG is about:

"...maximizing value subject to meeting the corporation's financial and other legal and contractual obligations. This inclusive definition stresses the need for boards of directors to balance the interests of shareholders with those of other stakeholders – employees, customers, suppliers, investors, communities – in order to achieve long-term sustained value."

The strength of this approach to CG is its general acceptance. Many people hold the view that public companies are in business to earn profits for the benefit of their shareholders. Successful companies are perceived as those paying dividends to shareholders and whose share price goes up. Within the broad objective of maximizing shareholder values, the BOD will also act fairly in the interests of employees, customers, suppliers and others with an interest in the company's affairs.

5.2 Stakeholder Approach

An alternative view is that the aim of sound CG is not just to meet the objectives of shareholders, but also to have regard for the interests of other individuals and groups with a stake in the company, including the public at large. The OECD argues that there is a public policy perspective towards CG, as well as a corporate perspective:

"...from a public policy perspective, corporate governance is about nurturing enterprise while ensuring accountability in the exercise of power and patronage by firms. The role of public policy is to provide firms with the incentives and discipline to minimize the divergence between private and social returns and to protect the interests of stakeholders..."

From a stakeholder view, CG is concerned with achieving a balance between economic and social goals and between individual and communal goals. Sound CG should recognize the economic imperatives companies face in competitive markets and should encourage the efficient use of resources through sound investment. It should also require accountability from the BOD to the shareholders for the stewardship of those resources. Within this framework, the aim should be to recognize the interests of other individuals, companies and society at large in the decisions and activities of the company.

A problem with the stakeholder approach is that company law gives certain rights to shareholders, and there are some legal duties on the BOD towards their company. The interests of other stakeholders, however, are not reinforced by company law.

Supporters of a stakeholder approach to CG argue that there would have to be company legislation giving it support. A pluralist approach is that cooperative and productive relationships will be optimized only if the directors are permitted or required to balance shareholder interests with the interests of other stakeholders who are committed to the company. Changes in company law would be required to introduce such an approach in practice. If the law were to be changed in this way, it is much more likely that directors would be permitted to have regard for the interests of stakeholders other than the shareholders in particular circumstances, but would not be required to do so.

It is important to remember that although shareholder interests are not well protected by company law, extensive protection is provided by other aspects of law such as employment law, health and safety legislation and environmental law.

5.3. Enlightened Shareholder Approach

The enlightened shareholder approach to CG is that the directors of a company should pursue the interests of their shareholders, but in an enlightened and inclusive way. The directors should look to the long term, not just to the short term, and they should also have regard to the interests of other stakeholders in the company, not just the shareholders. Managers should be aware of the need to create and maintain productive relationships with a range of stakeholders having an interest in their company.

A criticism of the enlightened shareholder view is that most shareholders do not fit the image of enlightened investors. Most shares in public companies are owned by institutional investors, who are themselves relatively unaccountable to their beneficiaries. However, the

role of institutional investors in CG is likely to evolve in the future, with institutions expected to be more proactive in promoting the rights and interests of shareholders.

Which approach is likely to apply?

In practice, the shareholder value approach to CG is the generally accepted view. There is already scope and flexibility in the existing law to apply pluralist or enlightened shareholder concepts, and that most BOD do take into account the interests of stakeholders in the decisions they make. It is argued that the pluralist approach could damage share values, since actions to further the interests of other stakeholders might reduce returns to shareholders. It seems unlikely, in view of current attitudes, that a pluralist approach will replace the shareholder value approach.

6. DEVELOPMENT OF CORPORATE GOVERNANCE

Concerns about CG have grown over time. As stated, the recognition of a need for changes in the way that companies are governed began with a number of spectacular and well-publicized corporate failures in the recent years. In each case, there appeared to be serious accounting or financial reporting irregularities and inadequate internal control and risk management practices.

6.1 Background

The seeds of CG idea were probably sown by the Watergate scandal in the US. As a result of subsequent investigations, US regulatory and legislative bodies were able to highlight control failures that had allowed several major corporations to make illegal political contributions and to bribe government officials. This led to the development of the Foreign and Corrupt Practices Act of 1977 in the US that contained specific provisions regarding the establishment, maintenance and review of systems of internal control that are supposed to be the signs of CG.

This was followed in 1979 by the proposals of the SEC of the US for mandatory reporting on internal financial controls. In 1985, following a series of high profile business failures in the US, the most notable one of which being the Savings and Loan collapse, the Treadway Commission was formed. Its primary role was to identify the main causes of misrepresentation in financial reports and to recommend ways of reducing incidence thereof. The Treadway report published in 1987 highlighted the need for a proper control system, independent audit committees and an objective Internal Audit function. It called for published reports on the effectiveness of internal control. It also requested the sponsoring organizations to develop an integrated set of internal control criteria to enable companies to improve their controls.

However, the modern trend of developing CG guidelines and **codes of best practice** began in the late 1980s and early 1990s in the UK. US and Canada followed this impetus in response to problems in the corporate performance of leading companies, the perceived lack of effective board oversight that contributed to those performance problems, and pressure for change from institutional investors.

CG reforms to date have largely involved promotion of best practice codes at a national level assuming that efficient legal and regulatory framework existed in these countries and empowered capital market regulators were capable of enforcing the rules. Some countries relied mainly on voluntary codes of practice, whereas others rely more on legislation and compulsion.

Development efforts at an international level were based on the belief that businesses have enough incentives to self regulate and that corporate level initiatives would trigger supplementary legal and regulatory reforms. Recommended principles on CG have been published by the Commonwealth Association and by the OECD. Nevertheless, the optimism underpinning this approach started to falter as not all firms have been enthusiastic about adapting the prescribed codes.

6.2 Codes of Best Practice - Chronology

The first attempt to study and advocate for CG in Europe came in December 1992 with the publication of the Report of the Committee on the "Financial Aspect of Corporate Governance" as established by the Financial Reporting Council, the London Stock Exchange and the accountancy profession of the UK, better known as the Cadbury Report. This report focused on addressing how BOD should carry out their crucial responsibilities to better ensure the reliability of company accounts in the face of a number of financial scandals and provide for a Code of Best Practice as an instrument for guiding corporate director's behavior. The report concluded: "The effectiveness with which boards discharge their responsibilities determines Britain's competitive position. They must have the freedom to drive their

companies forward, but to exercise it within a framework of effective accountability. This is the essence of any system of good corporate governance."

On the recommendation of the Cadbury Committee, a second committee was set up to review the progress on CG in UK listed companies. This committee issued the Greenbury Report in 1995, which focused mainly on directors' remuneration. The Greenbury Report issued a Code of Best Practice on establishing director remuneration policy.

Another major report, The Myners Report, was published in 1995 in the UK. The report focused on the relationship between company management and institutional investors. The significance of the Myners Report was that it urged institutional investors to reassess their role as shareholders and their responsibilities for ensuring good CG and the success of the companies in which they invested.

The Hampel Committee was set up in 1995 to review the recommendations of the Cadbury and Greenbury Committees. Their final report was published in 1998 and covered a number of governance issues, such as the composition of the board and role of directors, directors' remuneration, the role of shareholders (particularly institutional shareholders), communications between the company and its shareholders, and financial reporting, auditing and internal controls. The Hampel Report also suggested that its recommendations should be combined with those of the Cadbury and Greenbury Committees into a single code of CG. This suggestion led to the publication of the Combined Code, which now applies to UK listed companies.

The King Report, published in South Africa, took an integrated approach to CG. In 1992, the Institute of Directors in South Africa established the King Committee, which produced its first report in 1994. This was followed by a second report in 2002. The report took the view that a company has a wide range of stakeholders whose views should be considered, and there should be a participative CG system, applied with integrity.

CG gained great importance especially after the Asian financial crisis in mid-1997. Companies that used existing resources in an inefficient way and did not conform to international corporate management standards magnified the effects of the crisis in those countries. Corporate transparency and accountability are so critical for overall economic performance that they have begun to be an accepted norm throughout the world since the Asian crisis.

In 1991, the OECD and the World Bank signed a memorandum of understanding to broaden the global policy dialogue and cooperation on CG reform and to respond to the need of individual countries to improve CG. In May 1999, ministers representing the 29 governments which comprise the OECD voted unanimously to endorse the "OECD Principles of Corporate Governance" (Appendix II). The principles were negotiated over the course of a year in consultation with key players in the market, including the ICGN. They constitute the chief response by governments to the G-7 Summit Leaders' recognition of CG as an important pillar in the architecture of the 21st century global economy. The principles were welcomed by the G7 leaders at the Cologne summit in June 1999 and are likely to act as signposts for activity in this area by the IMF, the World Bank, the UN and other international organizations. OECD continues to monitor developments in CG in its member countries.

The US appeared to show little concern for better CG throughout the 1990s, although there were some activist institutional shareholders. The situation changed dramatically, however, with the collapse of the energy company Enron, followed by a number of other corporate collapses and governance scandals. The major auditing and accountancy firm Arthur Andersen, caught up in the Enron scandal and prosecuted for obstructing the course of justice, collapsed and was broken up. Recommendations for change have been proposed by the New York Stock Exchange, and statutory provisions on CG were introduced in 2002 with the Sarbanes-Oxley Act. The Sarbanes-Oxley Act is an extensive piece of legislation covering CG, external auditing, the honesty of financial reporting, insider trading, and even whistle blowing and corporate codes of ethics.

It should be noted that much of the pressure for change has come from institutional investors, particularly in the US, who have invested fairly heavily in companies in other countries. As shareholders in foreign companies, US investors expect to be allowed to exercise their right to vote and to be treated on an equal footing with other equity shareholders. In countries where minority shareholder rights are not always well respected, US investors influence has probably been influential in the CG changes that have happened.

7. CORPORATE GOVERNANCE IN DEVELOPING COUNTRIES

For developing countries, good CG is seen as an essential basic requirement for attracting foreign investment capital. Following the corporate scandals in developed markets (Enron, WorldCom, etc.), emerging markets have been reappearing on investors' radar. In many developing countries, there have been substantial investments in recent years by multinational companies, such as international banks. Higher growth and increased profitability, accompanied with improved CG standards may further attract investors disappointed by the recent downfall of the US and European markets.

It might be expected that especially the US and UK multinationals would establish a system of CG within their subsidiaries along similar lines to the parent company. Some multinationals have become increasingly aware of their reputation in markets in other countries, and alert to the demands of pressure groups as well as governments in the countries where they have operating subsidiaries.

Apart from multinationals, the largest commercial organizations in many developing countries are government-owned or government-controlled. Government-controlled organizations are not necessarily operated on fully commercial lines and some board membership may reflect political interests within the country. Where the government is heavily involved in commercial activities, such as water provision, electricity provision, transport, road building, and so on, it should be expected that it will be influential in bringing about improvements in CG.

In less developed markets, where institutions are weak and ownership is concentrated, CG issues go much beyond agency problems. The controlling shareholder generally takes an active interest in running the company and holds executive roles. Minority shareholders and other investors may be constantly confronted with acts reflecting lack of property rights, contract violations, transfer pricing, targeted issues and repurchases, self-dealing, asset stripping and abuse of minority positions, etc. which remain unpunished. The dominant

conflict observed in less developed markets between the dominant shareholders/managers and other stakeholders, especially the outside investors and creditors, is referred to as the "expropriation problem".

7.1 Corporate Governance Reforms

CG reforms in emerging economies are driven by increasing need for extra-firm sources of capital in a period of globalization. Companies need higher investment levels to compete in global markets. This requirement is further intensified by the fact that national development banks traditionally financing enterprises through public borrowing and high inflation are no longer sustainable. Reforms are also demanded by portfolio investors who have detected some decoupling of emerging market performance from developed markets.

Despite the potential for a virtuous circle involving CG reforms in and increased equity investment flows to developing countries, the actual trends have proved less than satisfactory. On one hand, governance reforms in emerging markets have not progressed sufficiently. On the other, the investors' appetite for risk in emerging markets proved to be an over-simplification (Clark 1998).

In most developing countries, the reform process has been difficult and slower than expected due to the complexity and path dependency of the economic, social and legal structures (Bebchuk and Roe 1999). As Oman (2001) notes, oligopolistic coalitions who frequently operate as corporate insiders in developing countries, cling to politically endorsed privileges and hamper the introduction of accountability and transparency reforms. Thirdly, law enforcement in most developing countries is compromised by the fact that the courts are under-financed, under-resourced, and lack the necessary expertise.

McKinsey compared the CG framework and its control model in the emerging economies with the developed markets.

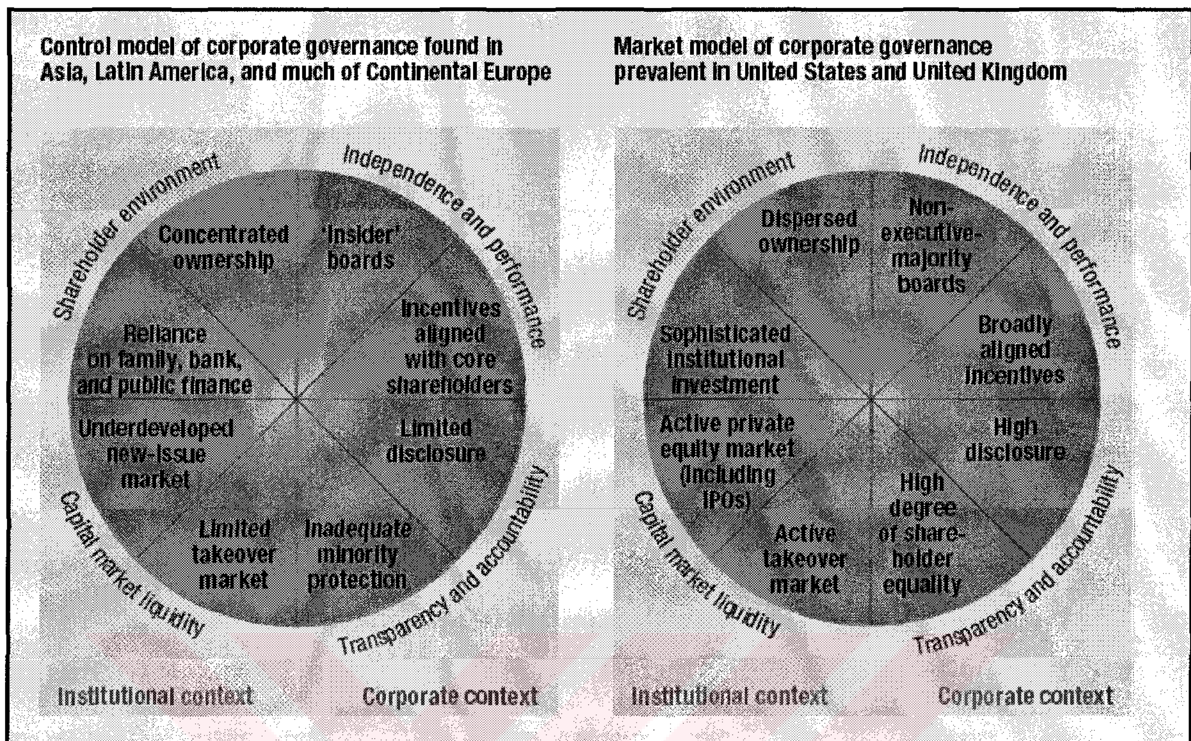

Figure 7.1 CG Comparison Across Nations
(Source: McKinsey, Corporate Reform in Developing World, 2003)

There has been an increasing awareness that the focus on primacy of boards and firm level compliance with best practice codes may not be sufficient to affect the way the corporations are governed and transplantation of OECD principles will not change the corporate behavior (see Allen 2000 for a discussion in Asian context). This is confirmed by a recent progress report on assessments of CG in 15 countries released by the World Bank (World Bank Group 2002). Using OECD guidelines as benchmark, the report states that the legal and regulatory frameworks of the assessed countries may be largely compatible with OECD principles, but compliance in practice remains an elusive task.

A parallel conclusion can be derived from McKinsey's 2001 "Emerging Market Investor Opinion Survey". The survey results indicate that institutional investors rate the enforceability of legal rights as the most important external factor of the CG framework when selecting emerging market countries for investment. This is followed by the quality of economic

management, independence of judiciary/quality of legal system, and the level of corruption. The survey results also highlight the need to work on the internal dimension of the CG framework – especially the dominance of family ownership. Investors participating in the McKinsey survey rate the distinction between company and family interests as the most important corporate-level factor in selecting the companies in which to invest, followed by clearly defined governance arrangements, accuracy of financial reporting, legally enforceable minority shareholder protection and the use of performance-based pay for top management. According to the results of the same survey, institutional investors were reported to pay as much as 28% more for the shares of well governed companies in emerging markets.

Below are the identified criteria for private equity investors to invest in an emerging economy according to another McKinsey survey (2002) . Over half (55%) of the respondents said that reform of the institutional context, reform driven by governments, local stock exchanges, and regulatory watchdogs, was at least as important as reform of companies. Within the institutional concerns, the two main concerns were weak enforcement of legal rights and management of the economy.

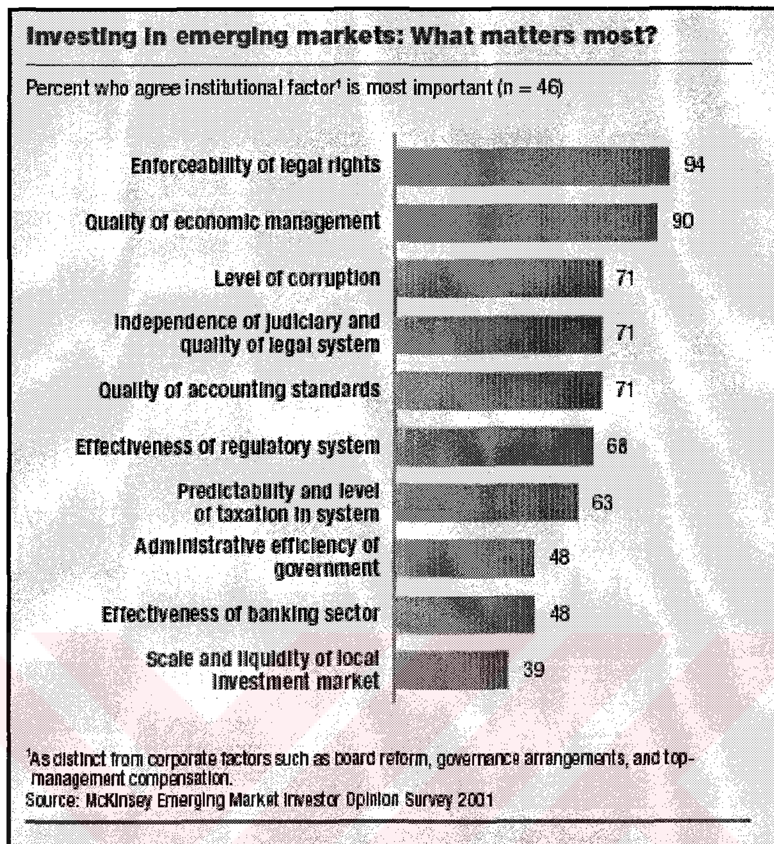

Figure 7.2 What Matters Most?
(Source: McKinsey, Corporate Reform in Developing World, 2003)

7.2 Challenges

Most important challenges faced by the CG reforms in developing and emerging economies are establishing a rule-based system of governance (as opposed to a relationship-based), combating vested interests, taking apart pyramid ownership structures, severing links such as cross shareholdings between banks and corporations, establishing property rights that clearly and easily identify true owners, protecting and enforcing minority shareholder rights, preventing asset stripping, promoting good governance within concentrated and family-owned ownership structures and cultivating technical and professional know-how.

8. CORPORATE GOVERNANCE IN TURKEY

8.1 Background

After the establishment of the Republic of Turkey, especially from early 1930s onwards, a strong emphasis has been placed on the role of the state in economic development. Until 1945, the state was the major economic player and subsidized the development of the private sector. A pro-market economic policy started to take shape after 1945, but the process continued to be marked with heavy state involvement in the economy. In fact, state involvement in the economy during the 1950s (both as producer and regulator) proved to be higher than the 1930s. Although state involvement in the economy continued throughout the 1960s and 1970s, the fledgling private sector eventually came of age and market economy institutions acquired a new dynamism. This dynamism has increased due to a new wave of pro-market policies in the 1980s, which started with the liberalization reforms of 24 January 1980 and continued with further liberalization under the military regime and the first civilian government.

Both international and domestic developments have combined to bring the CG debate to the fore in Turkey. On one hand, the CG debate at the international level had a pull effect; it has drawn the attention of Turkish companies and policy-makers to the linkage between CG quality and sustainable development. On the other hand, domestic realities such as limited FDI, limited and highly volatile external portfolio investment, restructuring of the banking system, and the possible drying up of funds from public or group banks had a push effect. These developments and the crisis-prone macroeconomic environment have induced Turkish companies and policy-makers to start questioning the current CG practice in Turkey.

8.2 The Findings

In 2002, McKinsey made a research on 188 companies from South Korea, Malaysia, Taiwan, India, Turkey and Mexico to rate the performance of these companies against some key components of CG. The results were aggregated to a CG score across nations in percentages.

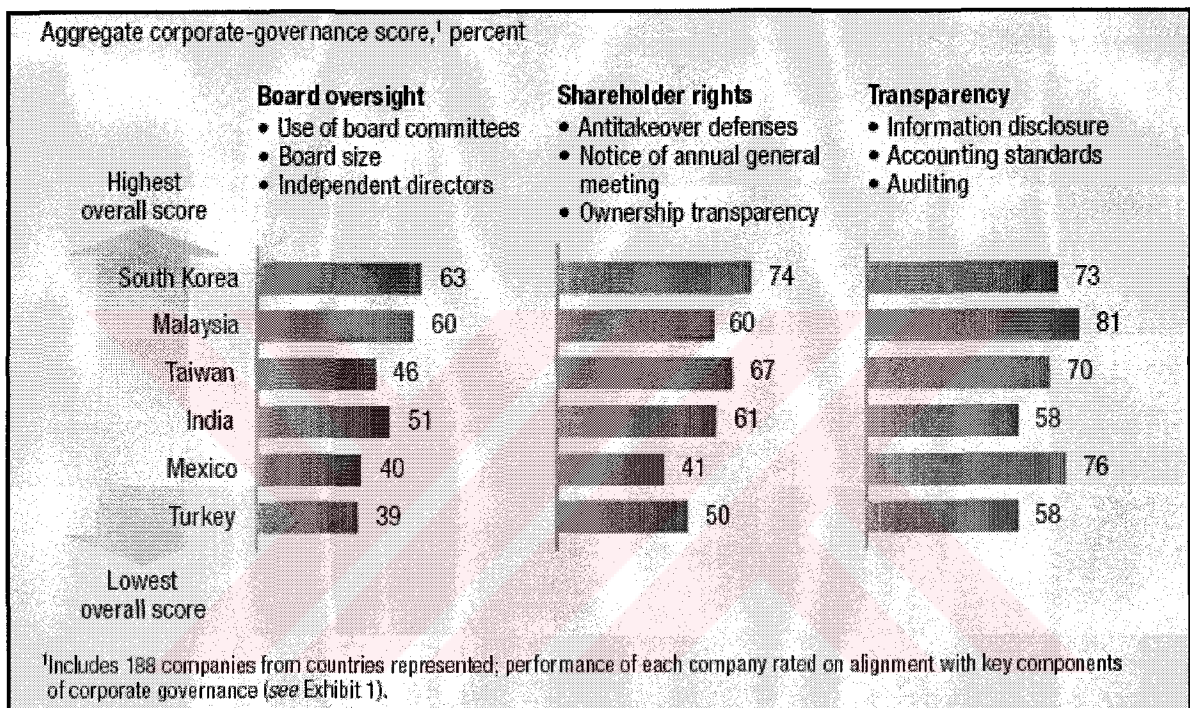

Figure 8.1 The Scorecard
(Source: McKinsey. A Premium for Good Governance, 2002)

The findings places Turkey at the bottom of the ranking with respect to board oversight and transparency and second from the bottom after Mexico with respect to shareholder rights.

Perception issues of similar nature is reflected in Transparency Internationals' Corruption Perception Index (2001 and 2002). Turkey ranks 54th among 91 countries in 2001 (with a score of 3.6 out of 10) and 64th among 102 countries in 2002 (with a worse score of 3.2 out of 10) in transparency. Turkey is perceived to be more corrupt than Chile, Malaysia, Poland and Morocco and better than Argentine, India, Russia and Indonesia.

In a 40 country assessment of La Porta et al, Turkey is rated 2 out of 6 with respect to shareholder's rights (worse than all including Philippines, Peru, Malaysia, Chile, Argentina, Colombia, India, and Pakistan but better than Mexico, Venezuela, Germany and Italy), 4 out of 10 with respect to judicial efficiency (worse than all 40 countries except Thailand and Indonesia), 51 out of 90 with respect to accounting standards (worse than all but Argentina and Colombia).

8.3 The Investment Climate

Turkey's underperformance with respect to attracting FDI is neither a recent nor a transitory phenomenon. Compared to developing countries, Turkey has attracted much lower FDI flows in proportion to its GFCF since mid 1980s. The underperformance in this area is closely related to investor or analyst perceptions of Turkey's CG framework as well as its wider political environment and macro-economic instability.

As already stated in the "Findings" section, Turkey's investment climate is not radiating confidence to the investors. Turkey is perceived as an solid and corrupt country. Capital market is characterized by low liquidity, high volatility, high cost of capital (low firm valuation) and limited new capital formation. Controlling shareholders maintain large stakes and have leveraged cash flow rights due to privileged shares and pyramidal ownership structures. Risk of expropriation by insiders is high. Shortcomings in the legal and regulatory framework contribute substantially to the risks of investing in equity markets in Turkey.

To better assess the CG framework in Turkey, the capital market and its institutions are depicted next.

8.4 Capital Markets in Turkey

The modern capital market of Turkey has only 20 years of history. From 1980s onwards, there was a continuous increase in the number and size of joint stock companies that opened up their equity to the public. The capital markets and the CG idea in Turkey has been in a development phase. Since Turkey is a civil law country, the legal and institutional frameworks governing Turkey's listed companies comprise the CC 1956, the CML 1981 as amended; the Decree-Law No. 91 1983; the CMB, and ISE. Specific legislation regulates the banking and insurance sectors.

8.4.1 Legal and institutional framework

The CML, CMB, ISE, Settlement and Custody Bank (Takasbank) are the major instruments involved in Turkey's capital market framework.

The CML was enacted in 1981 and the CMB was established. Secondary market operations, initially limited to equity trading, started in 1986 with the foundation of ISE. It should be noted here that in developing standards of CG, the Stock Exchange has been playing a leading role since its policy is to provide broad guidelines for listed issuers in the belief that self-regulation by listed issuers is more effective and efficient than the imposition of excessive and rigid regulations. In 1992, with amendments to the relevant legislation, the CMB's powers were increased to allow it to define new instruments in response to rapid market developments.

8.4.1.1 The Capital Market Law

In Turkey, the CML governs the securities markets, establishes CMB, defines the types of securities that can be issued, sets out issuance/public offering procedures as well as initial and continuous disclosure requirements and licenses, monitors and supervises financial

intermediaries and institutional investors operating in the market. The Decree-Law No. 91 regulates the establishment and activities of stock markets.

8.4.1.2 The Capital Market Board

CMB develops, regulates and supervises Turkey's securities markets. It drafts statutory laws to be submitted to parliament for approval and issues regulations. These rules are known as "communiqués" and published in the official gazette after receiving clearance from the Ministry. CMB has ample administrative powers, capable of directly imposing administrative penalties such as warnings, fines, suspension or cancellation of licenses. It is governed by an executive board composed of seven members including a chairman. The members of the board are appointed by the Council of Ministers.

8.4.1.3 Istanbul Stock Exchange

ISE is a public organization and is governed by a general assembly attended by its trading members licensed by CMB, a BOD, auditing and other committees, and the chairman's office. The chairman/CEO is appointed by the government for a five year term, candidates can have any professional background, including broker or public servant. He or she can only be removed for gross misconduct. CMB closely supervises the exchange, conducts yearly audits, and has the right to reject decisions of ISE's general assembly.

8.4.1.4 Takasbank

Takasbank is Turkey's central securities custody and national numbering agency compliant with ISSA G30 guidelines and US SEC rules 17f-5. Takasbank is solely authorized for safekeeping of securities. ISE owns 22.6% of Takasbank, the rest is owned by 27 banks and 77 brokerage houses. Takasbank is regulated by CMB with respect to its securities depository functions and by newly formed BRSA and CB with respect to its banking services.

The recent history shows that both the CMB and ISE have been responsive to market needs and that their structural fundamentals do not impose any problems for performing their roles. Nevertheless, there are two reasons for concern. One is the relative lack of flexibility and innovation caused by the public servant status of their employees. The other is the inefficiency of the organizational framework caused by the slowness and inadequacy of the judicial system.

Both CMB and ISE are active in developing CG standards. For this purpose, more recently the CML was amended and the scope of authority and duties of CMB were expanded. Additions to the law include a provision that permits CMB to attend shareholder meetings; provisions that enhance the protection of shareholders rights, and increased penalties for violations in related party transactions. In addition, with the amendments in 1999 new institutions are established under the CML, which include the Association for Securities Dealers, Securities Investor Protection Fund, Accounting Standards Board and the Central Registrar for Securities. Therese institutions further enhanced the infrastructure of the capital market.

8.5 Corporate Governance Framework

The CG debate in Turkey revolves around five issues:

- Shareholder and minority rights
- Financial reporting, auditing and disclosure of information
- Legal and regulatory framework
- Ethical issues
- Corporate structures.

8.5.1 Shareholder and minority rights

In Turkey, the fundamental document governing the shareholders' rights is the company's articles of association, which should provide for the rights to participate in the general assembly, to vote and acquire information, to have the company audited, to file a complain, and to take civil or legal action. There are no mandatory provisions in the CC.

In addition, the CC provides for privileged shares and imposes practically no limit to the extent of privileges that may be granted, including multiple voting rights, pre-determined dividend rate, priority entitlement at the time of liquidation etc. Minority rights start from 5% for public companies and 10% for non-public ones according to the CC. Shareholders can vote by notarized proxy by appointing a representative through a power of attorney; however the procedure is complicated and costly.

Insider trading or the trading of by the use of non-public information is a crime with penal liability and 2-5 years of imprisonment and heavy fine. Dissemination of false or misleading information is also covered under the same provision. The 1999 amendments to CML brought 2-5 years imprisonment to transfer of assets and profits out of firms for the benefit of those who control them. The CMB can take any violation of shareholders rights with respect to insider trading and manipulative practices to the public prosecutors; however the provisions are not clear and subject to interpretation.

8.5.2 Financial reporting, auditing and disclosure of information

The Turkish Accounting System is not compatible with the IAS. This discrepancy restricts investors' ability to make informed decisions about investment alternatives. A research jointly undertaken by seven major global accounting and auditing firms compares written national accounting standards of 62 countries and benchmarks them against IAS. It is apparent that Turkey is one of the 4 countries (Lithuania, Slovenia, Morocco and Turkey) where national standards have at least one major difference from IAS and it is the only country with

deviation in more than one area. It is reported that in two key areas, the absence of Turkish rules leads to important differences from IAS: inflation adjusted reporting and mandatory financial consolidation for parent enterprises. This benchmark is based on the accounting standards issued by the CMB. There is no set of generally accepted accounting principles that applies equally to all companies operating in Turkey other than general rules that govern the aspects of accounting in the Tax Procedures Code and the Uniform Chart of Accounts which prescribe a code of accounts and a format for presentation of financial statements.

Aware of the negative implications of these irregularities, many Turkish companies (in the order of hundreds according to the local office of one of the reporting firms) have already begun producing IAS-compatible financial statements. Obviously this voluntary act does not protect them from paying taxes based on fictive profits created by hyperinflationary economic conditions. Indeed, CMB has issued draft standards on inflation accounting and consolidation in line with IAS requirements; however the changes required in the tax code are still pending.

As discussed, compliance with requirements is assured by internal audits, external audits and regulatory audits. The internal audit framework is defined in the CC, but the provisions are vague. External audits are required only for listed companies. External auditors have to be certified by CMB. The Independent Audit Association founded in 1988 does not have statutory position to self-regulate the profession. It is arguable that the audits are credible and objective. In case of failures, the ISE and the CMB can issue private and public warnings, impose penalties, suspend trading or may put the companies on a "watch list." Regulatory audits are conducted by the CMB or by external auditors appointed by the CMB in case of complaints, suspects or when there is a need such as in the case of mergers and acquisitions. Although the existing regulations and the planned improvements present significant improvements, compliance is still a problem to be addressed.

8.5.3 Legal and regulatory framework

One of the building blocks of CG legislative framework, the CC, was originally taken from French Commercial Code in 1850 and amended in 1926 and 1956 - with provisions taken from German, Swiss and Italian law. The 1956 version, with its evidently eclectic nature, forms the basis of equity contract and provides the legal framework for incorporation, general assemblies, shareholder rights, definition of shares and bonds and their issuance. The CML had provisions taken from the Anglo-Saxon (common law) legal system but still has its roots in civil law. It primarily provides the legislative framework for securities market activities and establishes the CMB. Separate laws regulate the banking and insurance sectors. A major issue of legislation is related with the ambiguities in law and inconsistencies between CC, CML, and Banking Law with respect to disclosure, accounting, taxation and shareholder rights.

There are severe operational problems with the legal process and law enforcement in Turkey. The legal system is complicated, slow and costly. With the 1999 amendment, the CMB is empowered to avoid such impediments by resorting to administrative fines, including suspension and delisting. However, these new powers are compromised by the general inefficiency of the legal process and the weaknesses in law enforcement.

Adoption of best practice codes through regulation (voluntary adaptation but mandatory disclosure of reasons for incompliance) should be considered. Independence, continued professionalization and transparency of regulation and supervision should remain high in the agenda. Another important consideration for deciding on the scope of reforms is to understand that potential benefits of improved governance on growth can only be achieved if a competitive environment is supported by policies and sector specific regulatory reforms where monopolistic/oligopolistic structures exist.

8.5.4 Ethical issues

Changes in rules and legislation and even their effective enforcement do not necessarily lead to changes in values, behavior and attitude. Creating a culture where ethical behavior and integrity is valued in business as well as in day to day life is a matter for civil society, business and professional organizations to focus on. The legislation around civil society organizations in Turkey needs serious reforms as the current framework is limiting. Existence of an independent and alert media sensitive to and capable of detecting corporate misconduct and politically-endorsed tunneling is essential. Given the highly monopolized status of the media in Turkey, this issue needs special attention.

8.5.5 Corporate Structures

8.5.5.1 Ownership structures

According to a research (Aytac and Sak, 2000), in 45% of all the listed companies in Turkey, one shareholder controlled more than 50% of the voting rights. In majority of the cases, the dominant shareholder was a holding company controlled by a family. The survey also indicated that a vast majority of the firms (except about 20) did not use the capital market for funding purposes.

According to Yurtoglu, holding companies are the largest owners of the listed companies and the ultimate owners are mostly individual family members exercising control on cash flow rights through pyramidal with cascaded ownership structures.

However, the ownership structures are relatively transparent. Under CMB's disclosure requirements, the CMB and ISE must be notified immediately of any purchase or sale of shares amounting to one percent of the share capital by any acquirer or group of acquirers acting in concert with those who already hold ten percent or more of the shares or voting

rights. Disclosure of ownership structure and identity of major shareholders owning more than ten percent of the shares or voting rights is also mandatory.

Research on corporate structures in Turkey provides significant evidence suggesting that the holding company structure affects the economic performance of Turkish firms, including profitability, return on assets, dividend payments and investment decisions. For example, Yurtoglu (2000) finds out that concentrated ownership and pyramidal structures have been conducive to lower return on assets, lower market to book ratios and lower dividends. Yurtoglu (2000) demonstrates that profit rates of Turkish companies tend to diverge from the competitive market rates for longer time periods when these companies are part of the holding company structure and their leverage levels are low.

8.5.5.2 Control structures

There is no research on Board compositions in Turkey. There is no requirement for non executive or independent board members or for any board committees. Observations and anecdotal evidence suggest that both the statutory boards and the executive boards are dominated by family members and they largely overlap. Non-executive directors are very rare and are observed in case of significant foreign participation. In cases where CEO is not a family member, he is usually a long-term acquaintance of the family. Family councils or family constitutions are also very rare. Family members are given responsibility to oversee a certain business sector as the group CEO in the holding structure and usually perform the role of the Chairman of the Board for the individual companies. In general existing structures are not conduit to effective performance monitoring. The CMB does not have the power to disqualify or sanction directors.

8.5.5.3 Financing structures

Another feature of Turkish corporate structure is the financing system structured around big business groups (a holding company) with a group-owned bank. Research on the performance

implications of bank-centered finance and close bank-firm relations focuses on East Asia and Japan and its findings are inconclusive. There are arguments that a well balanced financial system with financial intermediation by both banks and capital markets can absorb shocks better. The current global debate is focused on the governance of the banks and related lending rather than the source of finance.

8.6. Non-Government Practices

In 2001, TUSIAD established a Corporate Governance Working Group functioning under the TUSIAD Company Affairs Committee, whose task is to examine the importance of private sector restructuring within the framework of transparency, accountability, fairness and responsibility principles for increasing worldwide competitiveness.

The Corporate Governance Working Group has been working intensively on the appraisal of CG principles and codes adopted by industrialized and developing countries together with the current practice of the Turkish corporations and the articles of the CC. This study has resulted in a report entitled "TUSIAD Corporate Governance Code of Best Practices: Composition and Functioning of the Board of Directors". This study is focused on the composition, independence and agenda of the BOD with the aim of the basic principles to serve as a starting point for the implementation of best practices in CG in Turkey. The report dwells upon the question of how Turkish companies should align themselves with the four fundamental principles of CG: transparency, accountability, fairness and responsibility, which will help them to reach a well deserved place in the global markets. With this perspective, the study focuses on the composition, independence and agenda of BOD which bears the greatest responsibility and has the strategic importance in the formation and practice of CG. This study will have served its purpose if it can be a catalyst for deliberations on the topic and trigger best practices for CG in Turkey.

9. CONCLUSION AND RECOMMENDATIONS

Good CG is gradually becoming fundamental to raising capital, satisfying investors, running successful businesses in increasingly global markets, for the creation of wealth and building of a modern competitive state.

It is debatable, after the post-crises reform experiences, whether a single set of rules of best practice in CG could be drawn up that would apply properly to all countries. Circumstances differ, and what is best for one country is not necessarily best for another. Even assuming that a consensus can be reached about what is best practice in CG, there could be disagreement about whether best practice should be recommended as a voluntary code or enforced through regulation. Nevertheless, many best practice codes such as OECD guidelines and EASD principles provide a comprehensive framework for defining voluntary best practice codes of CG for every country.

There are significant incentives for companies to differentiate themselves by voluntary governance measures since governance begins at home, inside the boardroom, among the directors. It is embedded in how, when, and why they gather, interact, and work with one another and with management. Qualitative reforms to the behaviors, relationships, and objectives of the directors and the management are meaningless unless they are subjected to the hard mechanisms of performance criteria, processes, and measurements. A combination of soft and hard solutions can turn governance from a vague concept into a means to deliver organizational resilience, robustness, and continuously improved corporate performance.

Turkey has been in a serious restructuring process for a well developed equity market to inject high level of domestic savings into investments and attract foreign institutional investors. Governance reforms has been the key for these restructuring efforts. Concentration for development has been yet on the public sector, financial sector, regulatory and other macro matters. However, there absolutely must be change at the micro level as well. Companies

need to learn to keep up with the restructuring process not to surrender their positions to those who can keep up with the change.

Gaining insight into other countries' experiences in the area of CG development will be very useful to policy makers in evaluating and possibly reshaping Turkey's institutional and regulatory structures. Furthermore, non-government and business organizations such as the Chamber of Commerce, and TUSIAD should promote awareness, encourage professional development and training, support and involve in research and finally coordinate with regulatory bodies, international organizations (codes of best governance practice), and research institutions to identify the priorities, scope and pace of necessary reforms.

For now, Turkish legislation needs more elaborate forms and statutory amendments, additions and derivative legislation. An effective property rights regime, enforcement of contract law, a well regulated banking sector, adequate and enforced bankruptcy procedures, sound securities markets, laws and regulations that ensures competition and remove barriers to foreign investment, transparent and fair privatization procedures, transparent and fair taxation regimes, an independent, well-functioning judicial system, effective anticorruption measures, empowered and participative public, an investigative and informed media, strong reputable agents (self regulatory bodies such as accounting and auditing professionals, CG analysts, consumer activist and environmentalist), an active, integrity-based business community are essential institutional components of good CG for Turkey. The challenge is to pace, sequence and synchronize these reform components.

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CURRICULUM VITAE

BURAK EGEMEN

Kişisel Bilgiler :

Doğum Tarihi	30/08/1977
Doğum Yeri	Bern, İsviçre
Medeni Durumu:	Bekar

Eğitim :

Yüksek Lisans	2000-2004	Yeditepe Üniversitesi Sosyal Bilimler Enstitüsü MBA
Lisans	1995-1999	Ortadoğu Teknik Üniversitesi İktisadi İdari Bilimler Fakültesi İşletme Bölümü
Lise	1992-1995	Kolej Ayşeable Lisesi

Çalıştığı Kurumlar:

2003 -	International Finance Corporation World Bank Group Yatırım Danışmanı
1999 - 2003	Citibank N.A. Kurumsal ve Yatırım Bankacılık Birimi Risk Yönetimi Müdür

APPENDICES

1. Turkey: Corporate Governance Assessment - OECD Principles Matrix, "Reports on the Observence of Standards and Codes", The World Bank Group
2. Accenture Coroporate Governance Guidelines

shares. However, while local authorities, CMB and ISE expect that directors' dealings in securities be published systematically, according to market analysts, there is considerable laxity in compliance and enforcement; and the quality of information provided by companies on this matter varies from one company to the next.

Directors must inform the board of directors of conflicts of interest between themselves or their relatives and the company. They may not participate in the deliberations of the board on this specific matter matter (article 332). Without express permission from the AGM they must not enter into business relations with the company nor undertake similar commercial activities either directly or indirectly (articles 334 and 335).

6.5 Disclosures for related party transactions

Article 15 of the CML deals with profit distribution and "disguised profit transfers", a form of insider expropriation in which funds and assets of the public corporation are transferred to a related company by using non-market prices or other mechanisms. Such transfers are not only unlawful, but carry heavy fines and stiff jail sentences of two to five years. While the penalties for violation are clear, CMB has decided against more detailed specifications about what procedures to follow and the type of disclosure required in related party transactions. CMB regulations only stipulate that the footnotes to the financial statements must contain detailed information about commercial transactions and payments between related parties - which in turn can provide clues about potential "disguised profit transfers". Further, there are no specific rules requiring the disclosure of related party transactions other than with equity participants. Based on the number of requests to investigate potential "disguised profit transfers" regularly appearing in CMB's weekly bulletin and published on their website, there isstrong evidence that related party transactions remain a problem in Turkey to date. For example, CMB has been approached twice in recent years regarding Turk Tuborg Bira & Malt Sanayi A.S. and its relationship to majority owner, Yasar Holding A.S. In the first case, Yasar was ordered by CMB to compensate Tuborg for "a series of improper share and real-estate transactions"[41] following an audit CMB performed on Tuborg's 1995 - 1997 accounts. In the second case, CMB audited Tuborg's records to investigate a claim against Yasar involving Tuborg and another Yasar subsidiary, Yasarbank[42]. In 1998 and 1999, Yasar authorized a series of transactions whereby Tuborg bought shares in Yasarbank, allegedly to save the bank from bankruptcy[43]. With losses totalling over US $1 billion, Yasarbank was placed under the supervision of the Central Bank Deposit Insurance Fund in 1999[44]. CMB found no substantial evidence of any wrong doing[45].

6.6 Other disclosure provisions, risk management

Most annual reports do not include discussions on risk management beyond a general statement about the macro economic environment and the market segment in which the company operates. However companies with ADR/GDR programs have somewhat more extensive annual reports, though according to market analysts they still do not meet best practice standards.

Listed companies are not required to be rated, even though Capital Markets Law discusses rating

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ANNEX: TURKEY OECD PRINCIPLES MATRIX

Section I: The Rights of Shareholders

A. Basic shareholders rights:

(i) Ownership registration

(a) Yes ☐ (b) No ☐ (c) Not available ☐ (d) Incomplete ■

Bearer shares and registered shares. The company has the right to refuse to register the transfer of registered shares. At listing, BOD

must resolve that it will not obstruct registration. This contradiction is a source of potential conflicts.

(ii) Share transfer

(a) Yes □ (b) No □ (c) Not available □ (d) Incomplete ■ — *See Section I, recommendation A (i).*

(iii) Access to information

(a) Yes ■ (b) No □ (c) Not available □ (d) Incomplete □

(iv) Participation and voting at AGM

(a) Yes ■ (b) No □ (c) Not available □ (d) Incomplete □ — *Except non-voting preferred shares.*

(v) Election of board

(a) Yes ■ (b) No □ (c) Not available □ d) Incomplete □

(vi) Share in the profit

(a) Yes ■ (b) No □ (c) Not available □ (d) Incomplete □ — *Preference and privileged shares may have higher dividends stipulated in the articles of association.*

B. The right to participate in decisions on fundamental corporate changes:

(i) Amendments to the statutes

(a) Yes ■ (b) No □ (c) Not available □ (d) Incomplete □ — *For such decisions, each share carries one vote.*

(ii) Authorization of additional shares

(a) Yes ■ (b) No □ (c) Not available □ (d) Incomplete □ — *For companies in the "registered capital system" the AGM delegates this right to the BOD up to the authorized capital limit.*

(iii) Extraordinary transactions (resulting in sale of the company)

(a) Yes ■ (b) No □ (c) Not available □ (d) Incomplete □

C. The right to be adequately informed about,.participate and vote in general shareholder meetings (AGM):

(i) Sufficient and timely information about AGM

(a) Yes ■ (b) No □ (c) Not available □ (d) Incomplete □

(ii) Opportunity to ask question and place items on agenda

(a) Yes ■ (b) No □ (c) Not available □ (d) Incomplete □ — *The code does not unequivocally give the right to ask questions. Shareholder representing 5% of capital can add an item on the agenda.*

(iii) Vote in person or in absentia

(a) Yes □ (b) No □ (c) Not available □ (d) Incomplete ■ — *Proxy permitted. No postal ballot.*

D. Disclosure of capital structures and arrangements enabling control disproportionate to equity ownership:

(a) Yes ■ (b) No ☐ (c) Not available ☐ (d) Incomplete ☐

Privileged shares with multiple voting rights permitted. Non-voting preferred shares are rare. Disclosure in share register and prospectus. On an ongoing basis to ISE and CMB.

E. Efficient and transparent functioning of market for corporate control:

(i) Clearly articulated and disclosed rules and procedures, transparent prices and fair conditions

(a) Yes ☐ (b) No ☐ (c) Not available ☐ (d) Incomplete ■

No takeover code, but detailed regulations on tender offer. In practice, the concentration of ownership imposes constraints on the market for corporate control.

(ii) No use of anti-takeover devices to shield management from accountability

(a) Yes ☐ (b) No ☐ (c) Not available ■ (d) Incomplete ☐

No anti-takeover devices are to be used

F. Requirement to weigh costs/benefits of exercising voting rights

(a) Yes ☐ (b) No ☐ (c) Not available ■ (d) Incomplete ☐

Section II: Equitable Treatment of Shareholders

A. Equal treatment of shareholders within same class

(i) Same voting rights for shareholders within each class. Ability to obtain information about voting rights attached to all classes before share acquisition. Changes in voting rights subject to shareholder vote.

(a) Yes ■ (b) No ☐ (c) Not available ☐ (d) Incomplete ☐

(ii) Vote by custodians or nominees in agreement with beneficial owner.

(a) Yes ■ (b) No ☐ (c) Not available ☐ (d) Incomplete ☐

Custodians must not vote unless given a proxy

(iii) AGM processes and procedures allow for equitable treatment. Avoidance of undue difficulties and expenses in relation to voting.

(a) Yes ■ (b) No ☐ (c) Not available ☐ (d) Incomplete ☐

B. Prohibition of insider-trading and self-dealing

(a) Yes ■ (b) No ☐ (c) Not available ☐ (d) Incomplete ☐

In practice, surveillance and enforcement difficult.

C. Disclosure by directors and managers of material interests in transactions or matters affecting the company.

(a) Yes ☐ (b) No ☐ (c) Not available ☐ (d) Incomplete ■

Any trade by directors or managers disclosed to CMB and ISE.

Section III: Role of Stakeholders in Corporate Governance

A. Respect of legal stakeholder rights

(a) Yes ☐ (b) No ☐ (c) Not available ■ (d) Incomplete ☐

Details were not sought in the current assessment.

B. Redress for violation of rights

(a) Yes ☐ (b) No ☐ (c) Not available ■ (d) Incomplete ☐

Details were not sought in the current assessment.

C. Performance-enhancing mechanisms for stakeholder participation

(a) Yes ☐ (b) No ☐ (c) Not available ■ (d) Incomplete ☐

Details were not sought in the current assessment.

D. Access to relevant information

(a) Yes ☐ (b) No ☐ (c) Not available ■ (d) Incomplete ☐

Details were not sought in the current assessment.

Section IV: Disclosure and Transparency

A. Disclosure of material information

(i) Financial and operating results

(a) Yes ■ (b) No ☐ (c) Not available ☐ (d) Incomplete ☐

(ii) Company objectives

(a) Yes ☐ (b) No ☐ (c) Not available ■ (d) Incomplete ☐

(iii) Major share ownership and voting rights

(a) Yes ■ (b) No ☐ (c) Not available ☐ (d) Incomplete ☐

High threshold for ownership reporting (10%).

(iv) Board members, key executives and their remuneration

(a) Yes ☐ (b) No ☐ (c) Not available ☐ (d) Incomplete ■

Aggregate remuneration for board and key executives does not offer sufficient details for shhs to assess the costs/benefits of remuneration and performance.

(v) Material foreseeable risk factors

(a) Yes ☐ (b) No ☐ (c) Not available ☐ (d) Incomplete ■

(vi) Material issues regarding employees and other stakeholders

(a) Yes ☐ (b) No ☐ (c) Not available ☐ (d) Incomplete ■

Layoffs and recruitment of 20% or more, and collective bargaining

agreements must be disclosed.

(vii) Governance structures and policies

(a) Yes ☐ (b) No ☐ (c) Not available ■ (d) Incomplete ☐

B. Preparation of information, audit, and disclosure in accordance with high standards of accounting, disclosure, and audit

(a) Yes ☐ (b) No ☐ (c) Not available ☐ (d) Incomplete ■

Not across the board compliance with IAS, e.g. inflation accounting, consolidation and segment information not mandatory.

C. Annual audit by independent auditor

(a) Yes ■ (b) No ☐ (c) Not available ☐ (d) Incomplete ☐

D. Channels for disseminating information allow for fair, timely, and cost-efficient access to information by users

(a) Yes ■ (b) No ☐ (c) Not available ☐ (d) Incomplete ☐

Section V: Responsibilities of the Board

A. Act on an informed basis, in good faith, with due diligence and care, in the best interest of the company and shareholders

(a) Yes ■ (b) No ☐ (c) Not available ☐ (d) Incomplete ☐

B. Fair treatment of each class of shareholders

(a) Yes ■ (b) No ☐ (c) Not available ☐ (d) Incomplete ☐

Board has powers to restrict shareholder rights in capital increase under the "registered capital system", but it cannot use this power in a way that leads to inequality among shareholders.

C. Compliance with law and taking into account stakeholders' interests

(a) Yes ■ (b) No ☐ (c) Not available ☐ (d) Incomplete ☐

Directors are required to comply with the law and must not apply AGM decisions if they are unlawful.

D. Key functions:

(i) Corporate strategy, risk policy, budgets, business plans, performance objectives, implementation and performance surveillance, major capital expenditures, acquisitions, divestitures

(a) Yes ☐ (b) No ☐ (c) Not available ☐ (d) Incomplete ■

Not clearly defined. Board considers major policies

and changes.

(ii) Selection, monitoring, replacement of key management

(a) Yes ■ (b) No ☐ (c) Not available ☐ (d) Incomplete ☐ — *Unless right reserved to shareholders.*

(iii) Key executive and board remuneration, board nomination

(a) Yes ■ (b) No ☐ (c) Not available ☐ (d) Incomplete ☐ — *Board members are appointed by shareholders or by the board in the case of interim vacancies.*

(iv) Monitoring of conflict of interest of management, board members, and shareholders, including misuse of corporate assets and abuse in related party transactions.

(a) Yes ☐ (b) No ☐ (c) Not available ☐ (d) Incomplete ■

(v) Ensuring integrity of accounting and financial reporting systems, including independent audit, systems of control, compliance with law

(a) Yes ☐ (b) No ☐ (c) Not available ☐ (d) Incomplete ■ — *Not clearly regulated in the Commercial Code*

(vi) Monitoring governance practices and making necessary changes

(a) Yes ■ (b) No ☐ (c) Not available ☐ (d) Incomplete ☐

(vii) Overseeing disclosure and communication

(a) Yes ■ (b) No ☐ (c) Not available ☐ (d) Incomplete ☐

E. Objective judgement on corporate affairs:

(i) Assignment of non-executive board members to tasks of potential conflict of interest (e.g. financial reporting, remuneration)

(a) Yes ☐ (b) No ☐ (c) Not available ☐ (d) Incomplete ■ — *The regulatory framework does not differentiate between executive and non-executive directors, although regulations exist for independent directors for Real Estate Investment Trusts.*

(ii) Devote sufficient time to their responsibilities

(a) Yes ■ (b) No ☐ (c) Not available ☐ (d) Incomplete ☐

F. Access to accurate, relevant, and timely information

(a) Yes ■ (b) No ☐ (c) Not available ☐ (d) Incomplete ☐

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*This table attempts to summarize the current provisions in the country, benchmarked against the items set out in the **OECD Principles of Corporate Governance**.*

***Yes** means that the country fully adheres in all respects*
***No** means that the country does not adhere*
***Not available** means that information was not provided or not sought*
***Incomplete** means that some provisions are in place, while others may not be.*

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Footnotes

[1] 1999 GDP TL 77,374,802 billion (source: ISE)

[2] 256 on ISE, 10 on regional, 1 on the "new companies" and 18 on the "watch list" market (source: ISE's Annual Factbook 1999).

[3] Ibid.

[4] Source ISE (June 2000).

[5] *Out of a total population of approximately 65 million (=50% below the age of 30).*

[6] Source: Paribas Capital Market.

[7] Source: Paribas Capital Market.

[8] US$ 830 million (0.7% of market capitalization) as of Jan 2000.

[9] Isbank also has a pension fund.

[10] *The commercial code is in the process of being overhauled by the ministry of justice.*

[11] As of 12/31/99 CMB's enforcement department employed a total of 48 employees (source: CMB).

[12] 42 out of 79 according to CMB (www.spk.gov.tr).

[13] The candidate can have any professional background, including broker or public servant (source: ISE).

[14] According to CMB, the prospectus content is in line with IOSCO's disclosure standards.

[15] *No matter how risky the investment, the offering prospectus complies with CML and related by-laws if all material facts and risks* are fully, clearly, and accurately disclosed (CML article 6).

[16] The minimum paid-in capital requirement is expected to be increased due to inflation.

[17] CMB requires the free float to be as follows: 15% if capital = TL 1,140,750 million; 10% if capital =1,140,750 and = 2,281,500 million; and 5% if capital =2,281,500 million.

[18] Source: Paksoy & Co., Attorneys at Law.

[19] If a share has several owners, the owners may exercise their right to vote through a representative.

[20] Unless the shareholders, when approving the capital increase, allow for it.

[21] CMB communiqué number IV/8.

[22] CMB resolution number 106/1273 (April 11, 1999).

[23] Koc Yatirim's shareholders were offered Koc Holding shares based on book value. However, Koc Yatirim shares were trading at a discount to net asset value, whereas Koc Holding shares were trading at a substantial premium over net asset value.

[24] Articles dealing specifically with minority shareholders rights: 310, 341, 348, 356, 359, 366, 367,d 377.

[25] 10% for non-public companies.

[26] This right is apparently quite ineffective in practice, since the internal auditor who goes to court on behalf of the shareholders is appointed pursuant to the recommendation of the board. Dissenting shareholders have to pledge their shares as guarantee for *potential damages. In case of dismissal, dissenting shareholders are liable to compensate the company. In addition the loss has to* be quantified before going to court but the shareholders do not have access to the books.

[27] Article 364 of the Commercial Code.

[28] Source: ISE (June 2000).

[29] Ten percent for non-public companies.

[30] Source: Paksoy & Co., Attorneys At Law (July 2000).

[31] Ten percent for non-public companies.

[32] Four penalized and six rejected (source: CMB Department of Legal Affairs, June 2000).

[33] Source: CMB (www.spk.gov.tr).

[34] Shares of certain companies, e.g. banks, insurance companies, brokerage houses, are registered. They are endorsed in blank so that they can be transferred as if they were bearer shares.

[35] "Issues regarding Corporate Governance found in Istanbul Stock Exchange Regulations", CMB, June 2000 ("... this contradiction can create problems and should be corrected in parallel with capital market regulations.").

[36] Upon taking office board members must purchase qualifying shares worth 1 percent of equity or the symbolic value of TL 5,000 in nominal value (US$ 0.01).

[37] Except in the case of real estate trusts ("REITs") where one third of the directors must be independent.

[38] CML articles 16 and 22/e.

[39] As of 12/31/99, 18 companies were traded on the "watch list" market (source: ISE).

[40] CMB Communiqué, Series: XI, No:1

[41] Source: Dorsey, James M., "Turkish Regulator to Audit Brewery at Soros's Request", Wall Street Journal, August 16, 2000.

[42] Source: Daily Sabah, "Turkish News for Week Ending August 5, 2000".

[43] *Source: Munir, Metin, "The Indiana Jones of Central Bankers", Euromoney, September 2000.*

[44] Source: Dorsey, James M., Wall Street Journal, August 16, 2000.

[45] Source: CMB, February 15, 2001

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ACCENTURE LTD
CORPORATE GOVERNANCE GUIDELINES

FUNCTIONS OF THE BOARD OF DIRECTORS

The Board of Directors is responsible for providing governance and oversight over the strategy, operations and management of Accenture. The Board collectively, and individual directors individually, are responsible primarily for the following:

- Reviewing and approving Accenture's strategic and financial plans for achieving long-term success of the company;
- Reviewing progress in executing the plans and/or in changing the plans in response to evolving business conditions;
- Selecting, evaluating and compensating the Chief Executive Officer (CEO) and approving compensation of other executive officers;
- Reviewing CEO and management succession planning and leadership development programs;
- Understanding the major risks faced by Accenture and the strategies for addressing those risks;
- Reviewing and approving any major transactions or changes in business direction; and
- Ensuring that processes are maintained to ensure the integrity of the financial reporting and disclosures by the company and compliance with legal and ethical responsibilities.

BOARD COMPOSITION AND PERFORMANCE

Size of the Board

Accenture's bye-laws provide for a board size of between eight (8) and fifteen (15) directors. The Board believes that fourteen (14) to fifteen (15) members is the appropriate size at this time, facilitating the desired mix of inside and outside directors. Over time, the Board expects to decrease the size of the Board to between nine (9) and eleven (11) directors.

Mix of Inside and Outside Directors

The Board composition currently consists of slightly more inside directors (8) than outside directors (6). At the time of incorporation in 2001, it was determined that eight (8) Board seats would be filled by insiders, as follows:

- The CEO
- up to two (2) members of Accenture management selected by the CEO, and
- five (5) individuals elected by Accenture partners as specified in the Partner Matters Agreement,

with all such nominees subject to approval by the Nominating & Governance Committee, the Board, and shareholders. However, the right of the partners to nominate the five elected seats will be phased out between 2004 – 2006, enabling the Board to effect an orderly transition to a

majority of outside directors. As each of these guaranteed inside seats is phased out, the Board may choose to continue to fill these positions with inside nominees, fill them with outside nominees, or eliminate the positions, so long as there will be no fewer than eight (8) members of the Board.

The Board has committed to having a majority of independent directors by no later than 2005.

Director Independence

The Board shall affirmatively determine that, to be considered independent, a director must not have any direct or indirect material relationship with Accenture. The Board has established the standards described in Appendix A to these guidelines to assist it in assessing director independence but may determine, at its discretion, that a director who does not satisfy those standards should still be deemed independent and shall disclose the basis for this determination in the applicable proxy statement of the Company. Directors who do not meet applicable independence standards also make valuable contributions to the board and the company.

Audit Committee members shall be subject to any additional independence requirements imposed by law or NYSE listing standards.

The Board shall perform an annual review of the independence of all directors and nominees. Each director and any nominee shall provide the Board with complete information regarding the director's/nominee's business and other relationships with the company and its affiliates, including executive officers of the affiliates, to enable the Board to make its determinations. Directors shall inform the Board of any material changes in their circumstances or relationships that might affect the Board's determination.

Director Selection Process and New Director Orientation

The Board is responsible for selecting and approving nominees for outside directors and for approving inside director nominees proposed by the CEO or Accenture partners. The Board has delegated the screening process to the Nominating & Governance Committee.

Shareholders may recommend future nominees for Board membership by submitting written suggestions, including name and other pertinent information for the nominee, to:

Chairman of the Nominating & Governance Committee
c/o Accenture
1661 Page Mill Road
Palo Alto, CA 94304 USA
Attention: General Counsel and Secretary

The Board has delegated the responsibility for orienting new directors to the General Counsel and Secretary, drawing on other individuals as required. The orientation program will include background information on the company, the Board and its governance model; Accenture's strategy, business operations, financial statements, capital structure and management team; key industry and competitive factors; the legal and ethical responsibilities of the Board; and other matters crucial to the ability of a new director to fulfill his or her responsibilities.

Characteristics of Board Members

The Nominating & Governance Committee is responsible for periodically reviewing with the Board the appropriate skills and characteristics of Board members in the context of the then-current make-up of the Board and its needs at that time.

The Board seeks geographic, age, gender and ethnic diversity among its members and expects that its members will have a range of skills and expertise sufficient to provide guidance and oversight with respect to all of Accenture's strategy and operations. The Board expects directors to be open and forthright, to develop a deep understanding of the company's business, and to exercise judgment and courage in fulfilling their oversight responsibilities. Directors should embrace Accenture's values and culture and should possess the highest levels of integrity.

The Board expects that its members will rigorously prepare for, attend and participate in all Board and applicable committee meetings and the Annual General Meeting of Shareholders. Directors are also expected to become familiar with Accenture's management team and operations as a basis for discharging their oversight responsibilities. Because directors must be prepared to devote sufficient time to discharging their responsibilities, they are encouraged to limit the number of other boards of public companies on which they serve. Directors who are considering joining other boards are expected to discuss this with the CEO and the Chairman of the Nominating & Governance Committee.

Directors are expected to keep current on issues affecting Accenture and its industry, and on developments with respect to their general responsibilities as directors. Accenture will either provide or pay for ongoing director education with respect to these matters as needed.

Term Limits

The Board believes that, other than with respect to the CEO and the directors nominated by the CEO as described above, directors should not serve more than three consecutive full three-year terms. After a director is off the Board for one year, he/she would again be eligible to serve on the Board. The Board believes that term limits will help insure that there are fresh ideas and viewpoints available to the Board.

Retirement Age

The Board has adopted a guideline retirement age of 65. It is expected that any Director reaching the age of 65 will complete the term to which he or she was elected. On a case-by-case basis, the Board may determine that a director may serve beyond the age of 65, as long as the limit of three full terms has not been reached.

Directors Who Change their Present Job Responsibility

The Board believes that a change in a director's job responsibilities from those that he/she held when elected should not necessarily result in that individual leaving the Board. However, the Board, through the Nominating & Governance Committee, should review the director's continued Board membership in such event.

When the CEO resigns from that position, he/she should offer his/her resignation from the Board at the same time. The Board will decide whether the individual should continue to serve as a director.

In addition, , the Board believes that inside directors other than the CEO should submit their resignations from the Board at the same time that they retire or resign from Accenture.

Separation of Chairman and CEO Positions

The Board should be free to decide whether the positions of Chairman and CEO should be held jointly by one individual or separately by two individuals. This decision should be based on what seems best for Accenture at a given point in time, particularly when there is a vacancy in either position. At present the Board does not have a position, one way or the other, on whether the positions of the CEO and Chairman should be separated.

If the same person holds the CEO and Chairman roles, the Board will designate one of the independent directors as the Lead Director. The Lead Director will be responsible for presiding at meetings of the non-employee directors, will provide oversight with respect to the functioning of the Board, and will work closely with the CEO in framing the issues for Board consideration and in setting the Board agenda. The Lead Director will be identified in the proxy statement for each annual meeting of shareholders, together with a method for interested parties to communicate directly with the Lead Director or the non-employee directors as a group.

Board Compensation

The Board believes that to create alignment with long-term shareholder interests, a substantial majority of an outside director's compensation should be provided in the form of equity. The Board believes that the Lead Director, or independent Chairman if there is one, as well as the members of the Audit Committee should receive higher compensation than other directors, reflecting the time commitment of such positions.

Moreover, because the Board believes that directors should be long-term owners, the Board has adopted a policy requiring each non-employee director to, within three years of his/her appointment, hold equity in Accenture with value of US$150,000 (valued at the time of acquisition). Such value of equity shall be held so long as the director remains a member of the Board.

From time to time, management should work with the Board's Compensation Committee to assess Accenture's Board compensation in relation that of to peer companies. Change in Board compensation, if any, proposed by the Compensation Committee should be reviewed and approved by the full Board.

Employee directors are not eligible for any director compensation.

Ethics, Conflicts and Board Conduct

Members of the Board shall act at all times in accordance with Accenture's Code of Business Ethics {LINK}, which is applicable to all directors and all other Accenture personnel. This includes, in particular but without limitation, strict adherence to Accenture's policies with respect to conflicts of interest, confidentiality, and ethical conduct in all business and personal

dealings. The Board does not expect to grant any waiver of any provision of the Code of Business Ethics for any director or executive officer. Board members must be mindful of possible conflicts of interest, including anything that could impair their independence as directors under these guidelines, and should discuss any issues with the CEO and Lead Director. If a significant conflict arises and cannot be resolved, the director would be expected to resign. The Board is further committed to full disclosure of potential conflicts and any waiver approved by the Board.

The company will not make any loans or extensions of credit to directors. No director or immediate family member may provide personal services for compensation to the company other than Board compensation described elsewhere in these guidelines.

Board Interactions with Third Parties.

Management speaks for Accenture. Individual directors may, at the request of the management, meet or communicate with various parties that are involved with Accenture. If comments from the Board are appropriate, they should, in most circumstances, come from the independent Chairman/Lead Director.

Board Evaluation

The Board conducts an annual evaluation of its overall effectiveness and the effectiveness of each committee. The Nominating & Governance Committee, using an evaluation questionnaire administered by the General Counsel and Secretary, manages this process. The Chairman of the Nominating & Governance Committee and the independent Chairman/Lead Director review the feedback and use the information to implement changes or improvements in the functioning of the Board.

The evaluation process addresses subjects including, but not limited to:

- Board structure and composition;
- Board independence, commitment and accountability;
- Board involvement in setting Accenture's strategy and monitoring its execution;
- Board oversight of management and involvement in management succession planning;
- The Board's focus on the most critical issues and risks;
- Clarity between the roles of the Board and management;
- Adequacy of access to information, employees and experts in a timely manner; and
- The appropriateness of committee charters and the functioning of the committees with respect to those charters.

LEADERSHIP

Selection of CEO

The Board is responsible for selecting and removing the CEO. However, in connection with the transition to status as a public company, it was agreed that, through July 2005, the partners may provide input into the CEO selection process in the manner provided in the Partner Matters Agreement. The Board is free to accept or reject the partners' input.

After July 2005, the Board will select the CEO in any manner that it believes is best for Accenture at a given point in time.

In selecting a CEO, the Board may consider candidates from within or outside of Accenture.

Formal Evaluation of the Chief Executive Officer

The Board, through delegation of authority to the Nominating & Governance Committee, should conduct an evaluation of the CEO annually. The independent Chairman or Lead Director should communicate such evaluation to the CEO.

The evaluation should be based on objective criteria, including performance of the business, accomplishment of long-term strategic objectives, development of management and such other criteria as the directors deem appropriate. In addition, the evaluation of the CEO should be based, in part, on input from the partners' income committee, as provided in the Partner Matters Agreement.

The Compensation Committee will use the evaluation when considering the compensation of the CEO.

Executive Compensation

Accenture has established an executive compensation system, which is applied to all partners, including the CEO and other corporate officers. The Compensation Committee will approve the compensation structure for the partners annually, including reviewing and approving the compensation for the CEO and executive officers, reflecting input from the Partner Income Committee and from the Board's evaluation of the CEO's performance.

Succession Planning

Annually, the CEO should meet with the non-employee directors, or a committee designated by the Board, to discuss CEO succession and his/her suggestions regarding potential successors. The non-employee directors should, in the normal course of meeting with Accenture management, have a process for meeting with executives who may be potential CEO successors.

In addition, the CEO should report annually to the full Board regarding non-CEO management succession planning.

BOARD OPERATIONS

Board Agenda

The independent Chairman of the Board or Lead Director and the CEO will together establish the agenda for each Board meeting. Annually, the Board will define a schedule of major discussion items for the following year.

Each Board member may suggest items to be placed on the agenda.

Board Materials Distributed in Advance

Information and data that are important to the Board's understanding of the business and any agenda items will be distributed to all directors before the Board meetings, with sufficient lead

time to allow directors to give such materials appropriate attention. On occasions in which the subject matter is too sensitive to distribute, the information will be discussed at the meeting. Board members shall also have access to company information as they may require.

Meetings of Non-Employee Directors

The Board's policy is to have a separate meeting of the non-employee directors at least twice a year during the regularly scheduled Board meetings, or as otherwise determined appropriate by the independent Chairman or Lead Director, without management present. Either the independent Chairman or the Lead Director, whichever role has been designated by the Board at the time, will chair the meetings.

Board Access to Senior Management

Board members have complete access to any member of Accenture management and to any Accenture employee. Board members will use appropriate judgment to ensure that this contact is not distracting to the business operations of Accenture and that such contact, if in writing, be copied to the Chairman or Lead Director and the CEO.

Furthermore, the Board encourages management to bring into Board meetings Accenture personnel who: (a) can provide additional insight into the items being discussed because of personal involvement in these areas; and/or (b) have future potential that the senior management believes should merit the individuals being given exposure to the Board.

Board Access to Independent Advisors

The Board and its committees will have the authority and budget to retain (either on a regular basis or in specific circumstances at their discretion) any independent financial, legal, compensation or other experts or advisors deemed necessary to properly exercise their responsibilities.

BOARD COMMITTEES

Number and Structure of Committees

The Board currently has the following three standing committees: Audit Committee, Nominating & Governance Committee and Compensation Committee. There will, from time to time, be occasions in which the Board may want to form a new committee (whether standing or ad hoc) or disband a committee.

Audit Committee

The Audit Committee is primarily responsible for providing oversight of the following:

(i) The quality and integrity of the company's accounting and reporting practices and controls, and the financial statements and reports of the company;

(ii) The company's compliance with legal and regulatory requirements;

(iii) The independent auditor's qualifications and independence; and

(iv) The performance of the company's internal audit function and independent auditors.

The Audit Committee shall be comprised of three or more members of the Board, each of whom shall be determined by the Board to be "independent" under the rules of the New York Stock Exchange and any other applicable listing or legal requirements, including the more rigorous independence requirements applicable specifically to Audit Committee members.

Each member of the Audit Committee shall have a working familiarity with basic finance and accounting practices, and at least one member of the Audit Committee shall be an "audit committee financial expert" as defined by the Securities and Exchange Commission. They shall also have other such qualities as the Board determines appropriate.

Nominating & Governance Committee

The Nominating & Governance Committee is primary responsible for:

(i) Assessing and selecting/nominating (or recommending to the Board for its selection/nomination) strong and capable candidates to serve on the Board;

(ii) Making recommendations as to the size, composition, structure, operations, performance and effectiveness of the Board;

(iii) Overseeing the Company's CEO succession planning process;

(iv) Conducting an annual review of the Company's CEO;

(v) Developing and recommending to the Board a set of corporate governance principles; and

(vi) Otherwise taking a leadership role in shaping the corporate governance of the Company.

The Committee shall be comprised of at least five directors as determined by the Board, at least three of whom shall be external members of the Board and at least two of whom shall be inside directors (neither of whom shall be the CEO). It is the intent that no later than 2005, all members of the Committee will be "independent" in accordance with the rules of the New York Stock Exchange and applicable legal requirements.

Compensation Committee

The Compensation Committee is primarily responsible for:

(i) Reviewing and approving the compensation of the Company's CEO and other executive officers;

(ii) Overseeing the Company's benefit plans; and

(iii) Reviewing and making recommendations to the Board regarding Board compensation.

The Compensation Committee shall be comprised of three or more members of the Board. It is the intent that no later than 2005, all members of the Compensation Committee will be "independent" in accordance with the rules of the New York Stock Exchange and applicable legal requirements.

Assignment of Committee Members

The Board is responsible for the assignment of Board members to various committees and will consider the skills and qualifications of each director, as well as the interests of individual directors, in making assignments.

The membership of the Audit Committee will include only independent directors. The membership of the Nominating & Governance Committee and the Compensation Committee currently include both independent and non-independent directors. Membership of these committees will be changed by 2005 to include only independent directors, consistent with New York Stock Exchange requirements, as additional independent directors are elected to the Board.

Frequency and Length of Committee Meetings

The Committee Chairman, in consultation with committee members, will determine the frequency and length of the meetings of the committee.

Committee Agenda

The Chairman of the committee, in consultation with the appropriate members of management and staff, will develop the committee's agenda. The committee agenda and meeting minutes of each committee will be shared with the full Board.

PARTNER INVOLVEMENT IN GOVERNANCE

In connection with the initial incorporation of Accenture, the company has entered into the Partner Matters Agreement, which establishes procedures for continued involvement of the partners in certain governance issues, including:

- Selecting five (5) partner nominees for membership on Accenture's Board (this provision will be phased out by beginning in 2004 and ending in 2006);

- Making a non-binding recommendation to the Board through a committee of partners regarding CEO selection in the event a new CEO is appointed before July 2005 (i.e., four years after Accenture's initial public offering); and

- Voting on changes to Accenture's executive compensation system, including the compensation structure for the CEO and other executive officers.

COMMUNICATING CONCERNS TO THE BOARD

Accenture has established several means for interested parties to communicate concerns about the company's conduct or practices to the Board of Directors. If the concern relates to the company's business ethics or conduct, financial statements, accounting practices or internal controls, the concern may be submitted to the Chairman of the Audit Committee, in care of the General Counsel and

Secretary. All such concerns will be forwarded to the Chairman for review. The company's Code of Business Ethics and underlying policies prohibit any retaliation or other adverse action against anyone for raising a concern. If anyone prefers to raise his/her concern in an anonymous manner, he/she may do so. The Company also has established internal mechanisms for communicating concerns or questions to the company's compliance office; those with such concerns may send an e-mail to compliance.program@accenture.com or contact the Accenture Ethics Line by phone at 1-312-737-8262.

The Board directs management to post these guidelines, along with other documents of interest to shareholders and others, on the Company's website. The Board solicits comments and suggestions on these guidelines; they may be directed to the Board c/o General Counsel and Secretary, 1661 Page Mill Road, Palo Alto, California 94304 USA.

Attachment A – Independence Standards

The Board has established the following standards to assist it in assessing director independence:

1. A director will not be independent if, within the prior five years, he or she
   a. Was employed by Accenture (including any affiliate);
   b. Was employed by, a partner in or otherwise affiliated with Accenture's independent auditors or any law firm retained by Accenture;
   c. Was an officer or senior employee of a company on whose board of directors an Accenture executive officers serves; or
   d. Personally provided professional services to Accenture or its affiliates or any executive officer, or otherwise received direct compensation from Accenture in excess of $100,000 in any such year.

   Note: Such a position by an immediate family member of the director shall have the same effect on the director's independence, except that the Board has concluded that employment by Accenture of adult children in non-executive officer roles shall not preclude a determination of independence of a director.
2. Relationships of the following types will not be considered to be material relationships that would impair a director's independence:
   a. The director is an executive officer, director or significant shareholder of another company that does business with Accenture and the amount of business conducted between Accenture and the other company (sales to, revenues from or business otherwise influenced) is less than 2 percent of the annual gross revenues of either Accenture or the other company (or $1 million, if greater)
   b. The director is an officer, director, trustee (or equivalent) of a charitable or non-profit organization and charitable contributions directed by Accenture or its executive officers (not including those matching contributions by employees) are less than 2 percent of the organization's annual charitable receipts.
3. For situations not covered by the guidelines in section 2 above, those directors who have been determined to satisfy the guidelines of sections 1 and 2 above shall make the determination of independence for such directors after considering all of the relevant facts and circumstances. For example, the independent directors could determine in a particular case that a director or nominee did not have a material relationship even if the relationship did not satisfy section 2 and that such individual should be considered independent. The company would explain in the next proxy statement the basis for any Board determination that a particular relationship was immaterial despite the fact that it did not satisfy the categorical standards set forth in section 2 above.