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STOCK EXCHANGES AS INTERNATIONAL ORGANIZATIONS AND ISTANBUL STOCK EXCHANGE

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TUTANAK

....Ahmet AKIN.........................'a ait

Stock Exchanges as International Organizations and Istanbul Stock Exchange

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....İşletme....... Anabilim Dalında *YÜKSEK LİSANS TEZİ* olarak oy

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ABSTRACT

Stock exchanges form secondary markets for the outstanding securities and provide liquidity. Thus, they encourage corporations to issue and investors to purchase new securities, which have liquid, secure and transparent secondary market, in the primary market. By this way, corporations finance their new, and investors use their surplus funds efficiently.

Stock exchanges have outgrown the borders of their domestic countries and become international organizations. Physical remoteness is no longer a barrier for the international transactions due to the rapid developments in telecommunication and computer technology. Investors can now follow the trends in securities market in any part of the world. In the US, SEC (Securities and Exchange Commission) needed to regulate the capital market transactions that can be executed through Internet as a result of these developments. Besides, countries recognized the importance of foreign investments and opened their markets more to the foreigners. Investors have been concerned more with the foreign markets to gain higher returns and to diversify their portfolios. Corporations have been willing to be listed on foreign exchanges in order to obtain higher prices for their securities, to broaden their shareholderbases, to have international recognition and to take advantage against their competitors.

Internationalization has increased the competition among stock exchanges. Cooperation and integration among stock exchanges became widespread. Besides, novelties have been implemented by considering the demands of investors and the issuers. Many stock exchanges established markets for small and medium sized companies. Moreover, investors are offered more investment alternatives.

Istanbul Stock Exchange (ISE), which began to operate in 1986, is a very dynamic emerging market. It has exhibited important progresses since it was established and became a very liquid market, which offers high return to the investors. In 1996, ISE

was the twelfth and in 1997 the fourth stock exchange where investors gained the highest return in the world.[1]

ISE is a very open market for foreigners. It has had foreign institutions operating within it. Foreigners are allowed to invest in ISE since 1989 with the enactment of Decree No.32. With the initiation of international market, which enables foreign securities to be traded, it became an open market for foreign participants in all respects.

Foreign investors have had considerable contributions to the development of ISE. They offset the inadequate demand of local individual and institutional investors. As their share in total trading volume is very low in comparison with the local investors although they hold about the half of the equities, they have stabilization effect on the price fluctuations. Besides, they are very active in the primary market where the new securities are issued and thus, they provide funds to the corporations to finance their new investments.

High share of foreign investors in the total investments has drawbacks as well. The market has become very sensitive to the foreigners' decision. Foreigners began to determine the market trend. We witnessed this after the crisis of South East Asian countries. The market has been effected very deeply by the negative trends in the foreign markets.

International market, which is operating in a free zone environment within ISE, has had important contributions to the internationalization of ISE. In this market, depository receipts of foreign shares and foreign mutual funds participation certificates, foreign debt securities can be traded. When the transactions of futures market begin, international dimension of ISE is expected to increase.

[1] International Finance Corporation, Emerging Markets Factbook, 1997, p.14; IFC Factbook, 1998, p. 14. The returns of exchanges are ranked according to the indices which are calculated for each country by considering the shares that foreign investors can purchase. Because in some countries foreign investors are not allowed to some shares. The returns include the dividends.

ÖZET

Menkul kıymet borsaları tedavülde bulunan menkul kıymetlere ikincil piyasa oluşturnakta ve likidite sağlamaktadır. Böylece firmaların yeni menkul kıymet ihraç etmelerini ve yatırımcıların likit, güvenli ve şeffaf ikincil pazarı olan bu menkul kıymetleri satın almalarını teşvik etmektedir. Bu yolla, firmalar yeni yatırımlarını finanse etmekte, yatırımcılar da fazla fonlarını verimli alanlarda kullanmaktadırlar.

Borsalar kendi ülke sınırlarını aşarak uluslararası kuruluşlar haline gelmişlerdir. İletişim ve bilgisayar teknolojisindeki gelişmeler fiziksel uzaklığı ulularararası işlemlerin yapılmasına engel olmaktan çıkarmıştır. Yatırımcılar artık evlerinden bile dünyanın herhangi bir yerindeki menkul kıymet piyasasını takip edebilir hale gelmiştir. Amerika'da SEC (Securities and Exchange Commision), bu gelişmeler neticesinde internet üzerinden yapılabilecek sermaye piyasası işlemlerini düzenlemek durumunda kalmıştır. Bunun yanında ülkeler yabancı yatırımların önemini farketmiş ve borsalarını yabancılara daha açık hale getirmişlerdir. Yatırımcılar da yüksek getiri elde etmek ve portföylerini çeşitlendirmek için yabancı piyasalara yönelmişlerdir. Firmalar ise menkul kıymetlerinin daha yüksek fiyattan işlem görmesini sağlamak, yatırımcı tabanlarını genişletmek,uluslararası piyasalarda tanınmak ve böylece rakiplerine karşı avantaj sağlamak için yabancı ülke borsalarında menkul değerlerinin işlem görmesini istemektedirler.

Borsaların uluslararasılaşması rekabeti artırmıştır. Bunun neticesinde borsalar arası işbirliği ve entegrasyon yaygınlaşmıştır. Yatırımcıların ve ihraçcıların taleplerini dikkate alan yenilikler getirilmiştir. Bir çok borsa küçük ve orta ölçekli firmalar için yeni piyasalar kurmakta ve böylece yatırımcılara yeni alternatif yatırım araçları sunulmaktadır.

1986 yılında faaliyete başlayan İstanbul Menkul Kıymetler Borsası (İMKB) çok dinamik gelişen bir piyasadır. Kuruldugundan bu yana önemli gelişmeler sergilemiş ve

yüksek getiri sunan likit bir piyasa haline gelmiştir. 1996 yılında dünyada en fazla kazandıran 12. ve 1997 yılında 4. borsa olmuştur[1].

İMKB yabancılara oldukça açık bir borsadır. 32 Nolu kararın çıkması ile yabancılar 1989 yılından itibaren İMKB'de yatırım yapmaktadırlar. Ayrıca, üyesi olarak faaliyet gösteren yabancı kurumlara da sahiptir. Yabancı menkul kıymetlerin işlem görmesini sağlayan uluslararası pazarın kurulmasıyla her yönü ile yabancılara açık hale gelmiştir.

Yabancı yatırımcıların borsanın gelişmesine önemli katkıları olmuştur. Piyasadaki yetersiz yerli bireysel ve kurumsal yatırımcı talebini telafi etmişler, hisse senedlerinin yarısına sahip olmalarına rağmen işlem hacminden oldukça düşük pay alarak fiyat dalgalanmalarını düşürücü rol oynamışlardır. Ayrıca yeni ihraçların yapıldığı birincil piyasada aktif olmuşlar, böylece firmalara yeni yatırımlarının finansmanda fon sağlamışlardır.

Yabancı yatırımcılarının piyasamızda yüksek paya sahip olmalarının dezavantajları da yaşanmaktadır. Piyasamız yabancıların aldığı kararlara çok duyarlı hale gelmiş, piyasasının trendini yabancılar belirler hale gelmiştir. Güneydoğu Asya krizinden sonra oluşan olumsuz havadan İMKB gecikmeli olarak oldukça çok etkilenmiştir.

İMKB bünyesinde kurulan serbest bölge statüsünde faaliyet gösteren uluslararası pazarın İMKB'nin uluslararasılaşmasına önemli katkıları olmuştur. Bu pazarda yabancı hisse senedi, borçlanma senedleri ve yatırım fonu katılma belgeleri işlem görebilmektedir. Vadeli işlemler piyasasının da faaliyete geçmesiyle uluslararası boyutunun artacağı beklenmektedir.

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[1] International Finance Corporation (IFC),Emerging Markets Factbook , 1997; IFC Factbook,1998, s. 14. Sıralama yabancı yatırımcıların yatırım yapabildikleri hissesenedlerini içeren her ülke için bir endex oluşturularak hesaplanmıştır. Çünkü bazı ülkelerde yabancılar her hisse senedini alamamaktadırlar. Getiri hesabı içinde sermaye kazançları dışında temettü gelirleri de dahil edilmiştir.

STOCK EXCHANGES AS INTERNATIONAL ORGANIZATIONS AND ISTANBUL STOCK EXCHANGE

CONTENTS

PART III
ISTANBUL STOCK EXCHANGE
AS AN INTERNATIONAL ORGANIZATION

ABBREVATIONS

ADR	: American Depository Receipt
AIM	: Alternative Investment Market
ANNA	: Association of National Numbering Agencies
CMB	: Capital Markets Board
CML	: Capital Markets Law
ECMI	: European Capital Market Institute
e.g.	: For example
FBIV	: International Federation of Stock Exchanges
FEAS	: Federation of Euro-Asian Stock Exchanges
FEIB	: Foreign Exchange Index Bond
GDR	: Global Depository Receipt
IFC	: International Finance Corporation
IFCI	: International Finance Corporation Investable
IM	: International Market
IMF	: International Mutual Fund
ISE	: Istanbul Stock Exchange
ISMA	: International Securities Market Association
ISSA	: International Securities Services Association
İMKB	: İstanbul Menkul Kıymetler Borsası
JASDEC	: Japan Securities Depository Center
JSCC	: Japan Securities Clearing Corporations
JSDA	: Japanese Securities Dealers Association
NASDAQ	: National Association of Securities Dealers Automated Quatations
NYSE	: New York Stock Exchange
p.	: page
P/E	: Price/ Earning
RSC	: Revenue Sharing Certificate

SCFOA	: Swiss Commodities, Futures and Options Association
SEC	: Securities and Exchange Commission
SFA	: Securities Futures Authority
TAKASBANK	: ISE Custody and Settlement Bank, Inc.
UK	: United Kingdom
US	: United States
USA	: United States of America
WEF	: World Economic Forum

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INTRODUCTION

Stock exchanges have become unavoidable organizations in capital markets. They are established to perform some important functions. Their one of the most important functions is providing liquidity for outstanding securities. This feature of them encourages both corporations and investors respectively to issue and purchase new securities in the primary market. Thus, they help corporations to obtain funds to make investments. Besides, because they form efficient markets that provide trust to the investors, financial savings increase and the ownership of capital is broadened. They also prevent savings from being used in inefficient fields.

Stock exchanges began to operate internationally. Several reasons have contributed to the globalization of stock exchanges. Firstly, market environment has changed a lot. Developments in telecommunication and computer technology accelerated the globalization of stock exchanges. Liberalization policies especially after 1980 can also be mentioned as another important factor, which have accelerated the globalization. Most financial markets became free for foreigners. These have happened also in many developed countries in order to attract foreign portfolio investments to finance their developments. Changes in the demand and supply side have had great impacts on globalization of stock exchanges as well. Investors and big companies began to seek better opportunities out of their countries.

Globalization has become a very actual topic in recent years. Countries, institutions and individuals have received many benefits from globalization. However, people became aware of its drawbacks as well. After the financial crisis of South East Asian countries globalization began to be discussed again.

In this study it is aimed to point out the international dimensions of the Istanbul Stock Exchange, to determine the advantages and drawbacks of its current situation and to suggest strategies in order to make it a global, competitive and beneficial market for Turkey in such a global market described above. Because of the high interest rates resulted by huge government deficit, private sector in Turkey has almost no ability to obtain funds by debt securities through the stock exchange. Therefore, I dwelt mostly on the stock markets operating within stock exchanges in the first two parts and on the stock market of ISE in the last part.

I began my study by introducing stock exchanges in the first part. Because I think it is necessary to understand the benefits, importance of stock exchanges and its impacts on the economy to evaluate the performance of ISE and its international dimension.

Second part is about the internationalization of stock exchanges. Forces behind the internationalization and recent developments in security markets are also explained in this part.

In the last part firstly, the history of ISE and its market structure are described. Then, its performance is evaluated in order to understand the developments in ISE and to have background for the other topics in the chapter. In the other section of the chapter, international dimension of ISE is studied. Changes in the structure of financial markets after 1980 that promote the internationalization of the country and ISE are generally explained. Then, the international dimension of ISE is generally assessed in terms of foreign participants. The study is ended by discussing impacts of an international stock exchange on Turkey and the future of ISE in 2000s.

PART I

STOCK EXCHANGES

1.1.DEFINITION

Financial markets that perform vital functions within economic systems can be divided into money and capital markets when the maturity of funds are considered. The flow of short-term funds that have maturities less than one year is facilitated in the money market, and the securities that have less than one-year maturity are called money market securities. In this market, temporary surpluses of funds and temporary shortage of funds meet. Funds that are obtained in the money market are usually used to finance the working capital of corporations or to finance governments' financial needs. Unlike money market, the flow of long-term funds is facilitated in capital market, and capital market securities have more than one-year maturity. In the capital market, generally fixed investments are financed.

Financial markets can also be divided into primary and secondary markets. In the primary market, issuers obtain funds by issuing new securities never before issued. On the other hand, in the secondary market existing securities are resold. The main function of secondary market is providing liquidity. It does not enable initial issuers to obtain funds.

After short explanations above, we can define a stock exchange as an organized secondary market where previously issued long-term securities are traded. While some of the stock exchanges are private organizations with their own rules, some have official status. Some others are semi-official.

Stock exchanges have a long history. The first stock exchange where securities are traded was created in 1770 in London above a cafe. The building for the stock exchange began to be constructed in 1801 and finished in 1802. However, it gained its legal framework in 1875. [2]

1.2. OPERATION PRINCIPLES

Equities and corporate bonds are the most common securities traded on stock exchanges. Only certain securities can be traded by the members of exchanges. Corporations must be listed on the stock exchanges in order to have their securities traded. Listing involves fulfilling some requirements determined by exchanges. These are generally called listing requirements.

Stock exchanges can be classified as national and regional. Although they both have the similar procedures, their listing requirements differ. Regional stock exchanges usually offer markets for the securities of smaller firms that can not qualify the listing requirements of national ones. On the other hand, listing on the national stock exchanges requires higher qualifications. New York Stock Exchange and American Stock Exchange are the national stock exchanges of the USA. Philadelphia Stock Exchange, the Boston Stock Exchange and the Cincinnati Stock Exchange are the examples of the regional stock exchanges in the United States. Similarly, many other countries have both regional and national stock exchanges. Tokyo Stock Exchange is the national stock exchange, while Osaka and Nagoya are the regional ones in Japan.

Investors are not allowed to trade by themselves within stock exchanges. Only the members of stock exchanges can trade. Listed US securities exchanges typically offer four major categories of membership[3]:

- Commission brokers: Commission brokers work for a member firm. Their duty is to execute buy and sell orders of customers of the member firms on the floor of the exchange.

- Floor brokers: Floor brokers work independently for the other members in

[2] *Sermaye Piyasası ve Borsa Temel Bilgiler Kılavuzu*, İstanbul Menkul Kıymetler Borsası, Istanbul, 1997, p.7.
[3] Frank K. Reilly. *Investments*. The Dryden Press. Orlando, 1992, p.124.

return of commission. They are said to be the brokers of brokers. For example, when the commission brokers of a member firm is too busy to execute all the orders, a floor broker can be asked to execute the orders.

- Registered traders: Registered traders are the members of stock exchanges who trade for their own accounts. They can earn profits by small changes in the security prices because they pay no commission. They are thought to provide added liquidity to the market.
- Specialists: Specialists are probably the most important members of the stock exchanges. Each listed stock in stock exchanges is assigned to one or more specialists. Transactions of these stocks are realized through the specialists. Generally they are responsible for maintaining fairness, competitiveness and efficient markets for the securities that are assigned to them. They act as both brokers and dealers. As brokers they execute orders for brokers and handle limit orders and other special orders for commission brokers in their assigned stocks. They act as dealers to minimize imbalances of supply and demand for stocks that are assigned to them by selling and buying for their own accounts.

There can be some differences between the members of stock exchanges in the USA and other countries. For example, Tokyo Stock Exchange has two kinds of members as regular members and Saitori members. While regular members can act as brokers for their customers and as dealers for their accounts, Saitori members can only act as brokers for regular members.

There are different types of orders that investors can make through their brokers according to their decisions. Market order is the most common one. It enables investors to buy or sell stocks at the best prices currently available. For example, when an investor places a market order to sell stocks that has \$30 bid-\$31 ½ ask prices, these shares will be sold for \$ 30 each which is the highest bid price currently available. However if the investor wants to buy, stocks will be bought for \$ 31,5 (lowest ask price).

Investors can specify the buy or sell prices by limit orders. An investor can place a limit order to buy a security for \$ 25 when its price is \$ 27. In this situation broker will leave this order to the specialist and if the price declines to \$ 25, specialist will make the transaction and inform the broker. When the investor wants to sell the same security for \$ 30 when its current market price is \$ 27, the same process will be implemented and if the price of the security amounts to \$ 30, it will be sold. Investors should also state time period in the limit order.

Short sale is another type of order that enables the investors to gain return when they think that the price of a security will decline. Shortly, the security is borrowed and sold in the exchange with the intent of buying it later with a lower price. For example, if it is thought that a stock with a price of \$ 20 is overvalued and its price is going to decline, a short sale position can be taken. After sometime, if the price of that stock declines below \$ 20 for instance \$ 18, the person who sold short gains \$ 2 for each stock before commission and the fee charged by the lender. However, investors may lose money in the reverse situation, that is, if the price of the stock increases instead of decreasing.

Investors can also place some special orders. A stop loss order is a special order limiting the potential losses. Assume that the price of a stock is \$ 70 when you bought it. You want to reduce any losses due to the declines and make a stop loss order at \$ 62. If the price declines to \$ 62, your stop loss order will become a market order and stock will be sold at the highest bid available. However, it is not guaranteed that you will get \$ 62 per share because the price of your stock may decline very rapidly and your order may be transacted a little lower. To avoid this situation a stop-limit order at \$ 62 can be placed instead of stop loss order. Then, when the stock price declines to \$ 62, stop loss order becomes a limit order at \$ 62 or better. Stop buy order is the other type of special order that is beneficial during the short sales. An investor who sold a stock short at \$ 60 may want to minimize any loss due to the increases in the stock price and can place a stop buy order to buy the stock with the market order if its price increases to for example \$ 62. Thus, the potential loss is limited to approximately \$ 7.

Margin trading enables investors to purchase securities and use them as collateral to borrow through their brokers and buy additional securities. For example, when shares for $ 5000 are purchased, then these shares can be used as collateral to buy additional shares. This transaction, buying additional securities by using the securities as collateral, is called margin buying. However, brokers can not lend as much as they want because there are margin requirements.

There are some miscellaneous orders, which are available for large investors as well. When the members of the stock exchange receive a fill or kill order (FOK), they execute this order in one trade or cancel the order. When they receive an all or none order (AON), they act similarly as they do in the (FOK) order, but the time period is one day. After they receive immediate or cancel order (IOC), they execute the order as much as they can and cancel the rest of the order. Not held order (NH) enables the members to conduct the order according to their ideas about the trend of the market. They do not need to execute the order immediately in order to take better position later.

Two major pricing systems exist and an exchange can use one of these or a combination of them. One is a pure auction process, in which interested buyers and sellers submit bid and ask prices for a given stock to a central location where they are matched. The shares of stock are sold to the highest bidder and bought from the seller with the lowest selling price. The other major system is the dealer market, in which individual dealers buy and sell the shares of stock for themselves. When investors want to buy or sell shares of a stock, they go to a dealer[4].

1.3. AIMS

1.3.1. PROVIDING LIQUIDITY

As stock exchanges are secondary market organizations, their initial function is providing liquidity for outstanding securities. This function is very crucial for primary markets. Persons who acquire securities in the primary market may want to sell them in the secondary markets. If they feel that it is difficult to sell them, they will hesitate to buy next time. Therefore, people who can sell securities in the secondary market may

[4] Reilly.ibid. p. 111.

want to purchase securities in the primary market. Thus, liquidity of securities provides flexibility to investors and raises the demand in the primary market and encourages corporations to issue new securities.

Important component of liquidity is price continuity for the securities traded. In continuous markets, securities are purchased and sold frequently, and there are little differences between prices of purchases and sales. Prices do not change much from the previous transactions if substantial new information do not come to the market. Thus, the markets do not face high volatility. Because continuity is important, in the stock exchanges of some countries, there are some members such as specialists in NYSE who are responsible to maintain the continuity in the market.

A continuous market requires dept, which means that numerous buyers and sellers must be willing to trade at prices above and below the current market price. These buyers and sellers enter the market in response to changes in the supply and / or demand and thereby prevent drastic price changes.[5]

1.3.2. FORMING AN EFFICIENT MARKET

Another important function of stock exchanges is forming an efficient market for securities. Efficiency in security markets is generally studied in three groups: informational efficiency, operational efficiency and allocative efficiency.

In informational efficient markets, security prices reflect all the information about the securities and adjust rapidly to the arrival of new information. However, there is a set of assumption for an efficient market[6]:

- An efficient market requires a large number of profit maximizing participants analyze and value securities, each independently of others.
- New information regarding securities comes to the market in a random fashion so that the timing of one announcement is generally independent.

[5] Relly, ibid, p. 106.
[6] Relly, ibid, p. 594.

- Investors adjust security prices rapidly to reflect new information. Security prices adjust rapidly because many profit maximizing investors are competing against one another.

There are three levels of informational efficiency, which form efficient market hypothesis altogether: weak form, semi strong form and strong form. In the weak-form efficiency security prices fully reflect all market-related data such as historical prices and past volume of trading. Investors can not earn excess returns by evaluating the past market information because it is assumed that current market prices already reflect all market information about the securities. On the other hand, semi-strong form efficiency asserts that security prices already reflect all publicly available information affecting the value of the securities including company annual reports, investment advises, the financial press, the condition of the economy and any other relevant information. Semi-strong form efficiency encompasses the weak form efficiency because market related data is a subset of public information. Lastly, in the strong form efficient markets all information including private or insider information is fully reflected in security prices. Strong form efficiency encompasses both the weak form and semi-strong form efficiency.

Operational efficiency is the second type of efficiency, which is related to the costs in the market. In an operationally efficient market, market participants can conduct their transactions with minimum costs. Therefore, operational efficiency increases when these costs in the market decrease. These costs generally include commission, settlement fee, taxes and cost of accessing the information.

Corporations that are listed on stock exchanges must provide information about their past performances. Investors decide to buy the securities of the related companies or not, according to their past performances and their expectations about their future performance. The same evaluation is done when the company issues new securities in the primary market. Investors decide to provide more capital to the company to finance their future projects. Many analysts interpret information about the companies and make comments in the financial press. Therefore, investors can obtain adequate information easily. Thus, stock exchanges enable firms that have better performance to find funds easily at lower cost and allocate funds efficiently.

1.3.3.HELPING ECONOMY TO FIND FINANCIAL SOURCES

Stock exchanges have indirect roles on the financing of the corporations. Corporations can easily issue new securities when there is a liquid and continuous secondary market. Similarly, the demand of investors for new securities rises when they can be easily sold in the secondary markets. Therefore, stock exchanges encourage both corporations and investors respectively to issue and to purchase new securities. Thus, stock exchanges enable firms to finance their long-term investments by short-term savings.

1.3.4. WORKING AS AN ECONOMIC BAROMETER

Hundreds of securities are traded in stock exchanges, and their performances are watched and assessed by many participants. Therefore, stock prices are thought to reflect the expectations of market participants about the future corporate earnings, potential cash flow stream, other information about the corporations and the level of economic activity of the country as well as the past information about the corporations and the market environment.

While expectations of economic conditions can affect stock prices, stock market movement can also affect economic activity. For example, the stock crash in October 1987 in USA significantly reduced the net worth of many individual investors, facing such investors to revise their spending behavior. Consequently, economic growth slowth[7].

1.3.5. PROVIDNG TRUST TO THE MARKET AND BROADENING THE OWNERSHIP OF CAPITAL

Savings of individuals are very precious. Therefore, they should be well protected. Stock exchanges are the places where the rights of the investors are protected well because corporations listed on the exchanges must fulfill some requirements, and they are always under the control of official organizations. Fraudulent activities such as insider trading, manipulation are strictly forbidden within stock exchanges. Stock

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[7] Jeff Madura, *Financial Markets and Institutions*, West Publishing Company, St. Paul, 1992, p. 216.

exchanges also enable investors to access material information about the corporation easily because they are responsible to disclose the material information.

Small investors can afford to be shareholders of corporations with huge capitals through shares that represent ownership claims. Investors will be willing to invest in securities through secure market, and thus the ownership of capital can be broadened.

1.3.6. FORMING FAIR PRICES

Stock exchanges are the places where the demand and the supply of securities are met. They are thought to form competitional markets for securities because they provide same opportunities to purchasers and sellers. Therefore, the prices, which are determined by demand and supply in them, are said to be fair.

However, some economists think that fair prices can not always be formed due to some reasons such as insider trading. The term refers to one's acquiring material information and trading the related security before the information is disclosed to the investing public. These people get unfair returns, and this hinders prices from being fair. There are legal protections against insider trading to prevent exchanges from this activity.

Furthermore, as institutional investors such as mutual funds have ability to buy and sell large amounts of securities, they are said to form unfair prices against individual investors. Their block sales may prevent market from forming fair prices. For instance, in the crisis of New York Stock Exchange in October 1987, some mutual funds sold large amounts of equities and accelerate the decreases in prices.

1.3.7. ENCOURAGING FINANCIAL SAVINGS

In countries where capital markets do not function properly, savings are generally invested inefficiently. People buy gold, real estate, foreign currency or they hold money.

Stock exchanges encourage investing in securities through liquid, efficient and safe market where fair and realistic prices are determined by the demand and the supply of investors. Therefore, financial savings generally increase where there is a well functioning capital market and a stock exchange.

1.4. IMPACTS OF STOCK EXCHANGES ON THE ECONOMIES

Stock exchanges enable corporations to obtain funds in the primary market and to finance their new investments by providing liquid, transparent and efficient secondary markets as described above. Therefore, they have significant contributions on the development of the countries by channeling funds from people who do not use their surplus funds in productive fields to who do. However, not all the stock exchanges can execute all these functions ideally. Stock exchanges in developed countries have been functioning generally for a long time and they are integrated with the economic system. Necessary legal measures are being implemented and the investors are familiar with investing through stock exchanges (by themselves or through institutional investors). On the other hand, stock exchanges were established not a very long time ago in most of the developing countries and have not integrated with their economies as much as in the developed countries. Therefore, many of them are not functioning well yet and have had limited contributions to their economies.

Some economists also find stock exchanges beneficial when combating inflation. They think that capitalization through the capital market is very useful in calming inflation because it is away of raising capital that absorbs the funds in the street without being accompanied by additional money supply, that is to say, it is a non-inflationary capitalization method.[8] Stocks are also included in the channels of transmission mechanisms of monetary policy by monetarists[9]. In this mechanism stocks are important in four channels.

- Tobin's q Theory: According to the Tobin's q Theory, when the money supply increases, people will purchase more stocks as well as they will buy some other things. Increasing demand for stocks will increase the stock prices. Thus, q, which is

[8]Shim S. Myun , " Problems and Tasks of Developing Capital Markets in an Inflationary Economy" in *Inflation and Capital Markets*, Capital Markets Board, Ankara,1986, pp.167-168.

defined by Tobin as the division of market value of firms by the replacement cost of capital, will rise. Companies will tend to issue stocks and spend more for investment because when q is high, the market value of firms become high in comparison with the replacement cost of capital. Companies can purchase new investment goods by issuing a small number of stocks. On the contrary, when q is low, the market value of firms is low relative to the cost of capital. Therefore, investment spending of firms will decline. Shortly, according to Tobin's q Theory when money supply increases, the demand for stocks increases thus stock prices increase. As the ratio q increases, firms spend more for investment and aggregate demand increases. On the other hand, when the stock prices decline, aggregate demand may also decline because firms are going to spend less for investment goods.

- Wealth Effect: Consumption spending is the spending of consumers on nondurable goods and services. It is different from consumer expenditure because consumer expenditure includes spending on consumer durable, but consumption does not. The lifetime resources of the consumers determine the amount of their consumption spending. Stocks are important components of consumers' lifetime resources. Therefore, increase in the stock prices increases the lifetime resources of consumers due to the increase in the financial wealth. This may lead to increases in consumption. Thus, aggregate demand will increase.

- Balance Sheet Channel: The adverse selection and moral hazard problems[10] are likely to exist more severely when the net worth of business firms become lower. Decreases in the stock prices make the net worth of firms lower. This may result lower investing because firms may engage difficulties in borrowing loans due to the potential adverse selection and moral hazard problems. Lenders may not be willing to make loans when net worth of firms are low because there is less collateral for the loans and as owners own lower equity stakes in their firms, they may engage in risky

[9] See Frederik F. Mishkin, *The Economics of Money, Banking and Financial Markets*, Addison-Wesley, USA, 1997, pp. 643-654 for more information about the transmission mechanism of monetary policy.
[10] These are the problems of asymmetric information. Adverse selection occurs when it is highly likely that the borrower whom the lender selects produces undesirable outcome. This is a problem that occurs before the transaction takes place. Unlike the adverse selection, moral hazard is the problem after the transaction occurs. It is highly likely that the borrower do not pay back the loan.

projects. Because firms may not find enough funds for investment spending, aggregate demand may decline.

- Household Liquidity Effect: In the balance sheet of households there are liquid assets such as financial assets and illiquid assets such as durable goods. Illiquid assets are likely to be sold less than their values when consumers have a financial shock. On the other hand, consumers can sell financial assets for their market values and can acquire cash easily. If there is a high likelihood of being in a financial shock for them, they will hold more liquid assets. When the amount of their financial assets is large enough relative to their debts, they will expect a lower likelihood of having a financial shock. Thus, they will want to purchase consumer durable goods or housing. Changes in the stock prices have important influences on the value of financial assets that the consumers hold. When the stock prices rise, the value of financial assets rise as well. This leads to increase in consumption of durable goods and increase in the aggregate demand. In contrast, when the stock prices decrease, consumers' expectation for financial crisis increases and their durable expenditures decrease which leads to decline in the aggregate demand.

PART 2
INTERNATIONALIZATION OF STOCK EXCHANGES

2.1. HISTORICAL BACKGROUND

Stock exchanges have vital roles on the economies. They had been working within their domestic countries. However, especially during the last decades they have outgrown the borders of their domestic countries and have become international organizations.

Factors that have had effects on globalization of finance have accelerated the internationalization of stock exchanges. Important historical forces promoting globalization of finance are as follows[1]:

- the postwar revival of production, trade and direct foreign investment
- the development of new financial instruments
- changes in domestic and international financial regulations
- advances in international telecommunication links

Foreign exchange markets initiated the financial internationalization after Bretton Woods system collapsed in 1973. Then, the bond markets followed in 1980s. Offshore Eurobond markets accelerated the internationalization of securities markets due to the advantages they offer such as lower costs and regulations. Globalization of equity markets came the latest. 1990s are the years when the equity markets globalized.

[1]Michael P. Jacobs. "Globalization of Finance" in Richard Roberts (ed.). *International Financial Centers 2*. Edward Elgar Publishing Limited, Cambridge. 1994. pp. 127-140.

2.2. FORCES PROMOTING THE INTERNATIONALIZATION OF STOCK EXCHANGES

Financial markets in industrial countries have changed a lot beginning in 1980s and become increasingly global due to the competition, financial innovation, deregulation and the changes in the technology. After these developments in the developed countries, developing countries also gained international dimension.

The forces promoting the internationalization of stock exchanges is studied below generally with regard to the changes in market environment, supply and demand side factors

2.2.1.CHANGES IN MARKET ENVIRONMENT

2.2.1.1.ADVANCES IN THE TELECOMMUNICATION AND COMPUTER TECHNOLOGY

Rapid tehnological developments enabled participants in distinct places to telecommunicate with each other in a high speed and to obtain information about security markets in any part of the world. Therefore, gathering and disseminating information gained high efficiency. Investors can now follow the markets even at home through Internet and can make some transactions.

Telecommunication costs have reduced relatively to very low levels in comparison with the last two decades. Besides, application of technology in the functioning of stock exchanges reduced the transaction costs and increased the speed and the efficiency of the transactions.

Enhanced communication and computer networks linked many participants in various markets. For example, London Stock Exchange established a computerized network called SEAQ in October 1986, which has also enabled international traders to conduct trading by telephones and computers. Besides, SEAQ is linked to NASDAQ, which is an over counter market for smaller firms in the U.S and provides mutual on-screen, access to the top 300 quotations in each market.[2]

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[2] *Private Capital Flows to Developing Countries*, A World Bank Policy Research Report, Oxford University Press, New York, 1997, pp.95-96.

2.2.1.2.DEREGULATION AND FINANCIAL LIBERALIZATION

In 1980s the protectionist ideas have begun to disappear. In many developing countries foreign capital has been encouraged. Capital and exchange controls have been lifted or generally eased. Controls on international capital have been reduced. Restrictions on cross-border capital flows were rescinded or relaxed in the U.S. and almost all other oil-importing nations in 1974. In 1979 and the early 1980s, Britain and Japan eliminated their exchange controls on capital outflows. West Germany lifted its restrictions on purchases of domestic bonds and money market instruments by non-residents in 1981, removing restraints on capital inflows[3].

Stock Exchanges in industrial countries became open both for international investors and issuers. Japan allowed for foreign stock listings in 1970s. However, foreign issuers were allowed in USA in 1980s. Stock exchanges also opened their markets for foreign members as well. For example, foreign members are allowed in Japan in 1986, and London Stock Exchange began to admit foreign membership on the exchange after October 37, 1986 when it initiated major changes known as Big Bang.

Countries have also taken measures to attract foreign investments. For example, in 1984 foreigners were granted tax-exemption for the income on bonds in Germany, and the withholding tax, about 30 %, which had been applied to foreigners' interest income was repealed in USA.

Markets witnessed many major adjustments in the financial markets of developing countries as well. Restrictions on portfolio capital have liberalized in many developing countries. Listed securities on the stock exchanges became freely available to foreign investors in most of them or relatively free in the rest. Foreign investors are now allowed for the repatriation of income and capital. Foreign investment ceiling on listed stocks in emerging markets has increased. Besides, tax rates are decreased considerably for foreign investments.[4]

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[3] Jocobs. op. cit., p.136.

[4] See Appendix 1, 2, 3, 4, and 5 to compare the current situation and the situation in 1987 in the developing countries.

Liberalization trend that began in the developing countries and followed by developing countries make the stock exchanges integrated with each other. Foreign investors, corporations and financial intermediaries now look for better opportunities out of their countries.

2.2.2.DEMAND AND SUPPLY-SIDE FACTORS

Investments through foreign stock exchanges are increasingly growing. Investors are now seeking for better opportunities in foreign countries. Factors that motivate investors to invest in foreign markets are generally potential higher returns and risk diversification. Growing importance of institutional investors in industrial countries also increased the international investments. Mutual funds, pension funds, investment companies and insurance companies have grown very rapidly and have become important market participants in the security markets. Pension funds, insurance companies and mutual funds in seven major industrial countries had assets close to US $ 17 trillion in 1994, compared with US $ trillion in 1985[5]. They are now dominant investors in the capital markets, for example it is estimated that they hold 49 % of US equities.

Many institutional investors have been expanding their horizons and investing their funds internationally. Global and international funds, which have foreign securities in their portfolios, have become very popular. These large institutions have tended to invest their funds internationally. The international share of mutual fund portfolio rose from 3,8 % in 1990 to 8,9 % in 1994 in USA. The degree of international diversification among pension funds varies significantly, however, ranging from 24 % of total assets in United Kingdom to around 17 % for Canada and the Netherlands, 9% for the Unites States, and a low of 5 to 6 % for France and Germany.[6]

Developments in the developing countries have had also effects on the internationalization of the security markets. The concerns of investors to developing countries have increased due to the very high returns and the diversification

[5] *Private Capital Flows to Developing Countries*, p. 97.
[6] *Private Capital Flows to Developing Countries*, p. 99.

potential. Therefore, investors, especially institutional investors began to follow all the markets in the world and invest big amount of funds out of their countries.

There have been also many changes in the supply-side. Corporations have tended to issue securities abroad. Cross-listings on stock exchanges have become widespread and the shares of foreign companies in market capitalization and trading volume have increased.

These two factors, which have had great impacts on the internationalization process of stock exchanges, are studied in more detail in the latter part of this chapter.

2.3. BENEFITS AND RISKS OF STOCK EXCHANGE INTERNATIONALIZATION

Internationalization brought new market participants to the markets. Investors, especially the institutional investors began to trade in various stock exchanges through financial intermediaries from different countries. Large corporations are listed on foreign stock exchanges in addition to their domestic stock exchanges.

Foreign participants in stock exchanges are thought to have some contributions. Many stock exchanges become more liquid due to the additional demand from foreign investors. As a result of higher liquidity, the sensitivity of market prices to the sale of equity and thus volatility are reduced because the higher liquidity makes it possible to absorb liquidity shocks without large price adjustments. These positive effects of foreign participation in the stock markets of Latin American countries after they open their markets to the foreign participants are good examples. The total value traded in four Latin American markets, that is, Argentina, Brazil, Chile and Mexico, amounted to US $ 245,211 billion in 1996 from US $22,117 billion in 1990 and the turnover ratio in these markets increased sharply from 33,5% in 1990 to 56,4 % in 1996. However, the monthly standard deviation of these markets fell respectively from 25 %, 18 %, 11 % and 16 % prior to liberalization to respectively 11 %, 15 %, 8 5 and 11 % during the period after liberalization through June 1995 (including the period after the Mexican Crisis).[7] Taiwan stock market also benefited from the international participation. A study that tested price effects of stock market liberalization in Taiwan concluded that Taiwan' stock returns are less volatile in the period after liberalization.[8]

Additional demand from foreign investors have had impacts on the prices of the securities traded on the stock exchanges as well. According to an analysis that correlated the net foreign purchases and share prices, US$1 billion foreign investments into emerging stock markets increases share prices 1,4 %, and 0,3 % in the developed markets. The relationship is showed in Table 2-1.[9] Changes in the

Table 2-1: Share Prices and Net Foreign Purchases and Sales-Developed and Emerging Markets, 1986-93

		1986	1987	1988	1989	1990	1991	1992	1993*	Av.
Developed Markets	Net Foreign Purchases (US$ Billion)	38.6	10,6	29,4	76,5	-10,0	84,9	30,7	107,2	46,0
	Share Price Returns (% US $ Term)	39,0	15,0	21,4	15,1	-19,3	16,5	-7,7	19,7	12,5
Emerging Markets	Net Foreign Purchases (US$ Billion)	3,3	5,9	3,5	10,1	13,2	15,8	22,5	52,0	15,8
	Share Price Returns (% US $ Term)	8,7	10,0	53,2	51,7	-30,1	15,6	-1,4	64,2	21,4

* Estimated

Price/Earning(P/E) ratios also indicate the effects of foreign investments on the share prices. P/E ratios gave increased sharply after foreign investment restrictions were

[7]Kent Hargis, " Do Foreign Investors Stimulate or Inhibit Stock Market Development in Latin America", *The Quarterly Rewiev of Economics and Finance*, Vol.38. No. 23(Fall 1998). p. 312, 315.
[8] Felix B. Kwan and Mario G. Reyes ," Price Effects of Stock Market Liberalization in Taiwan ", *The Quarterly Rewiev of Economics and Finance*, Vol. 37, No. 2 (Summer 1997), p. 520.
[9] Michael Howell," Cross-border Equity Flows: Hot or Cold? A Global Flow of Funds Analysis", Baring Securities, April 1994, p. 8 cited in *Uluslararası Sermaye Hareketlerinde Portfoy Yatırımları ve Türkiye*, İstanbul Menkul Kıymetler Borsası, İstanbul, 1994, p. 59.

liberalized. In Mexico, the ratio increased from 4,6 in May 1989 (before the markets are opened) to 17,1 at the end of 1994. The P/E ratio of the Brazilian market rose to 13,1 from 6,8 before liberalization in May 1991 and the Chilean market surged to a P/E of 21,4 from 3,9 in 1989.

The new environment after the foreigners come to the market attracts new listings (stocks, bonds etc.) to the market as well. The market enlarges both because of additional investments from foreigners and new foreign and domestic listings. Thus, foreign participants help domestic corporations find funds to finance their new investments both by increasing liquidity and demand in the secondary market and by purchasing new issues in the primary markets.

Internationalization of stock exchanges has also increased the efficiency especially in the emerging markets. Large corporations in emerging markets began to be listed on the developed markets. Therefore, they needed to disclose necessary information. Besides, markets began to take measures by considering the demands of large institutional investors. Foreign intermediaries such as investment banks, brokerage houses made the information accessible from the foreign markets.

Foreign investments in stock exchanges are funds for the countries especially developing ones to finance their developments. As many emerging markets do not have sufficient financial sources within their countries for developing, foreign investments are very crucial for them. They have positive contributions also to the balance of payments of the countries. Many foreign investors do invest their proceeds again in these countries. Therefore, they help countries to have enough capital for new investments.

When the markets are internationalized, foreign businesses begin to operate in these markets. The markets generally benefit from the competition. They may increase the employment in the economy and change the market structure if there is monopoly or oligopoly. Since the competition among businesses operating in security market increases, the prices of their services declines. Therefore, the investment in securities market may increase.

Internationalization of stock exchanges may have some drawbacks as well. Markets became very susceptible to the inflows and outflows of funds. Foreign investors' decision to leave country or make less amount of investment can influence the countries' economies. In contrast to the flow of cross-border investments in stock exchanges, balance of payment will be affected negatively by the high outflow of foreign portfolio investments. During a financial crisis, foreigners may abandon the market by selling the securities they have in the secondary markets and transfer the proceeds to their own countries. This will further deteriorate the problems of the country in the financial crisis.

All the benefits and risks of opening of markets to foreigners are similar in both developed and emerging markets. However, as developed countries have generally better economic conditions and have sufficient demand and supply to the security markets within their countries, especially the risks, but also the benefits are limited for them.

2.4. DEVELOPMENTS IN THE STRUCTURE OF STOCK EXCHANGES

Globalization brought tough competition among countries and organizations. Developments in emerging markets increased this tough competition. These countries recognized the importance of international investments. Therefore, they have liberated their regulations and moved the restrictions on foreign investments in order to take share from international investments to finance their developments.

Many novelties in stock exchanges have been implemented to have advantages in the global market. Many stock exchanges establish new markets within them to attract new listings and offer investors more alternatives. Markets for small and medium sized companies are the most common one. Because these companies have high growth and earning potential, the concern of investors to them increases. Therefore, markets for them with distinct requirements are opened to enable them to be listed. In March 1996, " Nouvear Marche" (New Company Market) within Paris Stock Exchange was set up for small, but rapidly growing corporations, and it is determined that foreigners constitute the half of the investors trading in this market. London Stock Exchange opened "Alternative Investment Market" (AIM) for small and medium sized corporations. " Nieuwe Market" within Amsterdam Stock Exchange operates again for these kind of firms.

Stock exchanges are exploiting new financial instruments. Transactions of derivatives, depository receipts and participant certificates of mutual funds became widespread in addition to the equities and debt securities.

The cooperation and integration among stock exchanges increased. Some stock exchanges cooperate or integrate in order to minimize the transaction cost, to facilitate the foreign transactions and to attract more foreign investments in the new competitive environment.

New measures are applied in the markets to provide better protection to investors. Investor Protection Fund is one of the applications, which gives confidence to the investors by preventing them from losing their money because of the problems arised by the intermediaries. The regulations are revised to minimize the manipulation and insider trading activities in the market. Besides, as the majority of investments tend to be invested through institutional investors, new regulations are implemented to supervise and control the activities of institutional investors and other intermediaries operating in the capital markets to protect investors from frauds. Investors are also provided easy access to the information about the market and corporations.

Technological developments are tried to be implemented in the markets. Electronic trading system is applied in most of the markets and some are changing their systems with the progressed ones. With the implementation of technology, investors became able to conduct their transactions in a fast, transparent environment with less cost.

2.5. INTERNATIONAL INVESTMENTS THROUGH STOCK EXCHANGES

Investing internationally has become very popular for some decades. Investors recognized the potential benefits of international investing. Increases in financial and economic communications and trends towards deregulation have formed a very accessible and huge global market. Investors have been considering foreign markets when making investment decisions.

2.5.1.REASONS AND BENEFITS

Several reasons can be mentioned to explain why investors should add foreign investments to their portfolios. Firstly, investors can enlarge their investment choices by global investment, for a large percentage of investment opportunities are out of their domestic countries. Secondly, they can diversify their portfolios with foreign securities in order to reduce risk. A properly diversified global portfolio can increase return without increasing risk or provide the same return with less risk or even higher returns with lower risk. Lastly, international investment enables investors to benefit from high returns in foreign countries.

2.5.1.1.RELATIVE SIZE OF INVESTMENT OPPORTUNITIES OUT OF DOMESTIC MARKETS

We can see the allocation of stock market capitalization of international markets in Table 2-2. It is not logical for any investor in the world to ignore stock markets that are out of domestic country. For example, for an American investor approximately 67% of opportunities were out of USA in 1990 in terms of capitalization. In 1997 this ratio decreased to 52 %. There is the same situation for investors in other countries. There are four times more investment choices out of Japan than there is within Japan for Japanese investors.

Table 2-2 shows also the breakdown of the number of domestic companies listed. Although emerging markets have low share in total capitalization, their share in total number of listed domestic companies is 49,11 % in 1997. An important amount of investment alternatives lies out of any country in the world.

Table 2-2 : Shares of Stock Markets in World Capitalization and in Total Number of Domestic Stocks Traded (%)

	1990		1997	
Market	1	2	1	2
Emerging Markets	6,52	44,078	9,47	49,11
Developed Markets	93,47	55,922	90,53	50,89
Germany	3,77	1,41	3,5	1,72
Japan	31,04	7,09	9,41	5,88
U.K	9,03	5,83	8,47	5,04
U.S	32,55	22,6	48,03	21,08
Other	17,06	18,98	21,09	16,43
World Total	100,00	100,00	100,00	100,00

1= Capitalization 2= Number of Domestic Companies Listed

Source:IFC Factbook, 1998

We can conclude similarly when we evaluate the breakdown of world foreign bond markets within the stock exchanges. Ignoring bond markets in foreign countries reduces investors' available investment opportunities. According to statistics of FBIV about the bond markets in 1996, 23242 bonds are listed in Germany, which is about as many as two and a half times of those in Luxembourg (Luxembourg ranked second in the rankings with 8441 bonds listed after Germany). However, the number of bonds listed in Germany comprised just a bit more than ¼ of bonds listed in 49 stock exchanges included in FBIV statistics. Therefore, even for investors in Germany, which has the largest number of bonds listed, there are three times more investment opportunities out of Germany.

2.5.1.2.HIGH RETURNS AND DIVERSIFICATION

International investment is appealing due to the potential high returns. Many emerging markets offer very high returns in comparison with the developed countries. In 1996, Bangladesh ranked first, Russia second and Venezuela third in the world stock market rankings with the returns of respectively 196 %, 155,9 % and 131,8 % in dollar. In the same year an American investor gained 21,4 %, an English investor 23,3 and a Japanese investor –16,0 return in dollar within their countries. In 1997, Russia ranked the first with an increase of 142,7 % in dollar. Oman and New

Zealand followed with the increases of respectively 141,7 % and 139,1. [10]Again three major developed markets had considerably low increases in their stock markets. Therefore, relatively high returns out of the domestic country are increasing the concerns of investors to foreign countries.

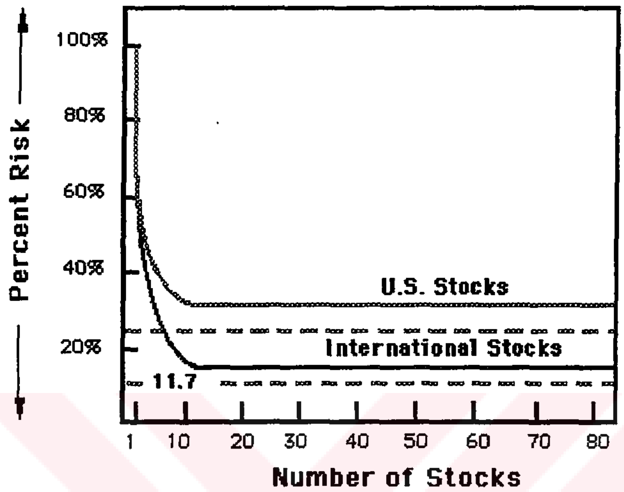
Other important benefit of international investment is reducing the diversiable risk and thus, the total risk of the portfolio. A diversified portfolio, which consists of securities that are not highly correlated with each other, can provide a greater return for a given level of risk or provide the same return for a reduced risk. When some securities are experiencing above average rates of return, some other securities will provide below average rates of returns at the same time. By combining these kinds of securities which have low positive correlation, zero correlation or, negative correlation (which is ideal) with each other would stabilize the rates of return and reduce risk. However, because prices of securities in these portfolios are all affected by domestic economic conditions and are probably highly correlated, investors can reduce risk to some extent by purely domestic portfolios. Therefore, including foreign securities in purely domestic portfolios will contribute to diversification of the portfolio and will reduce the risk.

The benefits of international diversification are demonstrated in Figure 2-1. When the number of randomly selected domestic securities (in this figure American securities) in a portfolio is increased, standard deviation, which is used to compute risk, declines. This is the positive result of domestic diversification. However, the standard deviation of domestic portfolio does not continue to decline after a number of securities. This is because all unsystematic risk is eliminated and adding any more domestic securities can not reduce total risk. On the other hand, including foreign securities to domestic portfolio reduces risk for any number of securities. This can be seen by comparing the upper curve, which demonstrates portfolio of the US securities with lower curve, which demonstrates the international portfolio.

International portfolio has lower risk, which reflects only worldwide systematic factors. Domestic portfolio consists of securities, which are affected by

[10] See Appendix 6 and 7.

Figure 2-1: International Diversification



Source: B. Solnick, "Why not Diversify Internationally Rather Than Domestically", *Financial Analyst Journal*, 1974 cited in *Depository Receipts and Istanbul as a Regional Center via DRs*, Seminar Organized by TAKASBANK, Istanbul, 1997

macroeconomic and market circumstances of the country. However, many other countries are not affected by these circumstances. Therefore, adding securities of other countries would reduce the potential risk.

The correlation of stock market indices is thought to be affected mainly by integration of countries. The countries whose economies are more integrated have higher correlation, that is, if economic conditions of one country affects the other, the correlation between them is expected to be high. This happens generally among industrialized countries. In countries where international transactions are restricted, the degree of interaction (and therefore influence) is reduced. Thus, such countries are more insulated and economic conditions there should not be similar to economic conditions in other countries[11]. Therefore, adding securities of less-industrialized countries that are less integrated with other countries especially industrialized ones would contribute to diversifying.

[11] Cheney, op.cit, p.170.

2.5.2. WAYS OF INTERNATIONAL INVESTMENT

2.5.2.1.LISTED FOREIGN SECURITIES ON A LOCAL STOCK EXCHANGE

Buying listed foreign securities on the domestic stock exchange is similar to buying domestic securities. This is an easy way for investors to buy foreign securities. It saves local investors not only from foreign currency transactions but also from other difficulties and expenses when investing directly in securities listed on foreign stock exchanges. Although the number of foreign securities listed on a local exchange is limited, the number is increasing in many markets. For illustration, the number of foreign companies whose shares are listed on New York Stock Exchange and on exchanges in Germany was respectively 304 and 1290 in 1996 in the main market. In 1997, this number increased to 355 and 1996.[12]

As the prices of foreign securities are affected by the conditions of the companies' domestic market, information about the domestic market is needed to evaluate the securities. Therefore, investors should obtain information about the general conditions of the country of the foreign company and its industry where they operate as well as information disclosed by the firms.

2.5.2.2.DIRECT INVESTMENT

Direct investing in securities listed on stock exchanges is the most intricate method for the individual investors. Firstly, they may face high transaction and custody costs relative to their domestic markets. Secondly, there is a substantial risk of fraud for them since in some markets, especially emerging markets, which offer high returns, there are not sufficient legal measures for fraud. Thirdly, they may have difficulties in obtaining information about the markets. Besides, they encounter different trading rules and investment practices. Lastly, they may face high currency risk.

Incontrast to individual investors, institutional investors can minimize these problems. Institutional investors have large pools of funds to invest in foreign

[12] Statistics , International Federation of Stock Exchanges (FBIV). www.fbiv.com.

markets. Large pools of funds enable them to bargain for custody and transaction costs, or many countries offer lower rates for larger amounts. Besides, they have research departments which seek for higher returns and suitable conditions to invest in different markets, and many of them cooperate with institutions in foreign markets to obtain easy access to information, get help for procedures and protect themselves for frauds. Institutional investors generally invest in different foreign markets. This may help them minimize the currency risk. Furthermore, they invest in futures markets to hedge for currency risk.

For these reasons, it is not a suitable way for individuals to invest directly in foreign stock exchanges. It is better for them to invest by other ways to access foreign markets. On the contrary, as institutional investors are armed for any conditions in foreign markets, they can receive many benefits by investing in foreign stock exchanges.

2.5.2.3. INTERNATIONAL AND GLOBAL MUTUAL FUNDS AND CLOSED-END FUNDS

Mutual and closed-end funds are two forms of investment companies, which invest funds they collected from many individuals and institutions in marketable securities and other instruments.

Mutual funds have become very popular due to the opportunities they offer. Small investors usually suffer from not being able to diversify their portfolios. However, mutual funds include a very large variety of securities in their portfolios, which can not be created individually. Investors benefit from experienced management of mutual funds. Besides, mutual funds provide liquidity to the investors by repurchasing investors' shares.

For the reasons above, many individual and institutional investors prefer to invest through mutual funds. As markets have been more open to foreigners and information and transaction costs of investing in foreign securities decreased, international mutual funds (IMFs) have become popular means of accessing foreign markets. IMFs are similar to other mutual funds. The only difference is that foreign securities are included in their portfolios. By participating in an IMF an investor receive benefits of international diversification, relatively high returns with less transaction costs than investors would incur if they invest by themselves.

IMFs in many countries priced in their domestic currencies. Thus, investors do not need to exchange foreign currencies into their domestic currencies. However, the values of IMFs are affected by the changes in the value of foreign currencies as well as they are affected by the prices of securities. When the value of foreign currency strengthens towards domestic currency, the security's value in domestic currency increases. In contrast, the value of foreign security decreases when the currency of that country weakens. Portfolios of IMFs diversify currency risk because they include securities from different countries.

Global Mutual Fund is another means of investing globally. Its difference from the international mutual fund is that global mutual fund includes the U.S. securities in the portfolio, but IMFs do not. This distinction is meaningful for the U.S. investors. Some mutual funds also offer index funds that consist of stocks of a country or a group of countries.

Closed-End Fund as mentioned in the beginning is the other form of investment company. In contrast to the mutual funds, closed-end companies do not repurchase the shares they sell. They have a fixed number of shares of outstanding stocks. The number of shares does not change until close-end company decides to make another public sale of securities. Their shares are traded in the secondary markets and demand and supply determine their prices of shares.

International closed-end funds differ from mutual funds in the region they invest. Closed-end funds do not diversify their portfolios by investing in different areas. They usually invest in specific country or region. Country funds are the examples of closed-end companies, which invest only in securities of a particular country. Regional funds invest in specific regions such as Europe Funds. However, investors can diversify their portfolio by buying several different regional or country funds.

2.5.2.4.DEPOSITORY RECEIPTS

A depository receipt is a certificate that is mainly issued by depository institutions as an evidence of ownership of a foreign corporation's securities, which are hold in the safekeeping of the depository institution. It can be traded on the over the counter market or on a stock exchange.

American Depository Receipt (ADR) is the firstly issued depository receipt in the world. It was first created in 1927 as a reaction to the restriction of English Laws that did not allow UK shares to leave the UK physically.

Although some economists think that ADRs may become extinct due to the trend toward globalization of the world's capital markets (because ADRs may not be desirable if financial markets with international custody and transfer network for shares are really global), the market share of depository receipts has fairly increased. Over 90% of the U.S. institutions are holding ADRs. Besides ADRs represent over 10% of the New York Stock Exchange's volume[13].

Depository receipts offer many advantages to investors. The reasons for the popularity of depository receipts among investors can be summarized as follows:

- It provides easy access to foreign securities. Thus, investors can diversify their portfolios by these depository receipts easily.
- Dividends are distributed and depository receipts are traded in the domestic currency.
- It saves investors from high transaction costs and many procedural differences that they will face when they invest in foreign securities.
- It offers high transparency by reports, disclosure, analysis and data. Other important information such as reorganization, dividend and corporate action is also supplied.

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[13] *Depository Receipts and Istanbul as a Regional Center via DRs*, Seminar Organized by TAKASBANK, Istanbul, November 13, 1997.

- Investors do not need to concern with different settlement and custody systems. It eliminates many of the cross-border custodial costs.

2.6. RISKS

Individual and institutional investors face risk when investing in foreign securities in foreign markets or in their domestic markets. One of their aims of investing internationally is diversifying their portfolios. Because some factors such as macroeconomic or physiological ones affect all the portfolios or securities in the globe, they can only eliminate unsystematic risk, which is unique to their portfolios.

The risk of international investment can also be categorized in three groups[14]:

- Global risk
- Country risk
- Microeconomic risk

Global risk is very related to systematic risk since some global events have impacts on almost all portfolios in the world. Investors reduce their country and microeconomic risk, but they can not avoid global risk.

2.6.1.GLOBAL RISK

The prices of the securities listed on stock exchanges are affected not only by the conditions of their companies and domestic markets but also by some global factors. Global factors have impacts on markets according to their integration level to the other markets. For example, during the Financial Crisis of South Asian Countries, the stock markets of countries, which have high economic relations with them, suffered high declines. We witnessed high declines in Japanese stock market because there is high correlation between South Asian Countries and Japanese markets. Stock markets of some countries were not affected so much.

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[14] *Uluslararası Sermaye Hareketleri Uluslararası Sermaye Hareketlerinde Portföy Yatırımı ve Türkiye*, p. 31.

As many stock exchanges have become open for foreign investors, investors buy and sell securities in various stock exchanges of different countries. Therefore, investors should be familiar with world markets even when they are investing in their domestic markets because markets are affected by the decisions of foreign investors and institutions.

2.6.2.COUNTRY RISK

Selecting countries to allocate funds is an important process of international investment. Investors usually begin with analyzing alternative economies to receive appropriate opportunities for their risk-return choices.

Country risk is unique for the underlying country and it refers to the factors that affect all the market. Economical, political, sociological and some physiological factors are the ones that have impacts on the performance of all the firms and the prices of securities.

Economic conditions of the countries have impacts on the security markets. Changes in the money supply, interest rate or inflation rate will influence security prices. The state of budget and trade deficits is also the key variables. Besides, foreign investments are very sensitive to the currency risk. Changes in the exchange rate directly influence the value of their portfolios in their domestic currency. Therefore, they seek for strategies to hedge the currency risk. Derivatives markets are used by some foreign investors to hedge the currency risk.

Country risk can be reduced by investing in securities of different countries. However, changes in the conditions of some countries influence the other countries. It is said that the world catches a cold when Wall Street sneezes. This is because some industrialized countries have important effects on the world economy, but the total risk usually decreases when investing in less integrated countries.

2.5.3.MICRO-ECONOMIC RISK

Foreign investors who seek for appropriate investment opportunities will try to determine the industries to invest after they decide to make investment in that country. Then, they should determine which companies would prosper within the industries they selected. Besides, they should find out which stocks are undervalued.

To sum up international investment has three step investment process: analyzing alternative economies, analyzing alternative industries, analyzing individual companies in selected industries.

Analysts group companies into industries because they think that industry effect has significant influences on the performance of an individual company. Investors should consider some key industry fundamentals before determining to invest in an industry[15].

- Historical Financial Performance
- Relationship of the Industry to the Economy
- Relationship of the industry to the Stock Market
- Imports and Exports
- Regulatory Environment
- Labor Environment
- Industry Structure
- Technology and Innovation

All these factors affect the microeconomic risk of the companies.

2.6.GLOBAL SUPPLIERS

The number of corporations listed on the foreign stock exchanges has increased to a considerable number. Table 2-3 shows the number of domestic listings and the foreign listings in some countries. In some markets the number of foreign and domestic listings are almost the same. This shows the demand of corporations for being listed in foreign markets. Foreign listings are generally denominated by the developed countries.

[15] Cheney, op.cit., pp.250-252.

Table 2-3: Foreign Companies in Stock Exchanges, 1997(In the Main Market)

Markets	Number of Foreign Companies with Shares Listed		Number of Foreign Companies Newly Listed
	Domestic	Foreign	
NYSE	2271	355	63
Germany	700	1996	730
London	2046	467	37
Paris	740	184	4
Swithzerland	216	212	0
Singapore	294	40	8
Tokyo	1805	60	1
Amsterdam	199	149	2

Source: Statistics, FBIV,www.fbiv.com

The survey of Euromoney gave us a brief idea about why firms are willing to be listed on foreign exchanges. An official from public relations department of Scott Paper, which is a US corporation, gave the following reasons for being listed on London Stock Exchange after NYSE and Philadelphia Stock Exchange[16]:

> We had no immediate need for extra equity, but may well do so at sometime in the future. We would like a broader stockholder base, and felt there would be some interest in the company overseas. The London Stock Exchange has high visibility, so it best served the purpose of getting the company's name known.

In the light of this answer, the advantages that firms are expected to have by being listed on foreign stock exchanges can be listed as follows:

- They can establish name recognition in foreign markets. Because many

[16] " Why Corporations Gain from Foreign Equity Listings", Euromoney Corporate Finance, March 1985, pp. 39-40 cited in Frank Fabozzi and Franko Modigliani, *Capital Markets*, Prentice Hall, New York, 1996, p. 319.

big corporations are now operating internationally, it became very important for them to be well known in foreign countries. By this way, they can have advantages against their competitors.

- They can diversify their shareholding internationally. Thus, they can broaden their shareholder base and increase their retail investors.
- They can enlarge their market, which may increase or stabilize their security prices through broadened ownership.
- They can raise new capital in foreign markets to finance their new investments.

PART III

ISTANBUL STOCK EXCHANGE AS AN INTERNATIONAL ORGANIZATION

3.1. ISTANBUL STOCK EXCHANGE

3.1.1. HISTORICAL BACKGROUND

Although Istanbul Stock Exchange, the only stock exchange in Turkey, is quite young, the history of stock exchange in Turkey goes back to the period of Ottoman State. Bond issuing of Ottoman State for the first time due to the foreign borrowing to finance the Kirim War in 1854 accelerated the establishment of a stock exchange in Ottoman State. A secondary market activity for these bonds started on the over the counter market. However, before this, some foreign stocks and bonds were also being traded via Galata Bankers. In 1884 Galata Bankers founded an association which can be thought as the first secondary market organization in Turkey. Then, in 1866 with the encouragement of lender states, Ottoman State established an exchange that was named as " The Dersaadet Bond Exchange".

The name of the exchange was changed as " The Stock and Bond Exchange" by a new regulation issued in 1906. It operated till the foundation of Turkish Republic. Some changes to the exchange were brought with a new regulation in 1922. Then in 1929, with the enactment of the Security and Currency Exchange Law, it was reorganized and renamed as " Istanbul Security and Currency Exchange". In 1938, it was moved from Istanbul to Ankara and operated with the name "Currency, Stock and Bond Exchange". However, it was moved back to Istanbul in 1941 due to the drawbacks of operating in Ankara, for industry was more common around Istanbul. In these years currencies as well as stocks and bonds were being traded in the stock exchange. Currency transactions became meaningless because of the currency control regime beginning in 1931. Eventually, currency transactions were canceled in 1959.

In 1980s, many novelties came to the capital markets in Turkey. Capital markets were regulated by Capital Markets Law enacted in 1981 and Capital Markets Board was established as the main regulatory body responsible for supervising and regulating the Turkish securities market in 1982. A new degree concerning the operations of a security exchange was issued in October 1983. Then, the regulations for the Establishment and Functioning of Securities Exchange were published in the official Gazette in October 1984. On December 26,1985 a new stock exchange with the name " Istanbul Stock Exchange" began to function. Stock trading commenced at the Cagaloglu building on January 3, 1986.

3.1.2. MARKET STRUCTURE

Both primary and secondary market transactions take place within ISE. Transactions are executed through members. ISE members consist of 140 brokerage houses, 51 commercial banks and 10 investment and development banks. Totally 201 banks and brokerage houses are operating within ISE. They must have authorization of ISE for each activity. Banks (except two of the commercial banks) are authorized for only bonds and bills market.

There are three markets within ISE. These are

- Stock market
- Bonds and Bills market
- International market

Beside these markets, regulation pertaining to the legal framework of Derivatives Market was published on Official Gazette on January 29, 1997, but the trading has not commenced yet.

Table 3-1: Authorizations of ISE

Intermediaries		Activities Authorized by ISE								Total
		H	T	R	L	UD	UT	UF	UR	
ISE Members	Commercial Banks	2	2	2	_	_	1	_	_	2
	Brokerage Houses	139	108	48	2	19	25	36	_	140
Banks Authorized in Bonds and Bills Market	Investment & Dev. Banks	_	10	9	_	1	6	6	1	10
	Commercial Banks	_	49	47	_	12	39	18	12	49
Total		141	169	106	2	32	71	60	13	201

H= Stock Market T= Bonds and Bills Market R= Repo/Reverse Repo Market UD= International Equity Market
L= Lot Off UT= International Bonds and Bill Market UF= Foreign Mutual Funds market

Source: ISE Annual Factbook, 1997

Transactions were conducted through call market trading system till November 17, 1987. Then, the system was changed to the continuous auction trading system. Bonds and Bills market initiated in June 1991, and the trading in International market commenced in 1997. After the initiation of computerized stock trading with 50 stocks in December 1993, full automation of stock trading was adapted in November 1994.

3.1.2.1. STOCK MARKET

Stock market employs fully computerized trading system which enables to determine stock prices on a multiple price-continuous auction method since October 21, 1994. ISE members are trading in stocks and right coupons through this fully computerized trading system. There are four sub markets within the stock market.

- National market: It is for the companies that can fulfill the listing requirements.

- Regional market: The stocks of the companies that can not fulfill the listing requirements or do not have the necessary qualifications to be traded on the national market can be traded on the regional market. Executive Council of the ISE decides to admit the corporations, which have the necessary qualifications for the regional market. Besides, when some companies are delisted permanently or temporarily from the national market, their stocks may also be traded on the regional market.

- New company market: The new company market is established to supply funds for the investments of the young companies that have growth potential and also to offer an investment alternative to the investors who are willing to earn high returns by taking high risk
- Watch list market: The stocks of companies, which are under special surveillance and investigation, are traded in this market.
- Wholesale market: Stocks in large quantities are traded in the wholesale market. Stocks of public entities can also be traded as a part of privatization.

Primary market, odd lot, official auction and right coupon transactions are conducted within relevant markets above during the same session.

3.1.2.2. BONDS AND BILLS MARKET

This is the only organized market where outright purchases and sales and repo/reverse repo transactions take place. The ISE Bonds and Bills Market was set up on June 17, 1991. In February 1993, transactions of repo/reverse repo commenced. Then, the Real Estate Certificate Market was launched on June 3, 1996 within the ISE Bonds and Bills Market.

The fixed-income securities traded in this market are government bonds, treasury bills, revenue-sharing certificates, bonds issued by the Privatization Administration and corporate bonds that are listed on ISE. Government bonds and Treasury bills are the most active securities in the market. All the securities but the securities issued by

Government and the Privatization Administration must fulfill the listing requirements.

Operations are conducted through an electronic order matching, administering and reporting system. In this system, multiple price-continuous trading-system is used and orders are processed according to price and time priorities. Market participants enter orders continuously to the computer system and eventually the best price orders and volumes are matched by the system.

There are different markets for normal orders and small orders. Classification of orders is done according to their nominal values or volumes. An outright purchase or sales order that has a nominal value up to 10 billion TL. and a repo or reverse repo orders that has a nominal value up to 100 billion TL. are both traded in the small orders market. Larger orders that have more nominal values than small ones are traded in the normal orders market.

3.1.2.3. INTERNATIONAL MARKET

This is a market within ISE for foreign debt securities, debt securities issued by Turkish Republic and its Local Administrations and for depository receipts of foreign equities of corporations and of mutual fund and investment trust participation certificates.

This market operates in the ISE International Securities Free Zone, which is a tax-free environment. In other words, all proceeds that individual and institutional investors earn are tax-exempt, and there are no restrictions for repatriation of these proceeds. All trading, settlement operations and the payments that investors receive from securities are denominated in U.S. dollars or in other currencies accepted by the ISE Executive Council. Besides, investors receive the yield in US dollars or again in other currencies accepted by ISE Executive Council.

The ISE IM Depository Receipts Market, the ISE IM International Bonds and Bills Market and the ISE IM Foreign Mutual Funds Market are the three submarkets of the International Market.

Foreign shares are traded in ISE IM Depository Receipts Market. There are main or parallel markets. Main market is for shares that can satisfy the requirements of ISE IM Listing.

Debt securities are traded on the ISE IM International Bonds and Bills Market. While intermediary institutions and banks can operate the outright sales and purchases transactions, only banks can operate the transactions of repo and reverse-repo.

Lastly, ISE IM Foreign Mutual Funds Market is the market where the shares of foreign mutual funds are traded.

There are important opportunities for both domestic and foreign individual and institutional investors and foreign issuers in this market. Firstly, by investing in this market investors can eliminate operational risks such as cash transfer and currency restrictions. The tax-exemption is another important advantage.

3.1.3. PERFORMANCE OF ISE

Istanbul Stock Exchange is rather a new organization, about 12 years old. However, it is one of the fastest growing secondary markets in the world. It has advanced a lot in terms of legal, technological, structural and functional aspects since it was founded in 1986. It has a very dynamic structure and exhibits promising progresses for the future.

ISE bears most of the mutual features of other emerging markets, that is, relatively high volatility, informational inefficiency, thinness and etc. Some studies investigated the efficiency in ISE. In one of these studies it is found that ISE is not informational efficient in the weak form by using the data of forty-five corporations listed on ISE from January 1, 1988 to December 31, 1994[1]. However, in the other study

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[1] Murat Kıyılar, *Etkin Pazar Kuramı ve Etkin Pazar Kuramının İMKB' de İrdelenmesi-Test Edilmesi*. Sermaye Piyasası Kurulu, Ankara, 1997.

where the efficiency in ISE is analyzed on a year to year basis and found out that up to 1990 the market was inefficient, but from 1991 onwards the market became efficient. It is also emphasized that improved liquidity, better quality of information and more educated investors, which are resulted by the measures taken by the exchange lead to this change[2]. I think ISE is going to gain more efficiency after the new law. Protection of investors, dematerilization and new measures against fraudelent activities are some of the main subjects.

ISE could not achieve to broaden the capital in Turkey because the number of domestic individual and institutional investors is very low. According to the statistics of ISE, there are about 500000 investors in ISE. This is really a very small number.

Other features of ISE regarding the performance are studied below in terms of liquidity, market capitalization, returns and the initial public offerings. Some comparisons with other stock exchanges are done by using the statistical information in Appendix 6 and 7 where the stock exchanges are ranked according to their various features in 1996 and 1997.

3.1.3.1. LIQUIDITY

Figures indicate considerable progresses in liquidity. Total trading volume in stock market has considerably increased between 1986- 1997 and reached US $ 58.104 million in 1997 from US $ 13 million in 1986. The share of its trading volume in that of all emerging markets had an increasing trend during the years and reached 4,93 % in 1995 and ended up with 2,19 % at the end of 1997. The figures about the traded number of stocks and number of contracts have also increasing trend. The turnover ratio rose at a very fast rate till 1995 and amounted to 129,7 in 1997.

[2] Nuray Kondak, *The Efficient Market Hypothesis Revised: Some Evidence from Istanbul Stock Exchange*, Capital Markets Board, Ankara, 1997.

With these figures, ISE ranked as the third and the seventh most liquid market in the world respectively in 1996 and in 1997 in term of turnover ratio. However, it ranked the twenty-third in 1996 and the twentieth in 1997 in the total value traded .

Table 3-2: Figures About Liquidity of ISE Stock Market

Year	Trading Volume		Number of Shares Traded (Total)	Number of Contracts Traded (Total)	Turnover Ratio (%)
	Total (US$ milion)	Share in the Emerging Markets (%)			
1986	13	–	3.273	–	1,23
1987	118	0,07	14.731	–	3,31
1988	115	0,02	31.679	112.076	7,28
1989	773	0,07	238.056	246.798	11,17
1990	5.854	0,65	1.537.387	765.836	27,72
1991	8.502	1,39	4.531.153	1.446.218	44,90
1992	8.567	1,29	10.285.263	1.681.529	66,50
1993	21.771	2,11	35.249.007	2.815.496	46,79
1994	23.203	1,30	100.062.057	5.085.181	77,80
1995	52.357	4,93	306.253.743	11.667.063	187,74
1996	37.737	2,32	390.917.238	12.446.347	92,74
1997	58.104	2,19	919.783.736	17.639.332	129,70

Source: ISE Annual Factbook, 1997; CMB Monthly Bulletin, June 1998;
IFC Factbook, 1997-98

Beside the stock market, liquidity in bonds and bills market has significantly risen in dollar. Table 3-3 and 3-4 show the figures about the liquidity of outright purchases and sales market and repo-reverse repo market. These two markets have become very liquid.

Table 3-3: Outright Purchases and Sales Market

Year	Trading Volume (US $ Million)		Nominal Value (US $ Million)		Number of Contracts Traded	
	Total	Daily Av.	Total	Daily Av.	Total	Daily Av.
1991	312	2,29	356	2,62	578	4
1992	2.406	9,59	2.841	11,32	7.031	28
1993	10.727	43,61	13.959	56,74	28.937	118
1994	8.832	34,91	11.166	44,13	37.091	147
1995	16.510	65,51	22.864	90,73	45.453	180
1996	32.737	129,91	47.145	187,08	80.058	318
1997	35.472	140,76	62.125	246,53	88.953	353

Source: ISE Annual Factbook, 1997

Total trading volume on the Bonds and Bills Outright Purchases and Sales Market reached US $ 35472 million in 1997 from US $ 312 million in 1991. Daily trading volume rose to a level of US $ 140,76 million at the end of 1997. Repo- Reverse

Table 3-4: Repo-Reverse Repo Market

Year	Trading Volume (US $ Million)		Number of Contracts Traded	
	Total	Av. Daily	Total	Av.Daily
1993	4.794	22,4	4.847	23
1994	23.704	93,69	25.601	101
1995	123.254	489,1	62.861	249
1996	221.405	878,59	109.862	436
1997	374.384	1485,65	181.628	721

Source: ISE Annual Factbook. 1997

Repo Market has exhibited also an increasing trend in liquidity and its trading volume increased to US $ 374.384 million in 1997.

3.1.3.2. RETURNS

We can get a general idea of capital gains and losses from price indices in the stock market. National-100 index has been calculated since the foundation of ISE. Calculation of National Financials and Industrial Indices began in January 1991. Lastly, in 1996 National- All Shares, National-30, National Services began to be calculated.

Table 3-5: Daily closing Values of Price Indices (US $ Based)

Year	National 100		National 30 (12/27/96=976)	National All Shares (12/27/96=534)	National Industrials (12/31/90=643)	National Services (12/27/96=572)	National Financials (12/31/90=643)
	(Jan.1986=100)	% Change					
1986	132	32,00	–	–	–	–	–
1987	385	191,67	–	–	–	–	–
1988	120	-68,83	–	–	–	–	–
1989	561	367,50	–	–	–	–	–
1990	643	14,62	–	–	643	–	643
1991	501	-22,08	–	–	570	–	385
1992	273	-45,51	–	–	335	–	166
1993	833	205,13	–	–	898	–	773
1994	413	-50,42	–	–	462	–	348
1995	383	-7,26	–	–	442	–	287
1996	534	39,43	534	534	572	572	500
1997	982	83,90	1155	940	757	1022	1287

Source: ISE Annual Factbook, 1997

National-100 index has shown great fluctuations. While the index rose at very high rates in 1987, 1989, 1993 and 1997, it decreased very sharply in some other years such as 1988, 1992 and 1994. In 1993 investors witnessed 205 % in dollar; however, the next year index declined 50 %. This indicates that ISE is a very risky market. On the other hand, investors have been able to gain high returns.

National-30 Index exhibited higher increase in 1997 in comparison with the other indices. National-Financial Index increased at a higher rate than National-Industrial and National-Services Indices during 1997 and it offered higher returns than National-Industrial did in long run (from 1990 to 1997).

The rank of ISE among the other stock exchanges in the world change dramatically every year when returns are taken into account. Some year it is near the top, some it is very close to the bottom. The impact of adverse price movements on the overall performance of the ISE is mirrored in the erratic track record shown below[3]:

- ISE ranked first in the world in 1987.
- ISE was placed at the bottom of the list in the world in 1988
- In 1989, ISE won the title of highest yielding stock market in the world.
- In 1991, the ISE finished the year as the world's third worst performing stock exchange.
- In 1992, the ISE dropped to the position of second biggest losing marketplace in the world.
- In 1993, the ISE bounced back, becoming the world's star performer behind Poland.
- In 1994, ISE was world's second worst performing stock exchange.
- In 1995 ISE was in the middle ranks.

ISE ranked twelfth in 1996 and the fourth in 1997.

[3]IFC Factbook, 1996 cited in Abdullah Yıldırım, *Fortune Made, Fortune Lost: The Saga of the Istanbul Stock Exchange*, Intermedia, Istanbul, July 1996, p.39.

3.1.3.3. CAPITALIZATION AND THE NUMBER OF COMPANIES TRADING

Total market values of the companies traded on ISE has exhibited important progresses. It increased 66 fold from 1986. It fluctuated in some years due to the changes in the prices. However, it has continued to increase with the listings of companies in the stock exchange.

Table 3-6: Total Market Capitalization

Year	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
Market Cap. (US $ million)	938	3.125	1.128	6.756	18.737	15.564	9.922	37.824	21.785	20.782	30.797	61.879
Share in the Emerging Markets (%)	_	0,97	0,23	0,91	3,10	1,82	1,09	2,29	1,13	1,08	1,35	2,74

Source: ISE Annual Factbook, 1997; IFC Factbook, 1997-98

Its share in the total capitalization of emerging markets increased from 0,97 % to 2,74 % in ten years. However, its market capitalization is very low in comparison with the developed and even with many of the emerging markets. In 1996, ISE was the thirty-seventh in the world rankings in term of market capitalization. In 1997, it rose to the twenty-ninth due to the new companies in the market and the high increase in the stock prices. The other aspect is that only about 25% of total capitalization is being traded in the stock market. Therefore, ISE is not deep enough when considered the total capitalization and free-floating value.

ISE began to operate with 80 corporations in 1986. At the end of 1997, this number increased to 258. There are seven companies in the regional market. Two companies in the new company market and five companies in the watch list market are traded. Inspite of the high potential of Turkey, there are not enough corporations in the market. Turkey ranked twenty-ninth in the rankings in terms of number of corporation

Table 3-7: Number of Companies Traded on ISE Market

Year	National Market	Reg. Market	New Comp, Market	Watch List Comp. Market	Total			
					During Year		End of Year	Share in the Emerging Markets
					New Entry	Delistings		
1986	80	–	–	–	–	–	80	–
1987	82	–	–	–	–	–	82	0,44
1988	79	–	–	–	–	–	79	0,43
1989	76	–	–	–	–	–	76	0,41
1990	110	–	–	–	35	10	110	0,85
1991	134	–	–	–	24	–	134	0,99
1992	145	–	–	–	13	2	145	1,00
1993	160	–	–	–	17	2	160	0,99
1994	176	–	–	–	25	9	176	1,00
1995	193	12	–	–	30	1	205	1,02
1996	213	11	1	3	25	2	228	1,03
1997	244	7	2	5	31	1	258	1,29

Source:ISE Annual Factbook, 1997; IFC Factbook, 1997-98

listed, just behind Iran and Czech Republic in 1997. However, there is an increasing trend in the market and corporations are recognizing the benefits of being traded on ISE. Its share in emerging markets has been increasing.

3.1.3.4. INITIAL PUBLIC OFFERINGS

The number of companies and the total market capitalization have increased due to the initial offerings. ISE has contributed to the financing of corporations by enabling them to enter the market by the initial public offerings.

Table 3-8: Public Offerings Between 1990-1997

Year	Number of Companies	Nominal Value (Thausands US $)	Amount Sold (Thausands US $)
1990	35	125.136	985.311
1991	24	77.477	391.627
1992	13	15.171	94.424
1993	16	18.130	152.447
1994	25	24.419	270.480
1995	29	44.440	246.783
1996	27	34.626	167.922
1997	29	66.091	420.377

Source: ISE Annual Factbook, 1997

3.2. INTERNATIONAL DIMENSION OF ISTANBUL STOCK EXCHANGE

3.2.1.FINANCIAL LIBERALIZATION POLICIES IN TURKEY AND THEIR EFFECTS ON THE INTERNATIONALIZATION OF ISE

Financial liberalization in Turkish economy has been implemented as a part of the new economic program, which began to be applied in 1980. This program was needed since two stabilization programs in 1978 and 1979 were not successful. Firstly, it was thought as temporary stabilization measures. However it became a long-term permanent policy which aimed the determination of prices and allocation of resources by the market forces.

Financial liberalization and liberalization of capital movements are two of the important outcomes of the policy begun in 1980 by the program. Turkey witnessed many structural adjustments in the financial sector.

Until the end of 1980s, state authorities were controlling the interest rates. This was known as ceiling policy. By this policy, it was aimed to supply cheap funds to the industry and decrease inflationary pressure by decreasing cost of capital. Therefore, real interest rates were negative or very low before 1980s. Individuals were being affected negatively from this policy. Many of them were investing their surplus funds in inefficient fields. Besides, this policy resulted in inefficiency in the economic structure. Because funds were very cheap, many inefficient, noncompetitive firms were founded in those years. In July 1980, time deposit rates were freed, but the banks began to determine the interest rate low by gentlemen agreements. However, interest rates increased in mid-1981 due to the competition arising from bankers and small banks. Then, Turkey faced financial crises in 1981 and 1982 because of the bankers who could not manage the money they collected and failed to carry out their obligations. After these events, nine banks were assigned to determine the deposit interest rates. At the end, Central Bank of Turkey became the responsible body for determining the interest rate of deposits in 1983. Deposit interest rates were controlled till 1988.

Another major change was made in the foreign exchange rate regime in 1980s. Before 1980, stabilized exchange rate system was being implemented. In this system exchange rates were kept fixed. During the implementation of this system, Turkish Lira was extremely appreciated according to its real value. Therefore, second exchange rate was formed in the black market. As a part of the stabilization program, it was decided to determine the exchange rates each month. Firstly, the value of Turkish Lira was devaluated. Then, foreign exchange rates began to be adjusted each day on July 1, 1981.

Thus, the difference between the official value and the black market value of Turkish Lira decreased. However, it was still not allowed for the individuals and institutions except some commercial banks to have foreign currencies. Exchange regime was liberated on July 7, 1984 and residents in Turkey have been allowed to carry foreign currencies and open foreign currency account.

Regulations in 1984 had contributions to the liberalization of capital movements. However, major adjustments for the liberalization of capital movements and foreign exchange rate regime came in 1989 with the Decree No. 32 Regarding the Protection of the Value of Turkish Currency and with the Decree amending Decree No. 32 in 1990. It became free to import and send foreign and Turkish currency abroad for residents and non-residents of Turkey. Besides, capital inflow and outflow became free to a very large extent.

Many developments in capital market came also in 1980s. Enactment of Capital Market Law (CML) in 1981, establishment of Capital Market Board (CMB) in 1982, application of CML to secondary markets in 1983 and the foundation of ISE in 1985 are the major developments.

New instruments were introduced to the market in these years. Some of the regulations pertaining the new financial instruments are as follows:

- Issuance of corporate bonds was regulated again in 1980.
- Government began to issue Revenue Sharing Certificates (RSC) in 1984 and Foreign Exchange Indexed Bonds (FEIB) in 1986.
- Corporations were allowed to issue commercial paper in 1987.Development banks have had the same right since 1986.
- Regulations for the operations of repo/ reverse repo and the issuance of asset back securities came in 1992.

Internal and external liberalization prepared the background for the internationalization of ISE. We can see this easily especially after the regulations in

1989 and acceptation of the convertibility of Turkish Lira. Our capital market became accessible for the foreign investors and issuers. Besides, securities of Turkish firms can now be traded in the foreign markets.[4]

3.2.2.LEGAL ASPECT

ISE is one of the most open markets for foreigners in the world. Liberalization policies beginning after 1980 have caused many amendments in regulations as well as new regulations that internationalize Turkish capital markets and ISE.

Internationalization of ISE has been promoted mainly by the enactment of Decree No.32 Regarding the Protection of the Value of Turkish Currency. By this law, it became free to take Turkish and foreign securities and other capital market instruments in and out of Turkey. Besides, it allowed non-residents to buy and sell securities in Turkey. Therefore, foreign investments in ISE initiated in 1989 with the enactment of this decree.

However, before studying the legal frame in detail, I think we should understand who non-residents are. In daily life the word "foreigners" is generally used instead of non-residents. According to Decree No.32 non-residents are the real persons and legal entities not considered as residents of Turkey. Therefore, we should first learn the definition of residents to understand who the non-residents are. Again in the same degree, residents of Turkey are defined as the real persons and legal entities who reside in Turkey including the workers, members of independent profession and independent businessmen and those residing in Turkey for more than 6 months permanently within one calendar year with the intent of settlement (the real persons and legal entities among non-residents those open branches or establish a company or participate to a company in Turkey, through capital allocation according to Turkish Republic Laws, are pertaining only to those activities regarded as residing in Turkey).

[4] See Appendix 1, 2, 3, 4 and 5 to compare the openness of Turkish capital market in 1987 and 1997. The list of ISE traded companies whose depository receipts\ shares are traded abroad is in Appendix 8.

Foreign institutional and individual investors do not face any restrictions not only when investing in securities traded on ISE but also when repatriating capital and profits due to the liberal regulations in Turkey. In the Article 15 of Decree No.32 it is stated that it is free for non-residents (including mutual funds and investment companies abroad) to buy and sell all securities and other capital market instruments through intermediary companies and banks authorized according to the Capital Market Legislation and to transfer the income and the sales proceeds from such instruments and other capital market securities, through banks and special finance institutions[5].

As mentioned above, non-residents are allowed to do transactions through intermediaries, for it can be important to know how much they invest and where they invest. Therefore, the banks and brokerage houses inform Treasury and Foreign Trade Undersecretariat about the transactions of residents and non-residents every three months [6]. Besides, banks, special financial institutions and brokerage houses inform Central Bank according to its instructions [7].

Non-residents are also allowed to issue, sell and introduce securities to the public in Turkey. According to the Article 15-c of Decree No.32, issue, public introduction and sale of securities and other capital market instruments are realized by

non-residents within the framework of the provisions of the Capital Market Legislation, that is, Capital Market Board is the responsible organization to make necessary regulations. CMB made the necessary regulations by Communiqué (III/20) on Principles Regarding Registration with the Board and Sale of Foreign Capital Market Instruments which was published in the Official Gazette on March 20,1996. By this regulation the followings are regulated:

[5] In the Article 3 of Capital Markets Law, other capital market instruments are defined as instruments which are not securities and which have terms (conditions) determined by the Board. Cash and cheques, bills of exchange, bond and certificate of deposits are excluded.
[6] Circular of Central Bank Regarding Decree No.32, Article28.
[7] Communiqué of Undersecretariat of Treasury Regarding Decree No.32, Article 28.

a) Initial Public Offering of Foreign Capital Markets Instruments: Non-resident joint-stock companies and investment trusts as described in the Decree- by-law No.32, and that issue capital market instruments according to the regulations of the country of residence can make initial public offering. They can offer securities that are traded on exchanges in countries where they are issued; and other instruments that represent claims and rights and besides participication certificates of mutual funds that are established abroad and which are approved by the Board as having similar characteristics to domestic mutual funds to the public. However, public offering of foreign stocks in Turkey can only be performed by means of depository receipts.

b) Public offering of foreign capital market instruments by their holdings: It is possible to offer foreign capital market instruments to the public by their holdings. It should be mentioned that these foreign capital market instruments must be the same ones that are described above.

c) Public offering of depository receipts: Depository receipts can be issued for any foreign security under the conditions of obeying the communiqué, but foreign stocks can only be offered to public by depository receipts.

d) Private placement of foreign capital market instruments and depository receipts: In the article 19 of communiqué, it is mentioned that private placements of foreign capital market instruments are subject to registration with the Board. Thus, private placement has been accepted as an exception of public offering and it is permitted.

According to Article 3, foreign capital market instruments and depository receipts subject to the transactions mentioned above shall be registered with the Board.

In the light of these regulations, International Market is established within ISE in order to enable non-residents to obtain funds through the primary market of ISE and create a secondary market for their securities by having them traded. Applications for admittance began on July 1, 1996. In this market depository receipts of foreign equities, depository receipts of mutual funds, and foreign debt securities can be traded. Applications for equities and foreign debt securities can be made in order to have them sold in the primary market as well as to have second listing on ISE. During the sale of securities in the primary market, issuers or sellers are also allowed to place some amount of securities privately to local or foreign investor groups.[8]

Turkish Laws also allow foreign institutions to operate in Turkish capital markets. There are foreign intermediaries or intermediaries with foreign shareholders (banks and brokerage houses) operating as the members of ISE. There are various regulations. However, regulations of Decree No.32 can give us a general idea. In the Article of 12 of Decree 32, it is stated that it is free for the non-residents to establish a company, to participate in a new or existing company, to make investment by opening a branch and to engage in all activities aiming production of all kind of goods and service and opening liaison office provided that the necessary permission is obtained pursuant to the Law of Encouragement of Foreign Capital No.6224 and operations are carried out within the framework of permission granted and the required capital is brought to the country. Besides, according to the same article the conclusion by the residents with the non-residents off agreements concerning license, know-how, technical assistance and management is free, provided that the necessary permission is obtained according to Law No.6224. In the Communiqué of Treasury Undersecretariat regarding Decree No.32 and Circular of Central Bank there are similar regulations. In the same regulations, the transfer of profits that are earned from commercial activities are permitted through banks and special financial institutions after tax, charge and other similar obligations are deducted.

The other point that should be mentioned is that Decree No.32 enabled residents of Turkey to issue, introduce and sell securities and other capital market instruments abroad (Article 15-c). Besides, according to the Article residents can purchase and sell securities traded on foreign financial markets abroad through banks, special financial

[8] *Sermaye Piyasası ve Borsa Temel Bilgiler Kılavuzu*, 1997, p.393.

institutions and intermediary companies authorized according to the Capital Market Legislation and to have their purchase value transferred abroad through banks and special financial institutions. This regulation has important impacts on the internationalization of ISE. Because residents can compare relative benefits of foreign and domestic markets and invest in any market where they benefit more. Thus, ISE is not the only market that they can invest. Therefore, ISE has been operating in an international environment in this respect. Besides, Turkish companies listed on ISE have been enabled to sell their securities abroad and to have international recognition.

3.2.3. FOREIGN SECURITIES TRADED ON ISE

Foreign securities are traded on ISE within the international market. Currently there are only two foreign listings in this market. This is not an adequate number, but the number is expected to increase.

The only listing of the parallel market of the ISE IM Depository Receipts Market is from a Kazakh company, JSC Kazkommertsbank, which is the largest bank of its country.

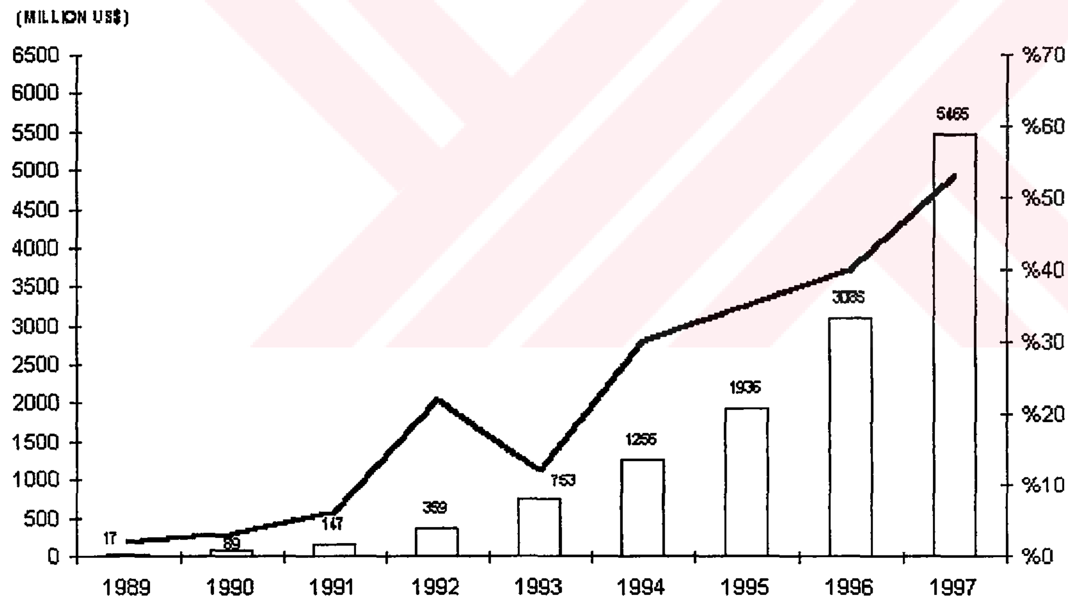
Epic Mutual Funds SA is the only listing of ISE IM Foreign Mutual Funds Market. American Express listed its entire Epic Mutual Funds range, some 15 funds on November 1997.

3.2.4. FOREIGN INVESTMENTS ON ISE

As Decree No.32 passed in August 1989, foreigners began to invest in the securities listed on ISE in 1989. The bar chart in Figure 3-2 shows the amount of foreign investments in ISE, and the line chart shows the share of foreign investors in the total free-floating capitalization.

The increasing share of foreign equity investments in the total amount of equity traded shows the high concern of foreigners to the Turkish market. While it was less than 5 % in 1989, it added up to 50 % in 1997. Although it decreased between 1992 and 1993, it had an increasing trend then. Foreign investments on ISE began in 1989 with US $17 million, and the amount of foreign investments has continuously increased and reached US $ 5765 million at the end of 1997.

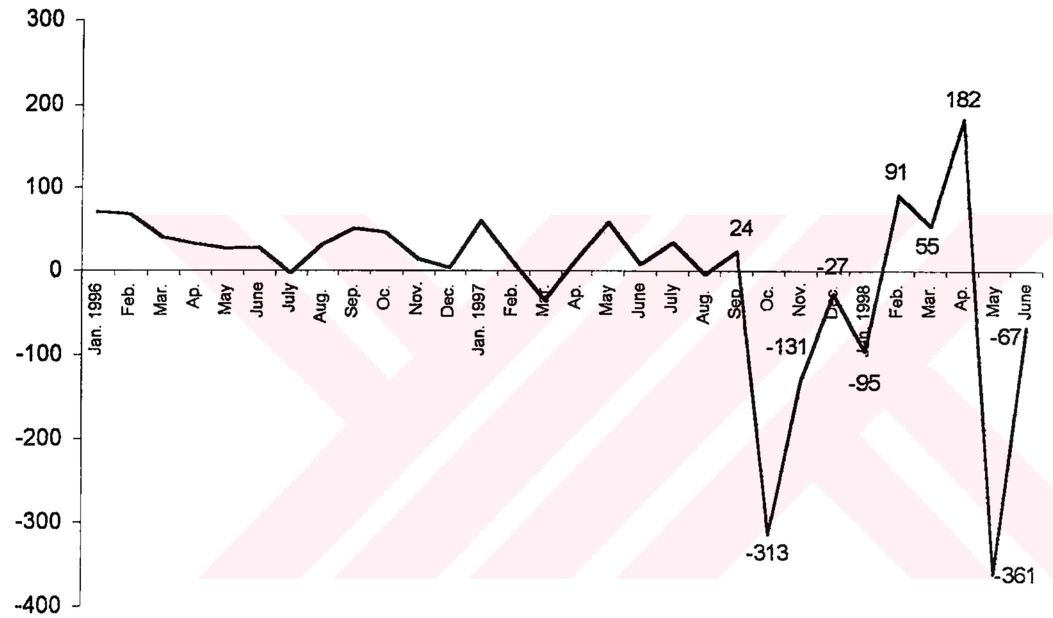
Figure 3- 2: Net Equity Investments by Foreign Investors



Source: Portfolio Investments, ISE, www.ise.org

The amount of foreign net investments has had a volatile trend since the crisis in the South East Asian countries. Their investment increased during 1996 and till October 1997. However, although the trend in Turkey was positive, in October foreigners accounted for US $ 313 million net sales. This was because they wanted to realize some earnings in Turkey to offset their losses in the South East Asian markets. The trend turned upward in February with an amount of US $ 91 million net purchase and continued till May. Their net sale was US $ 361 million in May and US $ 67 million in June.

Figure 3-3: Net Equity Purchases of Foreigners (January 1996- June 1998)(US $ million)



Source: ISE, Various Reports

3.2.4.1. INVESTMENT ATTITUDES OF FOREIGN INVESTORS

The majority of foreign investments in Turkey are from institutional investors. They have experience in investing in security markets and they have been investing in various countries. Therefore, they know how to benefit from the market.

The term of their investments differs from local investors. Foreigners generally take a long-term view. Table 3-9 depicts the figures about the foreign investments. Their long-term view can be better understood by assessing these figures. Their share in total purchases and sales were respectively 5 % and 3,9 % in 1996 when the portfolio held by them was 50,08 % of total, that is, they have had a very small contribution to the turnover of the stocks in comparison with the Turkish investors who hold the other half of the stocks in the market. Their long- term position in ISE continued in 1997 and 1998.

Table 3-9: Share of Foreign Investors in Total Purchases, Sales and their Holding Amount in the Total Free Floating Capitalization(%)

Year/ Month	Purchases	Sales	Holdings*
1996	5,00	3,90	50,08
1997	7,40	7,90	48,63
1998	8,20	8,70	49,60
9801	5,90	7,50	45,16
9802	9,40	7,80	49,74
9803	9,10	8,10	51,98
9804	11,30	8,90	53,00
9805	5,70	9,80	49,75
9806	8,20	9,10	49,60

* When calculating this ratio, it is assumed that 20 % of total capitalization is free floating

Source: ISE Various Reports

Yet there are clear signs that foreign fund managers and investors have been persuaded by the opportunity for quick and unprecedented profits to modify their investment perspective in the Turkish market. This has meant going for shorter-term choices and realizing profits so that, to some extent they have began to adapt the style of the local investors[9].

Their investment timing has been generally distinct from the local investors. Their strategy is to hold their portfolios or even to add more shares to their portfolios when prices fall and to sell the shares when the prices rise. In other words, in bearish markets they enlarge their portfolios by purchasing shares with cheap prices because they know that negative trend will not continue and the prices will increase again;

[9] YILDIRIM, op.cit ,p.69.

however in bullish markets they reduce their portfolios to realize earnings and purchase shares with cheaper prices later. Thus, they have managed to increase their earnings with this strategy even when Turkish investors suffer from losses. In conclusion, they have usually made right decisions. ISE National-100 dollar based index declined 83,5 % during 1992. On the other hand, we witnessed 205 % increase in dollar in 1993. In such a market environment, foreigners preferred to increase their portfolios in 1992 and reduce their portfolios in 1993. They proved good at timing during this period. They bought shares with cheap prices in 1992 and sold with high prices in 1993.As shown in Figure 3-2, the share of foreign investment in the free-floating capitalization increased during 1992, in contrast declined in 1993 when there was a boom in the stock market. In the 94 crisis, they followed the same strategy and increased their portfolios in contrast to the local investors. In that crisis, local investors panicked, but for foreign investors this was a similar situation that they had encountered in some other markets before.

A further significant difference between the foreign and local ISE investors is that non-residents differentiate between intermediaries that trade and those that provide depository and custody services. In this manner, they ensure dual verification of their trades, reducing risks. The fact that overseas banks are generally favored as depository institutions implied that foreigners suffered no losses from the collapse of brokerage houses in 1994 crisis[10]. Thus, they managed to protect themselves from high intermediary risk in Turkey. Unlike local investors, they did not have important problems when some banks and brokerage houses collapsed in 1994.

3.2.4.2.OPPORTUNITIES THAT ISE OFFER TO THE FOREIGN INVESTORS

Forces promoting foreign investors to add Turkish securities in their portfolios are relatively high returns and low correlation between Turkey and the other emerging and developed markets, which enable them to diversify their portfolios.

[10] YILDIRIM. ibid. p.70.

Table 3-10 on page sixty-three shows some figures about the emerging and three major developed markets from December 1992 to December 1997. IFCI Price Indexes used in the table are prepared by taking into account the stocks that can be bought by foreign investors. US and UK markets have annualized mean of respectively 16,68 % and 14,28 % which means that US investors earned 16,68 % average return by investing in U.S markets and English investors earned 14,28 % average return in this five year period. However, investors lost 0,12 % annually in Japanese markets. The annual change in Turkey was 47,52 % which made Turkey second in terms of return for foreign investors after Poland with 56,76 % annual increase. With this annual mean, Turkey surpassed all the Latin American, Asian and the other emerging markets except Poland in the world. Also in a year to year basis investors earned unheard returns in ISE as it is mentioned when the performance of ISE is studied in previous part. Therefore, ISE is very attractive for foreign investors because it offers higher returns than most of the other emerging markets and developed markets.

Annual standard deviations can be used to measure the risk of investing in the markets. ISE had been one of the most risky markets as well. It is the second risky market again after Poland when the standard deviations are taken into account. However, return/ risk ratio reveals that ISE had been worth investing but for the high risk because it has a return/ risk ratio of 0,78 which is higher than those in many other emerging markets.

From the standpoint of investors in developed countries, it is logical to invest in Turkey because Turkey has low correlations with their markets and the other emerging markets where they are investing. The correlations between ISE and markets in US, UK and Japan are respectively 0,06, 0,06 and –0,04. Therefore, foreign investors can reduce their portfolio risk by adding Turkish securities to their portfolios. Besides, as many institutional investors have investments in emerging markets, low or negative correlations between Turkey and other emerging markets will enable them to diversify their international portfolio by investing in Turkey as well.

Table 3-10 : Statistics of the IFCI Price Indexes (US $; December 1992- December 1997)

Markets		Annulized Mean	An. Standard Deviation	Return/ Risk	Correlation with Turkey
Latin American	Argentina	17,88	30,55	0,59	0,09
	Brazil	34,08	38,04	0,90	0,19
	Chile	11,28	23,56	0,48	0,06
	Colombia	16,20	24,63	0,66	-0,14
	Mexico	10,20	36,41	0,28	0,12
	Peru	21,00	32,67	0,64	0,00
	Venezuela	25,32	51,58	0,49	0,12
East Asia	China	-4,32	38,56	-0,11	0,13
	Korea	-22,56	30,87	-0,73	0,06
	Philiphines	2,52	35,16	0,07	0,21
	Taiwan	19,44	38,07	0,51	0,08
South Asia	India	1,80	29,34	0,06	0,13
	Indonesia	-3,12	37,83	-0,08	0,22
	Malaysia	-5,64	33,64	-0,17	0,21
	Pakistan	9,96	34,57	0,29	0,15
	Sri Lanka	7,56	30,38	0,25	0,10
	Thailand	-23,40	39,46	-0,59	0,08
Europe/ Mideast/ Africa	Czech Republic	-24,24	26,19	-0,93	0,18
	Egypt	-19,08	17,36	-1,10	0,14
	Greece	12,72	23,11	0,55	0,24
	Hungary	33,00	48,25	0,68	0,21
	Israel	21,96	22,10	0,99	0,53
	Jordan	12,84	14,62	0,88	0,08
	Morocco	24,12	21,48	1,12	-0,35
	Poland	56,76	71,05	0,80	0,13
	Portugal	22,08	19,47	1,13	0,20
	Russia	38,64	50,02	0,77	0,37
	South Africa	14,28	22,59	0,63	0,13
	Slovakia	-12,00	23,35	-0,51	0,34
	Turkey	47,52	60,66	0,78	1,00
	Zimbabwe	29,04	40,36	0,72	-0,17
Developed Markets	US, S&P 500	16,68	10,70	1,56	0,06
	UK, FT 100	14,28	12,44	1,15	0,06
	Japan, Nikkei	-0,12	23,94	-0,01	-0,04

Source: IFC Factbook, 1998

Foreign investors are also offered by ISE to invest in one of the safest markets in the world in terms of investment risk. ISE ranked near or at the top in the Global Securities Consulting (GSCS) Benchmarks indexes, which indicate the aggregate level of operational efficiency in security markets post-trade for the institutional investors.

Settlement benchmark compares the settlement efficiency of different markets in terms of the overall cost of failed trades to the market participants. The efficiency of different markets in terms of collection of dividends and interest, reclamation of excess withheld taxes, and protection of rights in the corporate actions is compared by the safekeeping benchmark. Operational risk benchmark is calculated by taking into consideration the settlement and safekeeping benchmark. However, It takes into consideration some other factors as well, that is, other operational factors such as the level of compliance with the recommendations of the Group of Thirty; complexity and efficiency of the regulatory and legal structure such as constraints on capital flows, foreign investment restrictions, and market supervision; counterparty risk and force majeure risk.[11]

Turkey ranked second in 1995, third in 1996 and finally first in 1997 among all the other emerging markets in terms of settlement efficiency. Turkey performed also well in settlement efficiency and operational efficiency. It ranked first and second respectively in settlement and operational benchmarks in 1997. The table regarding the GSCS Benchmark indexes is in the appendix.

3.2.4.3.TAXATION

There are different practices for taxation of foreigners with respect to their status. Taxation of foreign funds and trusts differ from the other foreign institutions.

Foreign financial intermediaries (banks and brokerage houses) who trade on their own accounts are subject to a 44 % corporation tax on the sale of securities and

[11] IFC Factbook. 1998. pp. 340-341.

collection of dividends. Local brokers are responsible for collecting and declaring within 15 days this corporation tax.[12]

Domestic funds and trusts are granted tax-exempt. Foreign funds and trusts are treated like domestic ones in taxation if they have a permanent representation in Turkey. Thus, they are granted exemption from corporate tax. Otherwise, they are subject to 44 % corporate tax. There are two alternatives for the taxation of capital gains for the funds and trusts that have a permanent representation.

- Capital gains are tax-exempt if at least 25 % of their investments in Turkey are in equities and if they trade through the ISE members. These funds do not pay tax for the dividends as well.
- They are subject to 11 % withholding tax if at least 25 % of their investments in Turkey are not in equities.

Capital gains from the disposal of the unlisted securities are also tax-exempt for these funds and trusts if they held for more than a year. Individual foreign investors are not subject to any tax due to dividends or capital gains from disposal of equities.

For foreign individual investors and corporations, tax rate for all kinds of bills, government bonds, revenue sharing certificates and other securities issued by the Privatization Administration Agency are as follows[13]:

- 0 % if issued before November 1, 1996
- 11 % if issued after November 1, 1996
- 13,2 % if issued after January 1, 1997

Tax rate for corporate bonds and commercial paper issued after January 1, 1997 is 13,2 %.

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[12] Taxation Regulations, ISE, www.ise.org.
[13] Taxation Regulations, www.ise.org.

3.2.5. FOREIGN INSTITUTIONS

The members of the ISE consist of both domestic and foreign banks and brokerage houses. Seven foreign banks that were established in Turkey and six foreign banks that have branches in Turkey are operating as members of ISE. There are ten brokerage houses with foreign partners. Some of them were established by foreign banks in order to execute in the stock market.

The approximate amount of their transactions is TL 1.431.000.000 million in stock market, TL 1.807.000.000 million in outright purchases and sales market and TL 5.700.000 million in repo-reverse repo market. Detail figures are available in Appendix 10.

In conclusion, ISE has been an open market for foreigners in terms of investing, having their securities traded and lastly operating as members of the ISE.

3.2.6.INTERNATIONAL RECOGNITIONS AND MEMBERSHIPS

International recognitions and memberships need providing some requirements. Thus, markets that qualify these requirements are recognized or accepted as a member by international organizations and gain confidence in the international markets.

ISE was accepted as a member of many international organizations after its rapid progresses. The ISE has been a full member of International Federation of Stock Exchanges (FBIV) since September 1992. Being a member of FBIV is important for ISE because it is accepted that ISE have sufficient institutional and legal basis. Other memberships of ISE are as follows[14]:

- Federation of Euro-Asian Stock Exchanges (FEAS)
- International Securities Services Association (ISSA)

[14] See International Recognitions and Memberships. ISE , www.ise.org for further information about these organizations.

- International Securities Market Association (ISMA)
- European Capital Market Institute (ECMI)
- World Economic Forum (WEF)
- Swiss Commodities, Futures and Options Association (SCFOA)

Of these organizations FEAS is the one which was established at the initiative of the ISE on May 16, 1995. Currently, there are 19 member exchange representing 6938 traded companies with a market capitalization of over 170 billion US dollars an average daily value of over 360 US dollars as of December 1997[15]. It is a beneficial step for regional globalization among member exchanges.

ISE won some recognitions as well. In October 1993, the ISE was recognized by US Securities and Exchange Commission (SEC) as "a Designated Offshore Securities Market". ISE is the twenty-first overseas exchange recognized by SEC. On May 9, 1995 ISE was identified as "an appropriate foreign investment market for the private and institutional Japanese investors" by the Japanese Securities Dealers Association (JSDA)

ISE Settlement and Custody Bank (TAKASBANK) was also recognized by some organizations such as SEC in 1995, Japan Securities Clearing Corporations (JSCC) in 1995, Japan Securities Depository Center (JASDEC) in 1995 and the Securities Futures Authority (SFA) in 1996. Besides, TAKASBANK is a member of Association of National Numbering Agencies (ANNA) and ISSA.

3.2.7.IMPACTS OF INTERNATIONALIZATION ON ISE

As a developing country, Turkey has a low saving ratio in comparison with developed countries. Besides, these low savings are demanded by the governments with high interest rates to finance the huge budget deficits. Thus, government securities constitute the largest share of all securities outstanding. Attractive government securities

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[15] Federation of Euro-Asian Stock Exchanges. Year Book. 1997. p.2.

are usually preferable against other investment alternatives. Moreover, Turkey has some macroeconomic problems that have had impacts on the ISE. Turkish people have suffered from high inflation rates for a very long time. Due to the high inflation rates people got used to investing their surplus funds inefficiently. For example, holding foreign currency, purchasing gold or real estate became common ways of hedging against inflation.

Proper capital market functioning began in Turkey in 1980s and only 12 years passed since ISE was established. The ISE is one of the youngest emerging markets. Turkish people have not yet understood the opportunities of investing in ISE. ISE has usually been thought as a gambling place and many people with surplus funds have preferred not to play[16] there. However, since ISE offered very high returns in the first years of its establishment, it attracted the concerns of many individual investors. There was said to be one million investors in ISE in those years. High concerns of investors continued till the collapse of some brokerage houses and banks in 1994 crisis. Many individual investors lost their money in that crisis and ISE lost confidence of Turkish people. Beside the small number of individual investors, ISE has not had enough institutional investors that invest in large amounts of money for long term and manage their portfolios professionally. Therefore, the duration of investment in ISE has always been short. Individuals usually try to gain speculative returns in short term. Therefore, both the turnover and the volatility of the exchange have been high during years. Furthermore, there were legal shortcomings. However, new legal measures were implemented in the market after the crisis and we hope some more new measures are going to pass in the Parliament soon.

ISE has shown great progresses in terms of liquidity, capitalization, technology, legal basis and internationalization. Internationalization of ISE began in 1989 and has had many contributions. Firstly, foreign investments are very important because ISE lacks necessary demand. Foreign investors have increased the demand in the secondary

[16] Actually, play is a wrong term. However, I wanted to emphasize that people consider the ISE as a place that enables them to earn high returns by chance rather than as a place to invest.

market of ISE. Their investment amount has increased during the years. As the demand in the secondary market encourages new public offerings in the primary markets, they help corporations to find capital in the primary markets by supplying demand in the secondary market. Besides, they have been very active in the primary market during the initial public offerings.

Their investment attitude differs from local investors. As studied previously, their investment view is usually long-term. They have very low share in total turnover in comparison with local investors. Thus, they have stabilization effect against high volatility. They have had contributions to the stabilization of the prices by also acting in reverse of local investors. Since foreigner began to invest in 1989, they have generally acted distinctly from local investors. Moreover, they offset the lack of local institutional investors aiming long-term investments.

ISE has attracted foreign investors, and foreign investment ended up to considerable amounts. However, there are not adequate number of foreign securities traded on ISE.

3.3. ISE IN MORE LIBERAL WORLD 2000s

Deregulation and financial liberalization has become the common trend in the capital markets. It was initiated by developed countries and then followed by the developing countries. Turkey has externally liberated its markets widely in 1989. Thus, ISE began to receive foreign investments just three years after its foundation. Currently, it is one of the most liberal markets in the world for externalities. Foreigners can take place in any field in capital market operations. They can invest in securities traded on ISE, have their securities traded and run financial intermediaries. Therefore, we can conclude that ISE went far away from many of the markets in terms of liberalization.

Developments in European capital markets are also of great importance for Turkish markets. After the Custom Union between Turkey and European Community, the financial integration is thought to follow. Stock exchanges in Europe agreed to integrate by harmonizing their regulations and by linking stock exchanges with electronic systems. Therefore, some measures will be needed to harmonize Turkish regulations about capital markets with the European regulations. European investors will not need to hedge their portfolios against currency risk when they invest in European Community because of application of mutual currency in the member countries. Therefore, a derivative market, which will enable foreigners to hedge against currency risk in Turkey, will increase the foreign investments from Europe and other countries. Besides, the settlement period in Turkey is T+ 2, but it is generally T+3 in most of the countries in the world. It is shorter in Turkey because inflation and interest rates are very high. However, same settlement period with other markets will promote foreign investments. A financial integration with Europe enables foreign intermediaries to operate within ISE freely. Therefore, the competition will increase and Turkish financial intermediaries will need to strengthen their capital structure because their income from commission will decrease and the risk that they encounter will increase because they will need to operate within European stock exchanges.

ISE has a high potential for the future. Private sector in Turkey is very strong. All big and small and medium sized companies are the important candidates for new listings. However, companies hesitate to enter the market for several reasons. Firstly, the magnitude of black economy is very high in Turkey. Research, even by official sources, shows that the black economy had grown to at least 40 % of recorded economic value. In reality, therefore market capitalization is lower than mere appearances suggest.[17] The other reason is that they do not have sufficient information about the capital markets and the advantages that the listing on ISE offers. In family-owned companies owners are afraid of losing the control on the companies. ISE is trying to inform corporations by talking with the owners and managers of the corporations and presenting seminars in

[17] YILDIRIM, op.cit, p. 59.

various part of the country. Privatization of public-owned companies provided considerable amount of supply to the ISE.

The high potential of ISE comes also from the demand side. Turkish investors are not still accustomed to be investing in ISE. There are only about 500000 investors in Turkey. Like the corporations, Turkish people do not know much about stock exchanges. Individuals can be encouraged to invest through institutional investors as in developed countries. The number of institutional investors is growing. For example, the number of mutual funds amounted to 156 in 1997. Of these 156 mutual funds, 72 of them are Type A funds, which invest minimum 25 % of its funds in shares. However, the institutional investors have not formed adequate demand in the market yet. Therefore, Turkish stock market needs sufficient number of institutional investors, which invest for long run and manage their portfolios professionally. Social security reform which will entitle to use the funds of social security institutions in securities market can cause demand boom and broaden the shareholderbase. Currently, the funds that are collected by these institutions are used in inefficient fields and most of them are used by the governments.

ISE has many advantages against the other emerging markets. ISE and TAKASBANK have had all computerized systems. The trading takes place in an open and very transparent environment. It is one of the most accessible and liquid markets and the settlement and custodian systems are very efficient and secure. Therefore, it is also a very strong candidate to become a regional center with its structure.

In conclusion, Turkey has a high growth rate. Corporations in Turkey are operating with high earnings ratio in comparison with many developed countries. Therefore, ISE has high potential to exhibit with more demand from local and foreign institutional investors and supply from new companies with higher shares of publicly owned stocks. It will benefit from the strengths of the country and mature soon.

CONCLUSION AND SUGGESTIONS

Globalization in any field has become the driving force in this century. Financial markets adapted to this market environment almost the fastest. International capital movements have become very mobile. Developments in telecommunication and computer technology, deregulation and financial liberalization policies have enabled foreign participants to be aware of opportunities in any part of the world and to participate in various markets. Therefore, markets are subject to tough competition.

Stock exchanges are the crucial organizations in the new global world. They offer attractive opportunities by their secure, transparent, and liquid environment. Exchanges in emerging markets have increased their importance in the last decades. Many developing countries liberalized their regulations and moved the barriers for foreigners.

Istanbul Stock Exchange, which is the only stock exchange in Turkey, is one of the emerging markets in the world. It had almost all the features of emerging markets such as high volatility, short-term investment, a limited number of investors, low capitalization and less integration with the economy when began to operate in 1986. However, it has exhibited very rapid developments and proved a promising market for future.

Since it was established, Turkey has had many structural problems. Turkish people have suffered from high inflation for a very long time. They have searched for ways of hedging their savings. They have preferred some inefficient ways instead of investing in ISE because they did not know much about ISE. High interest rates as well as inflation in Turkey have hindered owners of surplus funds from investing in ISE. In addition to macroeconomic problems, Turkey has a high risk due to its geographic area. During the Gulf crisis, we felt this by the decline in ISE. However problems have not arisen only outside factors. ISE had some structural problems as well. It was not supervised well for some years. During these years, manipulation and insider trading were very common. Many small investors were fired by these activities. Besides, in 1994 crisis many small investors lost their money due to the collapse of some banks and some brokerage houses that executed their transactions. Therefore, stock exchange lost the confidence of investors. The number of investors decreased from 1.000.000 to about 250.000 in a very short time in those years. After these experiences, many new measures have been implemented to provide a more secure market, and it succeeded much. In such an environment described above, ISE has not exhibited its potential performance.

ISE has had foreign members since its foundation. However, it gained international dimension mostly with the first foreign investments in 1989. Then the international market, which enables foreigners to have their securities traded, initiated. The potential of ISE has attracted the concerns of foreigners, and their share in total investable amount has increased to over 50 % some time. Foreign investments have been crucial for ISE as it lacks adequate institutional investors and demand from local people. Foreign investors offset the less demand of local investors. Besides, they participate in many initial public offerings. Thus, they make contributions to the financing of corporations by these two ways. As foreign investors are usually institutional investors, they invest for long term and they do not generally try to gain returns by short-term speculative buying and selling. It is also less likely that foreign investors involve in manipulation on ISE. They play as stabilizer by also acting generally in reverse of local investors. Their investment altitude is distinct from local investors'. For example, in 1994 crisis when almost all the local investors panicked and tried to sell the shares they have, foreign investors purchased more shares and waited. On the other hand, they had acted reversely and sold stocks in 1993 when the prices became very high. On the other hand, still we can not call ISE a fully international market. Because securities traded on ISE are dominated by Turkish securities and only the depository receipts of a Kazach Bank and a foreign mutual fund are traded.

Although opening of ISE to foreign participants has brought many benefits, we witnessed some disadvantages as well. After the crisis in South Asian Countries, foreign investors began to sell a part of their shares in ISE because they wanted to offset some of their losses in other countries. This trend has had a great impact on

ISE. Because they hold half, sometimes more than half of the shares free-floating, they can influence the prices deeply. The index is now lower than it was last year. It is talked in the markets that index will have upper trend when the foreigners begin to come back to ISE. Thus, the trend in the market is determined by the foreigners. However, this is not so in developed markets. They are also influenced by the changes in the markets out of their countries, but the trend in their market is not so dependent to foreigners.

Now there are about 500.000 Turkish investors in Turkey. This is really a very small number of investors in comparison with other markets; for example, there are fifty million investors in the US, usually through funds. Attracting local people to the market should be achieved by institutional investors such as mutual funds and investment trusts. The market will benefit from their long-term investment view and stabilizing effects. However, currently neither mutual funds nor investment companies are offering attractive returns to the investors in Turkey. Besides, they usually act similarly with the market, so they do not help the market to stabilize the volatility. The reforms to the social security system can result a boom in the demand of ISE because there is a large amount of funds in this system. Thus, the shareholder base can be broadened and the funds can be managed professionally. By this way, high demand in the market will form and corporations will be keen on being listed on ISE. Currently, ISE does not have sufficient depth. However, corporations are recognizing the benefits of listing on ISE and the number of companies is increasing.

ISE is one of the most important candidates to become a regional center. It is a very liberal market, which permits foreigners to trade, to have their securities traded and to operate as members of ISE. Besides, it has a high potential in its market with a high growth rate, many candidate listings and domestic investors. When it can exhibit its real potential with its domestic participants, it will also attract foreign participants and reduce negative effects of globalization.

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APPENDICES

Appendix 1: Witholding Taxes for US-Based Institutional Investors
(Percentage Rates in Effect at the End of 1987)

Region	Country	Interest (%)	Dividends (%)	Long-Term Capital Gains on Listed Shares(%)
Latin America	Argentina	15,75	17,5	45
	Brazil	25	15	none
	Chile	35	40 (2)(5)	40 (3)
	Colombia	40	20	15
	Mexico	21	55 (5)	none (1)
	Venezuela	15	none (1)	none
Europe, Middle East	Greece	none	42 (5)	none
	Jordan	none	none	none
	Portugal	15	12	none
	Turkey	10	25	none
Africa	Cote D'ivoire	18	12	none
	Kenya	12,5	7,5	11
	Morocco	22	15	none
	Nigeria	40	15	20
	Zimbabwe	10	20	30
Asia	India (6)	25	25	40
	Indonesia	20	20	none
	Korea (4)	12,9	16,125	none
	Malaysia	20(0%)	40(0%)	none
	Pakistan	55	15	none
	Philippines	15	25	0,25 (7)
	Taiwan, China (8)	20	20	none
	Thailand	15(10%)	25(10%)	10

(Rates in brackets apply only to Country Funds, where these are different from normal treatment)

(1) Rates apply only to shares of publicly controlled companies (SAICA).

(2) None if reinvested;40 % withheld otherwise (with offsetting 10 % tax credit).

(3) Gains above inflation.

(4) Rates under tax treaty with the United States.

(5) Unlike the other countries listed, Mexico, Greece and Chile have no corporate profit tax on distributed earnings.

(6) Rate for Non-Resident Indian Portfolio Investors; rates on foreign direct investment are higher.

(7) Rate applies to gross sale proceeds.

(8) Available only to investors in approved investment vehicles.

Source: IFC Factbook, 1988

*Appendix 2: Entering and Existing Emerging Markets, Investment Restrictions**
(At Year-End 1987)

Entry	Country	Repatriation of Income	Repatriation of Capital
Free Entry	Malaysia	Free	Free
	Portugal	Some Restrictions	Free
	Kenya	Restricted	Some Restrictions
	Phillippines	Some Restrictions	Only after 3 months
	Jordan	Free	Free
Relatively Free Entry	Thailand	Some Restrictions	Some Restrictions
	Chile	Some Restrictions	Only after 5 years
	Argentina	Restricted	Only after 3 years
	Colombia	Some Restrictions	Free
	Mexico	Some Restrictions	Some Restrictions
Restricted to Specia Funds	Brazil	Free	Only after 3 months
	Korea	Free	Only on Fund liquidation
	Taiwan, China	Once per year	Free
	India	Free	Free
Restricted by Investor Nationality	India- Non residents Indians Only	Free	Free
	Pakistan-Non-Resident Pakistanis Only	Only after 1 year	Only after 1 year
	Greece	Free to EEC Nationals	Free to EEC Nationals
Restricted by Shares	Zimbabwe- only shares not already quoted on foreign markets	Restricted	Only after 2 years, with other restrictions
	Venezuela- only shares held by non- residents or shares arising from new issues or capital increases	Restricted	Restricted
Closed or Severely Restricted	Nigeria	Access not contemplated in current laws	
	Indonesia	Access not contemplated in current laws	
	Turkey	Allowed upon SPO authorization	

Key
Income= dividends, interest, and realized capital gains
Some restrictions= Typically, requires registration with or permission of Central Bank, Ministry of Finance or an Office of Exchange Controls.
Free= Repatriation done routinely

* It should be also be noted that some industries in some countries are considered strategic and are not available to foreign/ non-resident investors, and that the level of foreign investment in other cases may be limited by national laws or corporate policy to minority positions not to aggregate more than 49 % of voting

Source: IFC Factbook, 1988

Appendix3: Investment Regulations Summary for Entering and Exiting Emerging Markets (as of end-1997)

Entry Are listed stocks freely available to foreign investors?	*Exit* Repatriation of Income	Capital
Free Entry		
Argentina	Free	Free
Bangladesh	Free	Free
Botswana	Free	Free
Brazil	Free	Free
Costa Rica	Free	Free
Cote d'Ivoire	Free	Free
Croatia	Free	Free
Czech Republic	Free	Free
Ecuador	Free	Free
Egypt	Free	Free
Ghana	Free	Free
Greece	Free	Free
Hungary	Free	Free
Jordan	Free	Free
Malaysia	Free	Free
Mexico	Free	Free
Namibia	Free	Free
Oman	Free	Free
Pakistan	Free	Free
Panama	Free	Free
Peru	Free	Free
Poland	Free	Free
Portugal	Free	Free
South Africa	Free	Free
Turkey	*Free*	*Free*
Zambia	Free	Free
Relatively Free Entry		
Chile	Free	After1 Year
Indonesia	Some Restrictions	Some Restrictions
Jamaica	Free	Free
Kenya	Free	Free
Korea	Free	Free
Lithuania	Free	Free
Sri Lanka	Some Restrictions	Some Restrictions
Thailand	Free	Free
Trinidad & Tobago	Free	Free
Venezuela	Some Restrictions	Some Restrictions
Zimbabwe	Free	Free

Source: IFC Factbook, 1998

Entry Are listed stocks freely available to foreign investors?	*Exit* Repatriation of Income	Capital
Special Clases of Shares		
China	Free	Free
Philippines	Free	Free
Authorized Investors Only		
Colombia	Free	Free
India	Free	Free
Taiwan, China	Some Restrictions	Some Restrictions
Closed		
Slovekia	Restrictions	Restrictions

Key to Entry
Free Entry: No significant restrictions to purchasing stocks
Relatively Free Entry: Some restriction procedures required to ensure repatriation rights, or significant limits on foreign ownership.
Special Classes: Foreigners restricted to certain classes of stocks, designated for foreign investors.
Authorized Investors Only: Only approved foreign investors may buy stocks.
Closed: closed, or access severely restricted (e.g., for non-resident nationals only).

Key to Exit
Repatriation of income: Dividends, interest, and realized capital gains.
Repatriation of capital: Initial capital invested.
Some Restrictions: Typically, requires some registration with or permission of Central Bank, Ministry of Finance, or An Office of Exchange Controls that may restrict the timing of exchange release.
Free: Repatriation done routinely

Notes:
Some industries in some countries are considered strategic and are not available to foreign or non-resident investors. The level of foreign investment in other cases may be limited by national law of corporate policy to minority positions, not to aggregate more than 49 % of voting stock. The summaries above refer to "new money" investment by foreign institutions. Other regulations may apply to capital invested through debt conversion schemes or other sources.

Appendix 4 : Foreign Investment Ceiling for Listed Stocks in Emerging Markets (covered by IFO Indexes as of end- 1997)

Markets	
Latin America	
Argenfina	100% in general
Brazil	49% common stocks; 100% preferred stocks; 0% for bank ordinary shares
Chile	100% in general
Colombia	100% in general
Ecuador	100% in general
Jamaica	100% in general
Mexico	100% in general
Peru	100% in general
Trinidad & Tobago	30% in general
Venezueja	100% in general
East Asia	
China	100% only for B- and H-class shares
Korea	55% in general; 25% for KEPCO & POSCO; 33% for SKTelecom
Philippines	40% in general; 30% for banks
Taiwan, China	30% in general
South Asia	
Bangladesh	100% in general
India	24% in general
Indonesia	100% in general; 49% banks, 85% for securities companies
Malaysia	100% in general
Pakistan	100% in general
Sri Lanka	100% in general; 49% for banks
Thailand	10%- 49% depending on company by-laws

Markets	
EuropelMideast/Atrica	
Botswana	49% of free float
Bulgaria	100% in generall; banks need central bank approval
Cote d'Ivoire	100% in general
Czech Republic	100% in general; banks need central bank approval
Egypt	100% in general
Ghana	74% in general
Greece	100% in general;
Hungary	100% in general; above 10%, banks need central bank approval
Isreal	100% in general
Jordan	100% in general; 50% for construction, retail trade, & mining sectors
Kenya	40% in locally controlled companies
Lithuania	100% in general
Mauritius	100% in general; 15% for sugar companies
Morocco	100% in general
Nigeria	100% in general
Poland	100% in general
Portugal	100% in general
Russia	100% in general
Slovakia	100% in general; banks need central bank approval
Slovenia	Closed to portfolio investors
South Africa	100% in general
Tunisia	49 % in general
Turkey	*100% in general*
Zimbabwe	40 % in general

Source: IFC Factbook, 1998

Appendix 5: Withholding Taxes for Emerging Markets (U.S.-based institutional investors; at year-end 1997)

Market shares	Interest (%)	Dividends(%)	Long-term capital gains on listed shares (0%,)
Argenfina	0	0	0
Bangladesh	0	15	0
Barbados	12.5	12.5	0
Bolivia	12.5	25	0
Botawana	15	15	0
Brazil	15	0	0
Bulgaria	0	30	0
Chile	15	15	35
China	0	20	0
Colombia	7	0	0
Costa Rica	24.5	0	14.8
Cote d'Ivaire	0	10	0
Cyprus	3	20	0
Czech Republic	0	0	0
Ecuador	8	0	0
Egypt	0	0	0
Ghana	0	10	0
Greece	15	0	0
Honduras	10	10	10
Hungary	0	10	10
India	20	20	10
Indonesia	20	20	0
Iran	0	12-54	0
Israel	35	25	0
Jamaica	25	25	0
Jordan	0	10	0
Kenya	10	10	0
Korea	13.2	16,5	0
Latvia	0	10	0
Lithuania	0	0	0
Malaysia	15	0	0
Malta	0	35	0
Mauritius	0	0	0
Mexioo	0	0	0
Morocco	0	10	0

Market	Interest(%)	Dividends(%)	Long-term capital gains on listed(%)
Namibia	0	10	0
Nigeria	10	10	10
Oman	0	0	0
Pakistan	10	10	0
Panama	0	10	0
Paraguay	0	0	0
Peru	0	0	0
Philippines	20	15	0.5
Poland	40	20	0
Portugal	20	17.5	0
Russia	15	15	20
Slovakia	15	15	15
Slovenia	0	15	0
South Africa	0	0	0
Sri Lanka	0	15	0
Swaziland	10	15	0
Taiwan, China	20	35	0
Thailand	15	10	0
Trinidad and Tobago	10	10	0
Tunisia	20	0	0
Turkey	*0*	*0*	*0*
Venezuela	0	0	1
Zambia	15	15	0
Zimbabwe	30	15	10

Notes

Ghana : No withholding tax on dividends for individuals.
Israel : Tax treaties exist with some countries that lower these figures, including the U.S. (17,5 %) and the U.K. (15%).
Korea : Rates are for funds in which U.S. investments total more than 25 %. Tax rates shown include 10 % resident tax applied to base rate.
Poland : No withholding tax on interest for individual
Philippines: Transactions tax in lieu of a capital gains tax.
Tirinidad and Tobago: 15 % tax on dividends for individual.
Venezuela: Transactions tax.

Source: IFC Factbook, 1998

Appendix 6: World Rankings, 1996

Rank	Market Performance (%)		Market Capitalization (US $ Millions)		Number of Listed Domestic Companies		Value Traded (US $ Millions)		Turnover (%)	
1	Bangladesh	196,0	U.S.	8.484.433	India	8.800	U.S.	7.121.487	China	328,6
2	Russia	155,9	Japan	3.088.850	U.S.	8.479	Japan	1.251.998	Taiwan, China	204,1
3	Venezuela	131,8	U.K.	1.740.246	U.K.	2.433	Germany	768.745	Turkey	145,0
4	Hungary	94,6	Germany	670.997	Japan	2.334	U.K.	578.471	Slovakia	135,9
5	China	89,4	France	591.123	Czech Republic	1.588	Taiwan, China	470.193	Germany	123,2
6	Lithuania	82,0	Canada	486.268	Canada	1.265	Switzerland	392.783	Spain	113,1
7	Poland	71,1	Hong Kong	449.381	Australia	1.135	Netherlands	339.500	Korea	110,5
8	Paraguay	59,9	Switzerland	402.104	Slovakia	816	France	277.100	Switzerland	94,0
9	Zimbabwe	59,6	Netherlands	378.721	Pakistan	782	Canada	265.360	U.S.	92,8
10	Nigeria	55,6	Australia	311.988	Korea	760	China	256.008	Netherlands	92,4
11	Iran	52,7	Malaysia	307.179	France	686	Spain	249.128	India	87,6
12	Turkey	42,4	Taiwan, China	273.608	Germany	681	Korea	177.266	Poland	85,5
13	Jamaika	39,8	Italy	258.160	Israel	655	Malaysia	173.568	Slovakia	82,3
14	Egypt	38,8	Sweden	247.217	Egypt	646	Hong Kong	166.419	Norway	70,3
15	Morocco	38,4	Spain	242.779	South Africa	626	Australia	145.482	Malaysia	65,5
16	Spain	36,5	South Africa	241.571	Malaysia	621	Sweden	136.898	Sweden	64,4
17	Costo Rica	36,3	Brazil	216.990	Hong Kong	561	Brazil	112.108	Canada	62,2
18	Taiwan, China	36,1	Singapore	150.215	Brazil	551	India	109.448	Austria	61,8
19	Namibia	36,0	Korea	138.817	China	540	Italy	102.351	Brazil	61,5
20	Sweden	35,4	India	122.605	Lithuania	460	Thailand	44.365	Pakistan	60,8
21	Finland	31,7	Belgium	119.831	Thailand	454	Mexico	43.040	Denmark	54,2
22	Brazil	30,4	China	113.755	Taiwan, China	382	Singapore	42.739	Australia	52,2
23	Hong Kong	28,9	Mexico	106.540	Spain	357	Turkey	36.831	Czech Republic	50,0
24	Ireland	28,8	Thailand	99.828	Chile	283	Norway	35.882	France	49,8
25	Norway	26,8	Indonesia	91.016	Indonesia	253	Denmark	34.667	Hong Kong	44,2
26	Canada	26,4	Philippines	80.649	Italy	244	Indonesia	32.142	Italy	43,8
27	Oman	26,1	Denmark	71.688	Denmark	237	South Africa	27.202	Mexico	43,6
28	Panama	24,9	Chile	65.940	Sri Lanka	235	Belgium	26.120	Hungary	42,8
29	Portugal	24,9	Finland	63.078	Peru	231	Philippines	25.519	Finland	41,8
30	Netherland	24,5	Norway	57.423	Turkey	229	Finland	22.422	Indonesia	40,8
31	U.K.	23,3	Argentina	44.679	Sweden	229	Austria	20.528	Greece	40,2
32	Malaysia	22,9	New Zerland	38.288	Greece	224	New Zerland	9.871	Japan	37,1
33	USA	21,4	Russia	37.230	Singapore	223	Chile	8.460	Thailand	36,8
34	Denmark	20,0	Israel	35.934	Iran	220	Czech Republic	8.431	U.K.	36,8
35	Czech Republic	20,0	Austria	33.953	Netherlands	217	Greece	8.283	Philippines	36,6

Source: IFC Factbook, 1998

Appendix 7: World Rankings, 1997

Rank	Market Performance (%)		Market Capitalization (US $ Millions)		Number of Listed Domestic Companies		Value Traded (US $ Millions)		Turnover (%)	
1	Russia	142,7	U.S.	11.308.779	U.S.	8.851	U.S.	10.216.074	Taiwan, China	462,2
2	Oman	141,7	Japan	2.216.699	India	5.843	Taiwan, China	1.297.474	China	230,9
3	New Zerland	139,1	U.K.	1.996.225	Japan	2.387	Japan	1.251.750	Korea	188,4
4	Turkey	109,9	Germany	825.233	U.K.	2.046	Germany	1.029.152	Spain	169,9
5	Trinidad &Tobago	109,3	Australia	696.656	Canada	1.362	U.K.	829.131	Kuwait	144,9
6	Botswana	99,8	France	674.368	Australia	1.219	Switzerland	494.912	Germany	137,6
7	Ireland	76,6	Switzerland	575.338	Slovakia	872	Hong Kong	489.365	Turkey	129,7
8	Latvia	67,5	Canada	567.635	Pakistan	781	Spain	453.016	Swazailand	126,0
9	Hungary	60,9	Netherland	468.736	Korea	776	France	405.523	Hong Kong	113,4
10	Panama	60,5	Hong Kong	413.323	China	764	China	369.574	Slovakia	108,0
11	Barbados	50,5	Italy	344.665	Malaysia	708	Canada	355.585	Pakistan	106,2
12	Mexico	47,6	Spain	290.383	Germany	700	Australia	310.869	U.S.	103,2
13	Switzerland	46,3	Taiwan, China	287.813	France	683	Netherland	284.869	Switzerland	101,3
14	Portugal	43,6	Sweden	272.730	Hong Kong	658	Brazil	203.260	Brazil	86,0
15	Morocco	37,8	Brazil	255.478	Egypt	650	Italy	198.235	Ireland	83,4
16	Kuwait	36,9	South Africa	232.069	South Africa	642	Sweden	176.172	Oman	79,4
17	Italy	36,0	China	206.366	Israel	640	Korea	170.237	Poland	77,7
18	Greece	33,5	Mexico	156.595	Lithuania	607	Malaysia	147.036	Hungary	75,9
19	China	31,8	Belgium	136.965	Brazil	536	Singapore	63.954	Norway	74,9
20	Australia	31,5	India	128.466	Mongolia	434	Turkey	59.105	Malaysia	73,4
21	U.S.	30,3	Russia	128.207	Thailand	431	India	53.954	Greece	72,5
22	Saudi Arabia	27,9	Singapore	106.317	Taiwan, China	40	Mexico	52.646	Romania	71,7
23	Germany	26,1	Denmark	93.766	Spain	384	Denmark	46.878	Austria	70,7
24	Colombia	24,1	Malaysia	93.608	Singapore	303	Norway	46.421	Indonesia	69,3
25	Denmark	23,4	New Zerland	90.483	Chile	295	South Africa	44.893	Sweden	67,8
26	Venezuela	23,2	Finland	73.322	Indonesia	282	Indonesia	41.650	Canada	67,5
27	Pakistan	22,0	Chile	72.046	Czech Republic	276	Finland	36.368	Netherland	67,2
28	Israel	21,9	Norway	66.503	Iran	263	Kuwait	34.576	Portugal	65,8
29	Spain	21,4	Turkey	61.090	Turkey	257	Belgium	29.713	Italy	65,8
30	Netherland	20,7	Saudi Arabia	59.386	Peru	248	Argentina	25.702	France	64,1
31	Brazil	20,5	Argentina	59.252	Sweden	245	New Zerland	24.648	Denmark	56,7
32	U.K.	19,9	Israel	45.268	Sri Lanka	239	Austria	24.640	Finland	53,3
33	Egypt	18,0	Korea	41.881	Denmark	237	Thailand	23.119	Australia	52,2
34	Argentina	17,3	Portugal	38.954	Italy	235	Greece	21.146	Singapore	49,9
35	Peru	13,9	Austria	35.724	Greece	230	Portugal	20.932	Argentina	49,5

Source: IFC Factbook, 1998

Appendix 8: ISE Traded Companies Whose Depository Receipts/Shares are Traded Abroad

Company	Effective Date	Exchange
AKBANK		London
ALARKO SANAYI VE TICARET AS	December 20, 1995	NASDAQ, OTC
CIMENTO IZMIR FABRIKASI T.A.S.	December 1, 1993	Munich
	December 6, 1993	Munich
DEMIRBANK	October 27, 1994	Munich
EFES SANAYI YATIRIM ORTAKLIGI		London
EGS GAYRIMENKUL YATIRIM ORTAKLIGI	March 18, 1998	London
		NASDAQ
ERCIYES BIRACILIK VE MALT SANAYI A.S.	August 3, 1995	NASDAQ, OTC
	August 3, 1994	SEAQ INT.
KUTAHYA PORSELEN SANAYI A.S.	May 8, 1995	Munich
MARSHAL BOYA VE VERNIK SANAYI A.S.	October 27,1994	Munich
NET HOLDING	June 28, 1990	NASDAQ, OTC
RAKS ELEKTRONIK SANAYI VE TICARET A.S.	February 5, 1996	NASDAQ
SABANCI HOLDING	July 8, 1997	NASDAQ, PORTAL
		SEAQ INT
T. IS BANKASI A.S	May 13,1998	NASDAQ
		SEAQ INT
T. TUBORG BIRA VE MALT SANAYI A.S.	November 1989	Stuttgart
TOFAS TURK OTOMOBIL FAB. A.S.	March 3, 1994	London
		Berlin
		Luxemburg
		NASDAQ, PORTAL
		SEAQ INT
TURKIYE GARANTI BANKASI	November 29, 1993	NASDAQ, PORTAL
	April 4, 1994	NASDAQ, OTC
	February 12, 1996	London
UZEL MAKINA SANAYI A.S.	August 05, 1997	SEAQ INT
		NASDAQ
		London
YAPI KREDI BANKASI A.S.	June 26, 1997	NASDAQ, PORTAL
		SEAQ INT

Source: ISE Traded Companies Whose Depository Receipts/Shares are Traded Abroad,ISE, www.ise.org.tr

Appendix 9: Investment Risk Summary For Entering and Exiting Emerging Markets

Market	Settlement Benchmark			Safekeeping Benchmark			Operational Benchmark		
	1995	1996	1997	1995	1996	1997	1995	1996	1997
Argentina	83,80	83,70	87,90	89,50	88,80	92,13	66,40	66,10	68,95
Brazil	91,00	91,00	87,95	90,40	89,60	91,78	68,70	68,50	67,58
China	–	–	68,33	–	–	90,03	–	–	57,48
Czech Rep.	–	–	65,83	–	–	74,60	–	–	53,10
Greece	51,60	66,90	67,05	87,10	88,30	81,05	54,90	59,80	57,80
Hungary	–	–	17,55	–	–	80,50	–	–	36,35
India	-16,80	-0,70	-1,23	75,00	76,60	76,75	0,00	16,80	23,48
Indonesia	73,30	52,30	45,95	88,40	90,70	89,00	62,60	56,30	53,43
Ireland	–	–	54,48	–	–	90,30	–	–	56,90
Korea	82,70	86,10	90,83	91,00	93,90	90,93	69,20	71,70	72,68
Malaysia	80,80	86,10	91,18	90,80	92,40	91,43	67,20	69,90	71,53
Mexico	75,40	85,80	89,33	91,50	92,20	90,98	64,90	69,70	70,70
Peru	38,00	85,00	90,30	71,90	73,80	82,48	41,30	62,00	67,28
Philippines	51,70	75,60	82,88	73,50	78,20	78,95	45,80	57,20	60,40
Poland	–	–	77,40	–	–	74,35	–	–	56,63
Portugal	83,00	90,00	74,85	92,80	94,40	80,23	70,90	74,50	62,55
South Africa	14,50	1,30	-0,93	92,10	91,00	92,15	34,00	22,40	28,68
Thailand	82,20	82,20	86,93	91,50	91,40	88,05	69,20	69,10	69,73
Turkey	93,10	95,20	95,78	92,20	93,00	92,23	69,70	71,70	71,70
Venezuela	n/a	43,30	18,73	n/a	84,10	81,85	n/a	44,10	31,03

Source: IFC Factbook, 1997-98

Appendix 10: Transactions of Foreign Members of ISE in 1997 (TL million)

	Banks/ Brokerage Houses	Stock Market	Bonds and Bills Market		
			Outright Purchases and Sales Market	Certificates of Real Estate	Repo-Reverse Repo
Investment Banks	BANKER TRUST A.S.	-	96.182.642	-	46.500.000
	INDOSUEZ EURO T. MERCHANT BANK A.S.	-	14.113.568	-	12.437.000
	TAIB YATIRIM A.S.	-	13.932.768	-	49.016.500
Commercial Banks	ABN AMRO BANK N.V.	-	130.256.546	-	132.434.000
	ARAP TURK BANKASI A.S.	-	3.196.683		29.812.000
	BNP-AK BANKASI A.S.	-	33.175.491	-	77.400.000
	CITIBANK N.A.	-	128.459.716	-	390.800.000
	CREDIT LYONNAIS	-	4.150.577	-	-
	MIDLANDBANK A.S.	-	86.170.769	-	202.277.000
	OSMANLI BANKASI A.S.	-	212.817.573	-	1.132.591.000
	SOCIETE GENERALE (SA)	-	181.881.143	-	17.050.000
	THE CHASE MANHATTEN BANK N.A.	-	244.049.038	-	247.933.000
	TURKISH BANK	-	368.039	-	207.563.500
	TURK SAKURA BANK A.S.	-	46.716.320	-	28.469.501
	ULUSAL BANK	-	50.515.877	-	2.202.831.000
	WESTDEUTCHE LANDESBANK AG.	-	484.873.120	-	353.000.000
Brokerage Houses	ABN AMRO H. GOVETT IST MEN. DEG A.S.	101.677.657	4.905.459	-	85.821.500
	ARTI MENKUL DEGERLER	98.122.120	-	-	-
	BANKER TRUST MENKUL DEGERLER	46.953.276	840.882	-	-
	CHASE MANHATTEN YATIRIM A.S.	-	-	-	-
	CITICORP MENKUL KIYMETLER A.S.	10.937.245	-	-	-
	GLOBAL MENKUL DEGERLER	972.742.929	50.352.933	-	354.007.000
	TAIB YATIRIM A.S.	110.711.007	-	-	-
	TAKSIM MENKUL DEGERLER A.S.	41.003.562	35.903	-	-
	TURKISH YATIRIM A.S.	30.272.951	-	-	-
	UB ULUSAL YATIRIM A.S.	18.426.253	20.340.747	-	157.209.500
Total		1.430.847.000	1.807.335.794	-	5.727.152.501

Source: ISE, Annual Factbook, 1997.

Bankalarımız 1997, Türkiye Bankalar Birliği, İstanbul, Mayıs 1998 is used to determine the foreign banks. All the brokerage houses listed above can not be considered as foreign institutions operationing within ISE. Some of them were established by the foreign banks, but some others are included in the table just because foreigners participate in them.