CORPORATE GOVERNANCE AND TRANSPARENCY
AN EXAMINATION OF THE RELATIONSHIP BETWEEN
CORPORATE GOVERNANCE INDEX AND FIRM PERFORMANCE

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ABSTRACT

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Corporate governance is a mechanism that involves management of relationship between parties (e.g. managers, stockholders and stakeholders) by providing regulatory procedures and processes, which are designed for monitoring, directing and controlling of business objectives. In this study, we firstly provide a historical background of corporate governance theory and practice in different jurisdictions over the world. Accordingly, we explain Turkish experience in capital markets where most listed firms are held responsible to comply with corporate governance principles enforced by Capital Markets Board of Turkey. In this regard, we analyze a specific Borsa Istanbul index, i.e. Corporate Governance Index (XKURY), produced to encumber firms that are entitled to be included with respect to their level of corporate governance mechanisms in effect.

In the empirical section, therefore, we try to evaluate the relationship between XKURY and the level of transparency revealed by stock market returns and liquidity in Turkey. We employ event study methodology where the sample includes all companies that had the experience of inclusion to and/or exclusion from XKURY between April 29th, 2013 and November 30th 2017 of which the relevant data is retrieved from Bloomberg. Since, corporate governance brings transparency to the market, which increases efficiency and reduces the possibility of abnormal returns, our first hypothesis is formulated as: *"Inclusion (exclusion) to (from) XKURY decreases (increases) the possibility of abnormal returns/losses in the stock market"*. On the other hand, it is expected that efficiency would increase in the market as an improvement in the stock market liquidity. In order to explore this fact, our second hypothesis is defined as: *"Inclusion (exclusion) to (from) XKURY tightens (widens) abnormal spreads in the stock's market"*. Our empirical findings show that inclusion to XKURY has a limited positive impact on abnormal returns but for most of the time this impact is blurred. However, its negative impact on spreads is highly clear and significant. In other words, spreads are tightening after inclusion. Exclusion from XKURY has a significant and negative impact on abnormal returns, and a positive impact, though insignificant, on spreads, meaning that they are widening, as expected.

Keywords: Corporate Governance, Corporate Governance Index, Liquidity, Abnormal Return, Event Study, Turkey.

ÖZET

KURUMSAL YÖNETİM VE ŞEFFAFLIK: KURUMSAL YÖNETİM ENDEKSİ İLE FİRMA PERFORMANSI ARASINDAKİ İLİŞKİNİN İNCELENMESİ

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Kurumsal yönetim yöneticiler, hissedarlar ve diğer paydaşlar arasındaki ilişkinin işletme faaliyetlerinin gözetimini, idaresini ve kontrolünü sağlayan düzenleyici prosedürler ve süreçler vasıtasıyla yönetimini içeren bir mekanizma olarak tanımlanabilir. Bu çalışmada ilk olarak, kurumsal yönetim teorisinin ve kurumsal yönetimin çeşitli ülke uygulamalarındaki yerinin tarihçesine kısaca yer verilmektedir. Sonrasında ise, Türkiye'de Sermaye Piyasası Kurulu tarafından yürürlüğe konulan kurumsal yönetim ilkelerinin borsa şirketleri nezdindeki uygulamaları irdelenmekte olup, Borsa İstanbul endekslerinden biri olarak hayata geçirilen ve kurumsal yönetim uygulama seviyesi yüksek olan firmaların dahil edildiği Kurumsal Yönetim Endeksi (XKURY) hakkında bilgi verilmektedir.

Bu itibarla, çalışmanın ampirik kısmında, XKURY ile şeffaflık düzeyi arasındaki ilişkinin piyasada oluşan anormal getiriler ve likidite üzerinden değerlendirilmesi amaçlanmıştır. Çalışmada 29.04.2013 ile 30.11.2017 tarihleri arasında XKURY endeksine/endeksinden girişi/çıkışı gerçekleşen tüm firmaların Bloomberg'ten temin edilen verileri olay analizi yöntemiyle incelenmiştir. Kurumsal yönetim, şeffaflık vasıtasıyla, pazar etkinliğini artırmakta ve anormal getirilerin

olasılığını azaltmaktadır. Bu kapsamda, ilk hipotezimiz: *“XKURY endeksine dahil edilmeler (çıkışlar) piyasalardaki anormal getiri olasılığını azaltmaktadır (artırmaktadır)”* şeklinde kurulmuştur. Öte yandan, piyasadaki verimliliğin artmasının bir sonucu olarak hisse likiditesinde de olumlu gelişmeler beklenmektedir. Bu önermenin test edilebilmesini teminen ikinci hipotezimiz ise, *“XKURY endeksine dahil edilmeler (çıkışlar) anormal fiyat aralıklarını sıkılaştırmaktadır (genişletmektedir)”* olarak belirlenmiştir. Ampirik analiz bulguları, XKURY endeksine dahil edilmenin anormal getiriler üzerinde sınırlı olumlu bir etkiye sahip olduğunu ancak bu etkinin zamanla belirsizleştiğine işaret etmektedir. Ancak, endekse dahil edilmenin fiyat aralıklarındaki genişleme üzerindeki olumsuz etkisi oldukça anlamlıdır. Başka bir deyişle, fiyat aralığı genişlemeleri, şirketlerin XKURY endeksine eklenmesinden sonra daralma göstermektedir. XKURY'den çıkarılma durumunun ise, anormal getiriler üzerinde önemli ve olumsuz bir etkiye sahip olduğu saptanmıştır. Bu durum, fiyat aralıklarının genişlemesi üzerinde, anlamlılık seviyesi düşük olsa da, beklendiği gibi pozitif bir etki yaratmaktadır.

Anahtar Kelimeler: Kurumsal Yönetim, Kurumsal Yönetim Endeksi, Likidite, Anormal Getiri, Olay Analizi, Türkiye.

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LIST OF ABBREVIATONS

BIST	: Borsa Istanbul Stock Market
BOD	: Board of Directors
CEO	: Chief Executive Officer
CMB	: Capital Markets Board
CML	: Capital Markets Law
CSRC	: Chinese Securities Regulatory Commission
EVA	: Economic Value Added
GDP	: Gross Domestic Product
HRM	: Human Resources Management
IRS	: Industrial Relations System
ISE	: Istanbul Stock Exchange
KM	: Key Management
LBO	: Leveraged Buy Out
MAR	: Mean Abnormal Returns
MBO	: Management Buy Out
MCAR	: Mean Cumulative Abnormal Return
OECD	: Organization for Economic Co-Operation and Development
OLS	: Ordinary Least Squares
RDT	: Resource Dependency Theory
ROA	: Return on Assets
ROE	: Return on Equity
SEC	: Securities Exchange Commission
SOX	:Sarbanes-Oxley-Act
UK	: United Kingdom
US	: United States
XKURY	: Corporate Governance Index of BIST
WTO	: World Trade Organization

INTRODUCTION

Globalization of the world, alongside with the enlargement of the businesses, has enforced researchers to analyze the subdivisions of a business on a broader perspective. In the complex environment that businesses face today, the researchers must be able to divide the big picture into subsets and as well as relate those subsets with the whole. Competition among businesses increases in an exponential manner. In order to survive, businesses have to realize the importance of efficiency and effectiveness optimization of their procedures. As a part of the organization, managers behaviorally and rationally react to corporate competition in different ways. The act of managers in terms of governing the business, like navigating a ship, may differ in mainly accordance with the attitude, perspective and incentives. In order to be effective and efficient, the conflicts between management, board of directors (BOD), shareholders and stakeholders should be minimized. Mainly the measurement of a business success is being processed by the financial performance. Considering this issue, the governance methods of a business happen to be the center of issue which determines the financial performance measurement.

The subject “governance” includes a broader essence on its origination of its philosophy. The reason for this case is the existence of different applicable methods for the cases which businesses face in the complex global environment. One of the important governance methods is the concept of “Corporate Governance”. Corporate governance concept harmonizes the incentive conflicts and behavior of managers, BOD, stakeholders and shareholders with the financial performance of the businesses. In order to provide effectiveness and efficiency into the businesses, the intention and interest of the managers shall be in line with the investors and creditors. Corporate governance strategies generate a significant effect on optimization on the interest of management.

Management representatives of a business must undertake the responsibility of protecting the rights and interests of shareholders and stakeholders as well as of attaining an adequate level of value maximization of the business. Utilization of effective corporate governance methods generates transparency, equity, commitment and accountability. Implementation of these concepts to the internal management of the businesses by the way of corporate governance strengthens the financial performance. Thus it is worthwhile to implement corporate governance strategies to attain sustainable value enhancement of the businesses.

To determine the efficient measurement on the financial performance of the firm, implementation of transparency is significant in terms of external and internal information symmetry. The dispersion of symmetrical information, i.e. “Internal Transparency”, in the internal processes of the businesses enables the managers, BOD and subordinates to perform in an efficient way. On the other hand, applying internal transparency methods provides accountability amongst the performing wheels of a business. The second subject matter “External Transparency” sustains an efficient and effective financial performance to the businesses by ensuring rendering significant benefits. Information symmetry is an important condition generated through external transparency. By means of symmetric distribution of information shares in the stock market are efficiently priced. Alongside with this fact, it is possible for a business to measure and reflect the financial performance in a high level of accuracy. Efficient pricing of the stocks is attained by the symmetric distribution of information through the public, which shows the financial performance of the firm in a truthful sense. In addition, it is feasible to minimize the conflicts between managers versus stockholders (agency conflicts). The main reasons for the agency conflicts are the deprivation of the feasible information set for stockholders and the interests and the incentives of the managers. With the effect of external transparency, it is feasible to synchronize the information and interest of managers and stockholders. The details on the subject of transparency will be discussed through further parts of the thesis.

Globalization of the world has enabled financial markets and economies to expand in many different directions. In liberalized economies the inner and outer regulatory bodies of the enlarged global businesses have failed to cope with increasing amounts of managerial and financial problems. Thus the businesses of the global world have been forced to deal with various scandals in recent history. The subject matter of “corporate governance” gained a relative importance after the investigation and solution processes of the financial and corporation scandals. Corporate governance methods appoint the businesses with relatively beneficial objectives on the management and financial performance. The key specialties appointed to the business by corporate governance; transparency, equity, commitment and accountability hold a significant role on sustaining a proper management and an efficient& effective financial performance.

This study focuses on research of the corporate governance mechanisms and its effects on Turkish businesses which are traded in the Borsa Istanbul. In this respect, we evaluate the relationship between Borsa Istanbul Corporate Governance Index (XKURY) and the level of transparency revealed by stock market returns and liquidity in Turkey by means of an event study analysis. We aim at understanding the subject of “Corporate Governance” as a big picture and dissolve it into pieces to understand the subsets of the subject.

The thesis considers corporate governance by understanding historical development, supporting theories, application of corporate governance practices across the globe, corporate governance practices in Turkey, literature review of the research and actual research with results and conclusion. Through the thesis the subject matter was divided into five chapters. Chapter I presents the relevant information on history of corporate governance and relevant theories which supports the ideology within subject matter are considered, Chapter II includes information on the applications of corporate governance practices across globe and divides the concept into regions, Chapter III includes the brief history and application of corporate governance practices in Turkey, Chapter IV includes the literature review, empirical analysis and our findings. The thesis is concluded in Chapter V.

CHAPTER I

CORPORATE GOVERNANCE

1.1. Brief History of Corporate Governance

It is difficult to determine a precise historical background of corporate governance, given that it holds a broad subject area to be discussed. The formation of corporations has enforced the separation of management and the shareholders. At a point, incentive conflicts between management and investors have started the discussion of "Corporate Governance". A statement to identify the historical estimate for the time when corporate governance emerged as a subject has been described by Cheffins as: *"The history of corporate governance correspondingly extends back at least to the formation of the East India Company, the Hudson's Bay Company, the Levant Company and the other major chartered companies launched in the 16th and 17th centuries."* (Cheffins B. R., 2012). With referencing to the statement, the subject of "Corporate Governance" has been a point of discussion to the businesses for centuries. On the other hand, it has been a subject for consideration in the academic literature in mid 1970's.

In the period before the exponential development of industrialization and technology, most of the sectors were mainly existed in the form of state-owned enterprises and family businesses. After the effect of modernization, the types of businesses, corporate policies and the economic environment have changed. Through this transformation process, asset price inflations and stock market crashes were two inevitable tragic results of the underdeveloped capital markets of the leading economies. Corporations have attained an important force on determination of the economic development and the living standards of the nations.

The term “Corporate Governance” evolved after the rapid growth in technology and the distortions in the volatile economy of leading countries of the world on the recovery and development period of post-World War II. Corporate governance term has been used in the academic literature for the first time by Richard Eels (1960) to express the “structure and functioning of corporate policy” (Braendle, Apreda, & Kostyuk, 2007). A systematic method of rules, regulations, processes and operations was needed in order to direct, monitor and control the corporations to reduce their dominance over the economies. Hence the regulatory organizations and agencies have commenced to develop methods in order to organize and regulate the structure and functioning of corporate policies.

The investors, taxpayers, corporations and governments have realized the importance of corporate governance to secure their information symmetry. As a result, in order to sustain feasible corporate governance methods, the debates on policy methods have accelerated. A statement on the development of corporate governance is being described as; *“The history of corporate governance, like other historical processes, is path dependent.”* (Morck & Steier, 2005). Corporate governance is a method which has developed with respect to the means of thesis and anti-thesis process of the policies that have been implemented in the past.

The stockholders (investors) are important actors which determine the capital structure and the upper management of the corporations. A statement to explain the awareness of shareholders on corporate governance could be given as; *“Shareholders, or more accurately institutional shareholders, would in fact become during the 1980s increasingly logical contenders to play a major corporate governance role.”* (Cheffins B. R., 2012). After the influential financial disruptions in the corporations and as well as economies, shareholders have started to play as a major actor to gain monitoring and control power in the corporations. A brief statement of investor attitudes states that; *“In short, investors demand transparency and accountability in return for their capital. They would be foolish to demand anything less. Countries and companies around the world have found that the best way to attract much-needed global capital is to meet those demands”* (Monks & Minow, 2004).

With the globalization of countries and corporations, the demand of investors to securitize their return on investment by the application of corporate governance methods became inevitable. Thus, to satisfy the mandatory needs of investors in corporations regarding accountability, transparency and sustainability, application of corporate governance methods have started acting as an intermediary.

Taxpayers and the governments are also important actors which are being affected from the dysfunctions and distresses in the financial system. The demand of taxpayers from the government is to create the necessary laws, regulations and institutions to enforce the corporations to operate in the means of accountability, responsibility and reliability. Information symmetry and trust in financial markets and government leads to a sustainable economy and an efficient financial development. Thus, in order to provide a sustainable growth in the economy, it is necessary to regulate the financial markets. Alongside with corporate governance, it could be stated that financial development proceeds as a result of “path dependent” or “history dependent” ways. The historical process of financial development is being explained as; *“... high-quality institutions cause financial development. In turn, financial development is a driving force behind economic growth. The historical legacy seems to play an important role in the relationship between the financial development of countries, their current institutions and their past institutions.”* (Carsten & Deelof, 2011). The financial development of the economies follows a historical pattern of trial and error. The regulation and deregulation cycle enables the regulatory institutions and corporations to develop better corporate governance methods. Through the recent history the governments have implemented various laws, regulations and formed institutions which directs and monitors the financial actions of corporations.

“Besides spurring productivity improvements, the rise of equity-based pay--particularly the explosion of stock options--and the run-up in stock prices in the late ’90s created incentives for the shortsighted and at times illegal managerial behavior that has attracted so much criticism.” (Holmstorm & Kaplan, 2003). The radical increase in the interest conflicts between agents and investors were tried to be solved by giving importance on equity based payment methods. Rather than aiming at

increasing the value of the firm, agents have acted for their own benefits. To prevent the illegal agency behavior and as well as to decrease agency conflicts there has been several crucial acts which have appeared after early 90's. Important acts and reports on corporate governance are: "The Cadbury Report (1992 UK); Organization for Economic Co-Operation and Development (OECD) 1999, 2004 and 2015; Sarbanes-Oxley-Act (SOX) of 2002 and Public Company Accounting Reform and Investor Protection Act…". Effective corporate governance methods were tried to be implemented into the economies with the increasing number of actions around the world. The organized actions of the governmental and non-governmental institutions on corporate governance have constituted the ethical and legal governance of corporations and development of economies.

In conclusion, corporate governance is a method which has been under a continuous development as a result of the events that happens through different periods of time. There exist key factors which enforced the ideology on the formation of each corporate governance method that has been implemented. Considering this issue 5 essential conditions which have been provided to the public after the reforms on corporate governance could be listed as; (1) Rights and equitable treatment of shareholders, (2) Interests of other stakeholders, (3) Role and responsibilities of the board, (4) Integrity and ethical behavior, and (5) Disclosure and transparency. These conditions generate trust, integrity and fairness in both the economies and the corporations. Origin of corporate governance relies on these main conditions which needs to be provided and the historical process of the financial cases through the different intervals of time.

1.2. Definitions on Corporate Governance

There exist various different definitions for corporate governance in the literature. The formation of the concept "Corporate Governance" started with the definition of Cadbury Committee's report on "The Financial Aspects of Corporate Governance" (Cadbury & Cadbury Report Comittee, 1992). In the report, the definition for corporate governance states that "*Corporate governance is the system by which companies are directed and controlled*". Based on the origin of definition, corporate governance is a system which manages the decision making processes which an organization directs and controls. The simple definition on the origin of corporate governance included the complex set of understanding which would shape the literature of the future.

In the recent history there have been many company scandals which took place in all around the globe. Several examples for the most popular scandals in the history are Waste Management 1998, Enron 2001, WorldCom and Tyco 2002, HealthSouth and Freddie Mac 2003. The existing history of scandals and the increasing number of new scandals have stimulated the regulatory institutions to guide the businesses for better corporate governance mechanisms. In order to prevent future scandals, Organization for Economic Cooperation and Development (OECD) has decided to create and develop regulations, guidelines and tests in 1999 which helps the businesses sustain a stronger corporate governance mechanism. After the revision on the decisions on corporate governance on 2002, OECD has announced their finalized agreements. Three important definitions given by (OECD Statistics Directorate, 2005) and (OECD, 2004) are as follows;

1) Procedures and processes according to which an organization is directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among the different participants in the organization – such as the board, managers, shareholders and other stakeholders – and lays down the rules and procedures for decision-making.

2) Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and its shareholders and should facilitate effective monitoring. [1]

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[1]The source was taken from OECD 2004. Page: 11

3) The corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities.[2]

With referencing to the 1st and 2nd OECD definitions, corporate governance is a mechanism which involves management of relationships between parties (e.g. managers, stockholders and stakeholders) by providing regulatory procedures and processes which are designed for monitoring, directing and controlling of the objectives of a business. On the 3rd definition of OECD, the importance of corporate governance on transparency to create efficient markets has been stated. By combining all of the knowledge given by OECD, it could be concluded that effective corporate governance mechanisms generate a transparent, stable and an efficient financial markets. Alongside with this, corporate governance helps sustaining a method of monitored operation for the firm which reduces the agency conflicts by synchronizing the company rules and regulations with the objectives.

In each definition of corporate governance, it is possible to capture different aspects of the complex philosophy hidden inside the big picture. The reason for this situation is the existence of a broad feasible set of area of corporate governance. Definitions of 3 different explanations on corporate governance have been discussed as follows.

The first definition considers origination of the term Corporate Governance. The term "govern" has been used to define the management of macro-economy. The reference in the article states that; "*The term "corporate governance" derives from an analogy between the government of cities, nations or states and the governance of corporations.*" (Becht, Bolton, & Roell, 2002). Governance of nations or states requires complex set of regulations, laws and controlling, monitoring and directing bodies. The macro-economic governance of the nations or states is similar to the governance of the corporations. Thus sustaining a corporation would require the necessary processes of governance in order to work systematically.

[2] The source was taken from OECD 2004. Page: 17

In the second definition of corporate governance, the importance of risk and return to the investors has been discussed. In their article, Shleifer and Vishny discusses the definition of corporate governance by stating; *"Corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment"* (Shleifer & Vishny, 1997). The investors demand a return for the risk that they take by supplying finance for the business. According to this definition, corporate governance is a method for investors to reduce the risk of agency conflicts and increase the return on their investments.

The third definition touches upon the area of effect of corporate governance. In the definition which has been taken from an article in Financial Times (1997) it has been stated that: "*Corporate governance - which can be defined narrowly as the relationship of a company to its shareholders or, more broadly, as its relationship to society -…,"* (Fernando & Loyola Centre , 2006). The application of corporate governance mechanisms on the businesses acts as a positive externality for both businesses and societies. A properly governed corporation will have an effect on the financial performance of the firm. The performance indicators will be provided to the public transparently. In conclusion, corporate governance has a comprehensive effect for the businesses and societies.

Overall, the term corporate governance holds a broader meaning than the term management. Corporate governance refers to the regulations and rules for directing, monitoring and controlling the firm in order to secure the shareholder rights, enhance competitive level, attain the optimal capital level standards in the global environment and secure the information transparency and economic growth of the society.

1.3. Actors of Corporate Governance

In the modernized world, different actors holds set of complex roles in assessing the future in financial systems. The subject matter "Corporate Governance" features a variety of relations between different actors within itself. Thus to understand the subject matter of the thesis deeper, it is beneficial to understand the main actors of corporate governance. The actors which play a role on effective corporate governance policies are Governments, Corporations, Board of Directors, Taxpayers, Agents, Auditors, Investors and Regulatory and Legal Bodies and all other parties which carries non-negligible, direct or indirect role on the actions of corporations. The key actors among all of the actors of corporate governance could be defined as; *"In particular, we conceptualize our comparative model for Multi-National Companies (MNC) by drawing on an actor-centered institutional theory perspective, focusing on five key governance actors: Employees, Shareholders, Board of Directors, Top management teams and Governments…"* (Augilera & Yip, 2004). In fact, the key actors of corporate governance are the ones who accommodate an interest in the operations of corporations.

1.3.1. Employees

Employees of a corporation incorporate a direct relation and influence on corporate governance. The share of the employees' influence on the governance of the corporations varies in accordance with the culture, sector, and operational structure and management methods used by the corporations. Employees are the individuals who play a key role on determination of the quality of the services and goods of the corporations. Hence the employees of a corporation hold a considerable amount of impact on the governance corporations. *"Employees mechanisms for influencing firm governance depend on the corporate governance regime in which they operate*" (Augilera & Yip, 2004). Employees generate power to influence on the determination of corporate governance methods with regards to different regimes that a business operates. Thus, by holding such power to effect, employees may influence the corporate governance by their effect on job legislations for working environment and rights, industrial unions and representatives and ultimately by becoming a shareholder.

The effect of employees on corporate governance of global corporations is inevitable. In order to generate effective corporate governance of globalized corporations, it is essential to well define the roles of employees while maintaining a protection on the employee rights. A statement on the impact of employees on corporate governance of globalized corporations could be given as: *"Employees have various legislated, statutory, contractual or negotiated rights (such as employment conditions) that affect globalization decisions"* (Augilera & Yip, 2004). In order to cope with the demands of and to satisfy the employees, corporations have implemented different strategies on human relations. The human relations systems on global corporations are explained by Fleming and Thörnqvist as: "*Thus the rules or patterns of governance can be externally determined in the industrial relations system (IRS) or internally determined by company management in human resource management (HRM)"* (Fleming & Thörnqvist, 2003). Discussed methods which are being implemented by corporations, motivate the employees towards firm commitment. With the integrity and motivation of employees it is possible to maintain efficient corporate governance mechanisms on corporations.

Employees of a corporation play a key role on definition and application of corporate governance mechanisms. Alongside with the positive effects, strong participation of employees on corporate governance may generate negative effects on the performance of globalized businesses. Thus the power of employees on corporate governance and its future effects on the operations of business shall be considered while managing the participation of employees on determination of corporate governance shall be done with an effective adaptation.

1.3.2. Shareholders

The role of shareholders varies across different nations. In the US and UK, there are mostly neutral shareholders among big institutional shareholders. Their role is mostly passive and they are focused on shareholder wealth maximization and these nations do not consider some other factors in the business. But in Japan, big institutional shareholders are mostly active and they act as part of a network ('keiretsu') that supports the role of the company within the network and, hence, are incumbent on management. In Germany, there are many different corporations where different stakeholders, especially banks and institutional shareholders influence the corporate governance of the corporation.

According to Aguilera and Yip (2004) there are three major types of different shareholders exists in the form of; neutral shareholders, partial interest shareholders and employee shareholders. Neutral shareholders' main desire and ambition is to get the maximum shareholder value and wealth. Employee shareholders have partial interest bias between maximizing shareholder value and employment conditions, level and pay. Banks and big institutional investors are known as partial interest shareholders. They have many additional interests in addition to shareholder value maximization. In Japan, institutional shareholders hold maintenance of the overall keiretsu as a major objective. In Germany, institutional shareholders typically have close relations and loyalty to management. In all countries, state shareholders have some other macroeconomic objectives such as maintaining national security, employment, competitiveness and prestige. Family shareholders are concerned with the family's legacy, loyalty to employees and tradition, and can also be risk averse. (Aguilera and Yip, 2004).

1.3.3. Board of Directors and Key Management

Board of Directors (BOD) and Key Management (KM) of a corporation constitutes a large influence on corporate governance by acting as a decision maker on core company laws, regulations, monitoring and control and ensuring compliance with obligatory laws, contracts and regulations by the government. On the other hand, the role of BOD and KM is to protect minority shareholder rights against majority shareholders and as well as to minimize agency conflicts. In order to express the possible impact of an effective management it has been stated that: "*The allocation of decision-making to the board, and thus away from the shareholders in general meeting, has the potential to protect minority shareholders against majority shareholders.*" (Davies P. L., 2000). In order to stabilize principal and agent relationships to minimize the conflicts it is essential to maintain integrity within the shareholders of a corporation. Once the integrity is reached it is essential to direct the interests of managers in line with shareholders.

In order to success on reduction of principal and agent problems (i.e. agency conflicts) it is essential apply a code of "corporate governance". These codes must clearly define the role and actions that should be attached to board of directors and key management. The importance on definition of corporate governance codes for corporations has been stated as: *"In sum, we should not underestimate the importance of the corporate governance codes on the grounds that they have not become part of traditional company law. If one takes a functional view, it is clear that the universe of board rules with which listed companies must comply has been significantly extended by the corporate governance rules."* (Davies P. L., 2000). The codes of corporate governance will act as a directory for BOD and KM on their actions while leading the path of a corporation. In order to maintain stability within the terms of corporate governance BOD and KM are crucial actors.

It is indeed a fact that BOD and KM are one of the key actors to determine the application of corporate governance. Thus it is essential to imply strategies of corporate governance to reduce agency conflicts and optimize the interests of shareholders while considering corporate goals and mission.

1.4. Theoretical Background on Corporate Governance

Corporate Governance is a subject in the literature where researchers try to understand the concept by visualizing from different perspectives. In this research, each important aspect on Corporate Governance for the research is discussed one-by-one.

1.4.1. Shareholder & Stakeholder Theory

The success of corporations is similar to the survival of an organism living inside an ecosystem, where there are complex environmental conditions which organisms need to face in order to survive. In order to understand this analogy in terms of business world, it would be beneficial to understand the various key actors who play role inside the global and unstable business environment which determines the success of a corporation. Shareholders (explained in 1.2.2) are the key actors, who play an important role in determination of the route of a corporation. However, it is important to understand the demand and impact of each actor with an interest on the performance corporation. Thus it is essential to understand stakeholder theory while discussing shareholder theory.

The importance on stakeholder theory is described on the book published by Cambridge University by Freeman, Harrison, Hicks, Parmar and de Colle with the following statement; *"Stakeholder theory is instead a larger view about corporations that encompasses shareholder theory. For Freeman, the introduction of stakeholder theory is not one view of the firm, but an invitation to a conversation that forces managers and the public to examine together two questions that have both ethics and business thoroughly embedded in them: "what is the purpose of the corporation?" and "to whom are managers responsible?" There are many possible answers to these two questions that fall within the boundaries of the law of corporations. Freeman outlines a range of potential answers to the two questions – from the shareholder view to the idea that managers have a duty to all value-chain stakeholders, to stakeholder prioritization based on Rawlsian conceptions of justice, to a feminist conception of the firm. Jones and Wicks also build their view of stakeholder theory on this conceptual foundation, arguing that ethicists and management scholars should devote themselves to exploring a range of theories of the firm. They suggest how business and ethics could be integrated into what they call a "convergent stakeholder theory."* (Freeman, Harrison, Hicks, Parmar, & de Colle, 2010).

As discussed in the earlier parts of the study, stakeholder theory considers shareholder theory on its understanding. Shareholder theory was proposed by Milton Friedman in the literature with an understanding of maximization. The ideology of this theory is that a manager's main duty is to maximize the shareholder interests by considering the rules and regulations of the law and social norms. On the other hand Stakeholder Theory, which has been introduced by Edward Freeman in 1988, states that corporations have a responsibility over a broader group of stakeholders alongside with the responsibility on shareholders.

In conclusion, it could be stated that stakeholder theory is a broader theory which considers both interests of shareholders and all stakeholders which have an impact on corporate decisions and actions. In our modern world, there exist multiple groups of actors who enforce the actions and decisions of corporations. Thus it would be beneficial to consider stakeholder theory as an important milestone while proceeding through the thesis.

1.4.2. Agency Theory

Among the theories of Corporate Governance, Agency Theory constitutes an influential part. In order to elaborate the ideology that relies within this theory, it is better to understand its components. In general, newly formed companies are owned and managed by the same actor. It is an inevitable fact for the companies to grow as long as there does not exist any problems with the going concern. As a natural result of the expansion process of a company, the shareholders would start to have a tendency to delegate the responsibilities on daily operations of a company to professional managers who are also called as agents. In other words as the companies expand, the principals (shareholders) employ accountable agents (managers, directors, partners and so on) to perform critical tasks related with the company on behalf of shareholders (which is to ensure the flow of work).

Agency relationship was first described with the paper written by Ross as: *"... agency relationship has arisen between two (or more) parties when one, designated as the agent, acts for, on behalf of, or as representative for the other, designated the principal, in a particular domain of decision problems."* (Ross, 1973). Agency relationship is a result of an interaction between the demander of a certain need and a designated supplier, which is able to manage those needs through common goals. After a short period, the theoretical definition of Agency Theory was stated with the works of Jensen and Meckling by: "*We define an agency relationship as a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent."* (Jensen & Meckling, 1998).

Agency theory considers the behavior managers (or agents) are considered in a pessimistic way. According to theory, agents are contractually bounded to the principals but yet they may have a tendency to take the advantage of their power towards their own interests. This dilemma, which is also called as "Agency Problem (Conflict)", causes a conflict between the interest of principal and the agent. As a result, monitoring of agents becomes a necessity for principals in order to align their interests with agents. As it is stated by Jensen & Meckling the necessity to monitor results with an increase in the agency costs, which consists of *monitoring expenditures by the principal, bonding expenditures by the agent and the residual loss* (Jensen & Meckling, 1998). The control mechanism of principals after monitoring of the agents is “voting rights”. With voting rights, it is feasible for principles to use their takeover mechanism by eliminating those agents which are not in line with the interests of principals. On the other side, after extreme levels of monitoring and lobbying of the agents, the agents may feel under pressure which may cause underperformance. The managerial failures on the integration of interests may also lead to agency conflicts. The two main managerial failures which cause agency conflict are stated by Moldoveanau and Martin as:

1. Failures of managerial competence (genuine mistakes and mis-calculations) relate to unwitting mistakes in the discharge of managerial control;

2. Failures of managerial integrity (lies, fabrications, embezzlement and self-dealing) relate to willful behaviors of the part of managers that negatively impact the value of the firm’s assets. (Moldoveanu & Martin, 2001).

Thus, in order to reduce the probability of agency conflicts it is crucial to imply optimal governance principals and policies.

Beside these useful understandings, there exist limitations on practices of agency theory. One of the main limitations is that the theory undermines the complex business environment. Another limitation is that it is harder to govern the rules and principals of the contractual agreement between principals and agents, which lasts for a long period of time.

1.4.3. Resource Dependency Theory

The arrangement of external resources is an important concept for the strategic, efficient and mission related management of a company. As a matter of fact, the companies are dependent to organize their key resources optimally in order to manage and sustain their day to day actions. The formalized version of the concept of "Resource Dependency Perspective" started to gain awareness by the public on 1970's. The theory has advanced after the book published by Jeffrey Preffer and Gerald Salanick named as "The External Control of Organizations: A Resource Dependence Perspective" on 1978.

The Resource Dependency Theory (RDT) is a study method, which focuses on the external resource dependency of corporations and how this condition affects the organizational behavior. The implications of RDT aim at optimizing the division on the structure of organizations which consists of key management, board members, employees, operations, external connections of the organization and any factors which are related with the management and strategies of the organization.

RDT relies on three essential factors which are; importance of social environment, interests and the autonomy and the power of the organizations. It is important to understand these factors in order to identify the internal and external actions of organizations (Davis & Cobb, April 2009). Governance of BOD and KM maintains these key factors for the organizations to secure and acquire necessary and scarce resources. In other words, the autonomous decision makers of the organizations act as key sources for enhancing the corporate operations, performance and efficiency of the organization. In terms of RDT, the internal and external access to resources is a critical dimension for the debates on corporate governance. In general, RDT argues that the availability of efficient skills, strategies and knowledge of key actors of an organization (BOD and KM) determine the accessibility of scarce resources. In other words, the key actors act as guarding entities which helps the organizations to maintain their essential resources such as; capital, know-how, contracts and agreements, projects and so on.

RDT is a concept, which supports the ideology of other theories related with corporate governance. In order to analyze the importance of RDT, it is better to integrate it with other theories. It is suggested by Hillman, Withers and Collins on RDT as; *"…using RDT has a long history of integration with other theoretical* *perspectives to examine the phenomenon of interest. In each different research stream discussed in this review, RDT has been integrated with other theoretical perspectives."* (Hillman, Withers, & Collins, 2009). RDT accommodates a broader view of corporate governance and uncertain diversity in organizational environments. RDT enables other theories to broaden the vision to explain on the mechanics of corporate governance.

1.4.4. Transaction Cost Theory

Another theory to understand the mechanics of corporate governance is Transaction Cost Theory. Transaction cost theory helps on the understandings for both corporate governance and agency theory. The essence of transaction costs originates from the decision of a firm to do an action by itself or to outsource. Traditionally, transaction costs were defined in the studies of Microeconomics by considering profit-maximizing agents as cost minimizers. The support on definition on occurrence of transaction costs has been stated as: "*Organizations choose between two methods of obtaining control over resources: the ownership of assets (hierarchy solutions) and buying the use of assets (the market solution). The decision is based on a comparison of the "transaction" costs for two approaches…Transaction costs will occur when dealing with another external party: Search and information costs, Bargaining and decision costs and policing and enforcement costs."* (Limited, Kaplan Financial (n.d.)).

The choice of organizations to obtain control would lead them to specific friction costs to attain additional resources, which are called as "transaction costs". The concept of friction losses has been stated as: *"Transaction costs are costs (e.g. in terms of money or time) incurred when making an economic exchange. If we extend this term, transaction costs do not only include bilateral transactions but subsume contractual relationships between individuals. In general, transaction costs symbolize "friction losses", i.e. the lost resources for the involved parties, but which are inevitable to reach certain goals."* (Brandale). As a matter of fact, friction losses exist after each transaction decision. Coase (1937) argued that organizations may try to maximize their benefits by optimally internalizing their operations. By internalization it is aimed to reduce the risk of volatility and uncertainty on prices and quality of good & services. Thus it is expected by the organizations to choose the relevant and significant methods of resource funding, by optimizing their frictions in terms of cost and sustaining a protective shield for uncertainty by minimization.

Transaction costs may originate from decisions on both internal and external exercises of corporations to attain resources. In other words, there exists friction costs each option that is chosen by the organizations. The friction costs include discovery costs, negotiation costs, cost of running a firm, which increases by size, cost of decision making and so on. The decisions of managers on selecting the sources of resources conclude by considering two inevitable states of decision maker which are: bounded rationality, which is defined as the limited capacity of human rationale to solve business problems, and opportunism, which is defined as the actions are done in order to optimize benefits, of principals. Thus it could be argued that the decision on resource selection of organizations results with transaction costs due to specific limitations.

Transaction costs which result from the nature of the decisions on attaining resources have consequences on corporate governance practices. Thus it is important to understand that proper use of corporate governance mechanisms functions as a cost minimizer in terms of various transaction costs of a business (i.e. Agency costs, Information costs, Decision costs and so on…). Alongside with organizational benefits, there are limitations on transaction cost theory as well. There exist complex relationships among organizations, which has negative impacts on the understanding of transaction cost theory. Transaction cost theory is insufficient to explain corporate governance standardizations and their proposal may differ with the proposals of transaction cost theory.

1.4.5. Stewardship Theory

Contrary to Agency Theory, Stewardship Theory supports the idea that the interests of managers (Steward) are on the same route with their organizations. The theory supports that BOD and KM of an organization act as a collaborative single entity which serves as a collective stewardship chain at the top the organization. The model of stewardship theory has been stated by David, Schoorman and Donaldson as: "…*In stewardship theory, the model man is based on a steward whose behavior is ordered such that pro-organizational, collectivistic behaviors have higher utility than individualistic, self-serving behaviors. Given a choice between self-serving behavior and pro-organizational behavior, a steward's behavior will not depart from the interests of his or her organization. A steward will not substitute or trade self-serving behaviors for cooperative behaviors. Thus even where the interests of steward and the principal are not aligned, the steward places higher value on cooperation than defection (terms found in game theory). Because the steward perceives greater utility in cooperative behavior and behaves accordingly, his or her behavior can be considered rational.*" (Davis, Schoorman, & Donaldson, 1997).

Stewardship theory assumes that the managers act just like a steward by cooperatively acting for an organization. In other words, the utility function of a steward is maximized through utility maximization of shareholders. Thus it could be assumed that their actions would be centered on goals and missions of organization.

In the perfect world of business where Stewardship Theory applies, it is possible to use effective corporate governance policies which work perfectly well. However, alongside with useful understandings of Stewardship theory, there is a weakness on stewardship theory. There is no certain line between the responsibilities of BOD and KM. Another fact is that the organizational goals and objectives may not be in line with the so called stewards due to situation and human psychology factors. Thus, in the case where there is a problem with the governance of an organization individuals may finger point one another. It is a natural fact of governance that if too many individuals are held responsible then none of them is accountable.

1.4.6. Systems Theory

Systems Theory constitutes a part of corporate governance with its extensive understanding of corporate governance. Systems Theory states that there are hierarchies of systems which exist to explain various conditions. On the other hand, there may exist infinitely varying complex environments for businesses which naturally results with formation of different systems. At this point, it could be stated that Systems Theory may be helpful for the researcher to understand components of a concept within the broad or narrow limits of the environment. In order to understand the mechanics which relies underneath different systems it is essential to consider the boundaries of a system (limitations), placement of the system (place of system among abstract of other systems) and the transactions which occurs within the system (exchange of input and output). Systems theory provides the researcher a method to understand and analyze the complex network of systems and their effects on the business environment.

According to Systems Theory, the control mechanism for system integrated environments is to apply optimally structured corporate governance policies. The relationship between systems theory and corporate governance has been stated by Hopt and Teubner as follows: "*According to systems theory, the control device for system integration cannot be found in (complete) central regulation or (pure) market coordination. In principle the control device is rather to be seen in the internalization of those (outside) interests into the corporate governance which have been seen so far left primarily to be taken care of in the market* (Hopt & Teubner, 1985). It could be inferred from this statement that to maintain a harmony within a system implementation of efficient corporate governance practices may not be feasible.

Considering Systems Theory, it could be suggested that in the case where corporate governance mechanisms are successfully managed within the relations of various entities of the complex system including managers, corporate associates, shareholders, stakeholders, regulatory and legal institutions, auditors and all other actors whom plays a role inside the system it may be feasible to take necessary actions for the demands of system.

In general, it may be useful to use systems theory as a part of an understanding the divisional structure of hierarchy within the business environment. It is possible to criticize systems theory by considering that it is not feasible to reach optimal system equilibrium. There exist multi-factors which affect the performance and maintenance of a business. Thus in the real world, it is necessary to use effective implementation of corporate governance mechanisms while considering the impact of diverse systems.

1.4.7. Integrated Multi-Theoretic Approach

Integrated multi-theoretic view of corporate governance considers multi-variables of internal company and the external environment in order to understand their effects. Multi-theoretic approach of corporate governance might be helpful to elaborate the divergent set of understandings and re-assemble those understanding on the same path. A statement to define multi theory approach is "*... multi theory approach to corporate governance might be more appropriate through recognition of a broader set of governance mechanisms and structures potentially affecting the governance of corporations. It was suggested that this was essentially due to wider interdependencies resulting from wider environmental influences that impacted on effective governance"* (Joe, 2011). Multi-theoretic view of corporate governance is an understanding, which integrates the broad corporate governance mechanisms and the environment of the organizational functions. In understanding corporate governance, multi-theoretic approach works as a concept which is useful to define broader forces of organizational operations, find methods of strategic management and maintain to sustainably manage those understanding of a business.

In summary multi-theoretic approach is a method to define corporate governance by an understating of the pieces of big picture. Multi theoretic approach is therefore a useful method for researchers, who seek to analyze and understand corporate governance on different dimensions.

1.5. Core Rules and Procedures (Principles) of Corporate Governance

In order to build the ideology for the concept of Corporate Governance in an efficient way, it is necessary to formulate key principles which define the code of conduct for the corporations. The 4 major principles of Corporate Governance are defined respectively as follows.

1.5.1. Transparency

The initial principle of Corporate Governance "Transparency" acts as a component to sustain strong information symmetry in the system. The definition of transparency suggests that a company should present its complete and accurate disclosed financial and non-financial information by considering a timely manner. OECD definition on transparency is stated as; "*Transparency refers to an environment in which the objectives of policy, its legal, institutional, and economic framework, policy decisions and their rationale, data and information related to monetary and financial policies, and the terms of agencies' accountability, are provided to the public in a comprehensible, accessible, and timely manner.*" (OECD D. , 2004). Undoubtedly, transparency constitutes a large impact on the determination on building the understanding of "Corporate Governance". The relevant information must be symmetrically distributed to the publicity by the key actors.

1.5.2. Accountability

The second key principle of Corporate Governance is "Accountability". As it is stated by OECD, the meaning of accountability is to ensure the collective responsibility of officials to maintain fairness and trust for the shareholders and publicity by providing relevant, efficient and effective information on a timely manner, which complies with the reports of internal & external control mechanisms. In other words, the key position of accountability on corporate governance has been stated as: "*Our own research into institutional investor attitudes toward corporate governance and accountability issues has highlighted the substantial effects that the* *process of corporate governance reform has had on institutional investor relations. In a decade, corporate attitudes toward their core investors have been transformed from relative secrecy to greater transparency. Similarly, the attitudes of institutional investors have been transformed from relative apathy toward their investee companies' activities to an active interest."* (Solomon & Solomon, 2004).

Accountability holds a great importance to define and declare the responsibility of the actions of key actors of a corporation (BOD, CEO and management, dependent & independent auditors and fiscal council) to comply with the principles of corporate governance and to provide relevant, reliable and transparent information to the interest groups.

1.5.3. Reliability

The third key principle of Corporate Governance is "Reliability" of the necessary information provided to publicity. In order to maintain better corporate governance, it is necessary to minimize the uncertainty of the information shared by corporations to the publicity. The importance of reliability on information provided has been defined on OECD principles as: "*Information should be prepared and disclosed in accordance with high quality standards of accounting and financial and non-financial disclosure. The application of high quality standards is expected to significantly improve the ability of investors to monitor the company by providing increased reliability and comparability of reporting, and improved insight into company performance.*" (OECD, 2004). Corporations should comply with the principles of corporate governance in the process for distribution of the information to the public. As a natural outcome of their compliance, they would be able to generate reliable information through the time. Reliability is important for corporate governance in terms of generation of an accurate monitor and control environment for the necessary actors.

1.5.4. Fairness and Trust

The last key principle of Corporate Governance is "Fairness" in terms of equal treatment to key actors and publicity. As a result of fairness it is possible to ensure trust for the market (publicity) and as well as principals (shareholders) for which the actors which plays a role as agents (managers) take actions in order to maintain and integrate the essential interests of the publicity & principals with agents. The relationship between fairness and trust with corporate governance is stated as: *"A key driver of corporate governance is the concept of fairness…The OECD defines fairness as "protecting shareholder rights and ensuring contracts with resource providers are enforceable". and for trust " In parallel with fairness corporate governance is driven by trust… Trust is particularly important where corporate governance is based on principles, since principles require interpretation to make judgments."* (Davies A. , 2011).

Fairness is an important driver of corporate governance by ensuring equity. On the other hand, "Trust", which is another driver of corporate governance, exists by maintenance of accuracy, reliability and fairness through time. Thus it could be argued that fairness and trust are two parallel functions of corporate governance which have important roles among the core principles of corporate governance.

1.6. Benefits of Corporate Governance

Implementation of effective corporate governance methods would result with the following benefits; (a) Insurance of corporate success and sustaining a reliable economic growth, (b) Provide confidence for investors on their investments which helps the companies to effectively raise capital, (c) Reduced cost of capital and risk of investment which optimizes the share value, (d) Maintains the mission and objectives of the company in line with the interest of investors and organizational structure, (e) Reduces corruption, mismanagement and interest conflicts and (f) Provides trust, reliability and integrity within the economy.

Most of the abovementioned benefits of corporate governance find its roots in transparency. The more transparent a firm, the more confident investors would be. Consequently, they would increase their investments in the firm which would result in reduction of cost of capital. Transparency would also help key managers to avoid fraud and take proactive measures against such misconduct. All these benefits of transparency enable the firm's capacity to improve and not only maximize the wealth of shareholders but also maximize the economic utility of all stakeholders.

CHAPTER II
CORPORATE GOVERNANCE AROUND THE WORLD

2.1. Introduction to Corporate Governance Around the World

The need for corporate governance mechanisms, urged soon after the revolutionary improvements on industrialization and formation of the resource and allocation based economic system "*capitalism*". The radical prosperity on the progress of the economies has lead to a change in the family and state owned businesses into large enterprises. Alongside with the benefits of rapid growth in the economy, deficiencies in the market have started to show up. Unfortunately, the insufficient regulatory environment and due to insufficiently developed markets in those economies resulted with vast financial tragedies such as: economic bubbles & bursts and stock market collapses, breakdowns in the economy and many other economic tragedies.

The notion of industrial economies and capitalism is to effective accumulation and allocation of "Capital". The utility preferences of investors in the economies of different nations vary due to complex combination of different variables such as: Culture, Politics, Geography, Education level, Income, Technology & Innovation and so on. A statement by Morck and Steier explains the relation of corporate governance and allocation of capital as: *"Yet the ways in which economies accumulate and allocate capital are quite different in different countries, and seem closely related to how each country handles corporate governance issues."* (Morck & Steier, 2005). It could be inferred from the statement that the preferences of the individuals of a nation is a key determinant to position the accurate and necessary corporate governance mechanisms.

In fact the when the knowledge of investors on capital allocation generates an extensive force on businesses, in terms of spending the capital on corporate level improvements such as: research and development of new technologies, PPE acquisition which relates with the nature of operations of the business and makes investments which relates with the future of business.

It has been suggested in the “Agency Theory” that there may be an existence of a conflict between managers and shareholders which reduces the effectiveness of funds raised by the efforts of investors. To reduce the impact of this condition, which is namely called as “Agency Conflict”, it is essential by investors to monitor the actions of managers of the firm that they have invested and governance of any listed firm that they plan to invest in the future. However, the constant monitor of firms by investors has costs. To reduce the burden of costs on investors, the independent regulatory bodies, which are formed by governments, have implemented mandatory and effective corporate governance mechanisms for the firms. Morck and Steier explains this relation with their following statement: *“American and British capital markets and regulators try to shift this cost away from investors by mandating that firms disclose detailed financial reports, insider share holdings, management pay, and any conflicts of interest.”* (Morck & Steier, 2005). In fact, most of the markets inside developed economies mandate firms to transparently present the relevant information by using effective channels and on a timely basis.

Even though there are cultural, moral and ethical rules inside the building blocks of a nation, due to human nature, the businesses must be monitored, governed, regulated and fairly presenting status reports. Unfortunately, through the history of “Capital”, due to lack of effective monitoring, regulation and corporate governance mechanisms there had been variety of business scandals and stock market crashes across the globe such as Enron, Tyco, WorldCom, Olympus, Tesco, Credit Crisis and many others.

In order to reduce the risk of fraud, market speculation and information misstatements, the governments have reacted by amending laws, regulations, controlling and monitoring methods. With such reforms the governments were also able to strengthen corporate governance principles. One of the most important acts on corporate governance is Sarbanes-Oxley Act (SOX, 2002), which offered 3 major changes in corporate governance practices. The offerings by Sarbanes-Oxley Act were as follows: change and improve in the process of auditing and presentation of relevant financial information, optimization of board of directors by employing directors the responsibilities of self-awareness, accountability and precaution in order to reduce any conflicts of interest and improve the ability of board of directors to monitor management and finally new principles on transparent disclose of relevant financial information. After many other similar acts across the world the practices on corporate governance have continuously improved.

2.2. Corporate Governance in US, UK, Asia and OECD

As discussed in the earlier parts of the thesis, the practices of corporate governance differ between the nations due to cultural, political, managerial and many other individual differences. Considering that case, even though the core principles are essential, it is expected by different nations to practice different corporate governance methods. Primarily the Anglo-Saxon, European and Asian practices of corporate governance are considered during the thesis. The illustration on the subject matter of corporate governance differences is shown in Figure 1, by Steger & Amann as follows (Steger & Amann, 2008):

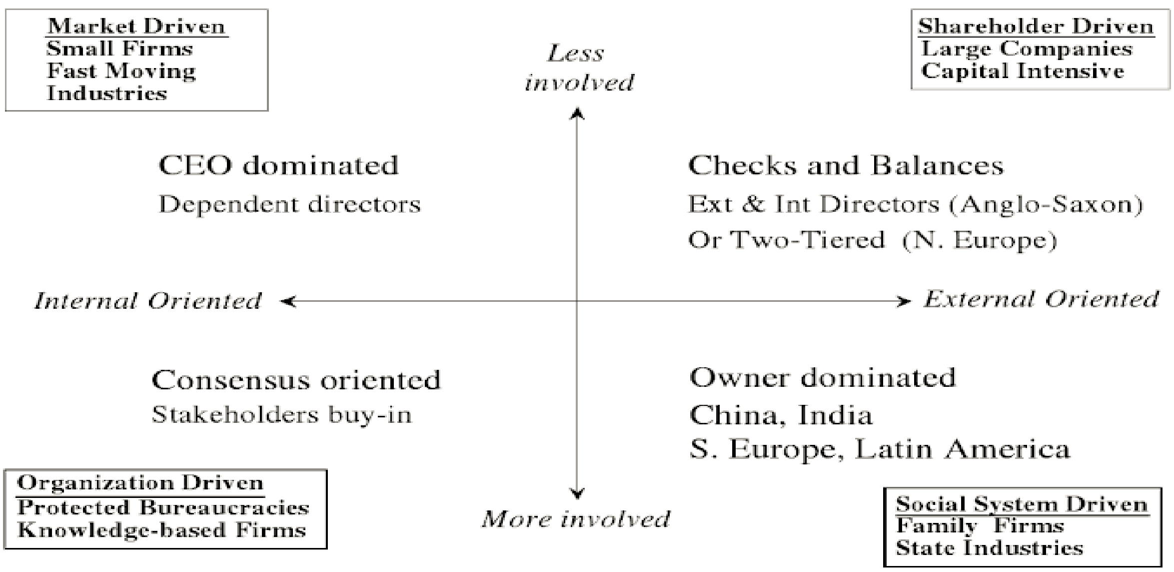

Figure 1: *Characterization of corporate governance systems*

The character of markets as well as business orientation determines appropriate corporate governance mechanism. With the combination of each characterization, the identity of corporate governance mechanisms is determined. Henceforth the mechanisms of corporate governance are realized and applied into to the financial system and the business environment. The discussed process explains the reason of the question “Why are there different practices in different regions around the world?”

In summary, there exist multi-factors which results with the differences on corporate governance practices around the world. In order to deepen the understandings on mechanics of corporate governance practices, it is essential to analyze corporate governance practices across different regions of the globe. The following parts of the thesis considers the corporate governance practices by analyzing key divisions as; US, UK, Asia and OECD.

2.2.1. Corporate Governance in US

In the financial history timeline of the US there have been remarkable amount of financial breakdowns which shaped the future of the nation. The Great Depression, 1929, which started in the US was an important financial breakdown. The long lasting depression, stock market crash and liquidity crises have lead the American public to distrust the economic stability. The 1929 crisis have urged need and importance of corporate governance practices and effective use of regulatory bodies. After Great Depression, 1929, the US authorities have executed critical congresses on 1933 the Securities Act and 1934 the Securities Exchange Act respectively. The 1933 Securities Act was the initial federal legislation done by US to regulate the securities market. The legislation aimed to increase transparency on the financial disclosures, create a barrier on the fraudulent sale of securities, and prevent any possibilities on distorted presentation of the relevant information (misstatements) and any activities which may result with a fraud.

With its regulations, the act aimed at regulating and preventing any corruptions on the primary markets. Immediately after the Securities Act, to regulate the secondary market, Securities Exchange Act of 1934 was considered by US authorities. The Securities Exchange Act pointed out the importance of secondary markets on the economy and brought in legislations which ensured the protection of the interests of investors from the financial intermediaries. The financial intermediaries included securities exchanges, brokers, dealers and any other parties which are related with the trade of securities. The necessary actions taken by the act such as, formation of Securities Exchange Commission (SEC), regulation and monitor of securities markets and traders and anti-fraud monitoring. After a while U.S. authorities have decided for another act on 1938 namely called as the Maloney Act. This act promoted the regulatory authority of SEC on the Over-the-Counter markets, which consists of securities trade firms, investment banks and non-bank agents (brokers/dealers).

Another important act was the Investment Advisers Act of 1940. The Investment Advisers Act was originated by considering a report on the investment trusts and investment companies which was generated for a Congress on 1935. After these major acts US market generated a primary basis for a regulated system.

The regulatory acts between 1933 and 1940 paved the way for the era of regulation and deregulation cycle. In the post-war era 1960's and 1970's showed an economic prosper for U.S. During those time period the market was characterized by powerful managers and weak owners. This condition, which is also called as "managerial capitalism", resulted with agency conflicts. During those periods internal control and monitoring mechanisms were also weak. After several company failures another act was realized namely as Securities Investor Protection act on 1970. The legislation established a regulatory body, which is namely called as "Securities Investor Protection Corporation". The organization was formed in order to provide insurance for the investors to provide a protection from financial intermediary failure due to fraudulent actions or misappropriation.

In 1977 an act called as the Foreign Corrupt Practices Act was conducted. The act aimed to reduce bribery by prohibiting US corporations to make any irrelevant payments to foreign parties. Another important legislation in 1977 was

SEC’s new rule on obligatory establishment of record keeping, audit committees and assignment of independent directors for the companies listed in New York Stock Exchange. During 1980’s the macroeconomic developments have sky rocketed and US markets started to face with foreign competition. The power of managers has started to shift from managers to investors, which is also called as “investor capitalism”. Institutional investors were important capital providers to the companies due to their fund raising potential and diversification of investments. The concepts of Leveraged Buy Out (LBO) and Management Buy Out (MBO) increased the frequency of takeovers.

Approaching to 1990’s the investor capitalism was re-arranged due to the growing demands of managers. The concept of “Shareholder Value” was adopted into the system. This concept imposed that the primary goal of companies is to increase the wealth of shareholders by paying them off with the funds raised by operations. Various methods of payments were formed in the US market to meet the demands of the understanding of “Shareholder Value Maximization”. In order to link the shareholder interests and manager interest in line with long term corporate goals the corporate governance mechanisms needed a reform after the large scandals such as Enron and WorldCom.

As a responsive action for the accounting, auditing and fraud scandals, Sarbanes Oxley Act (SOX) in 2002 made critical reforms on the understandings of corporate governance. The aim of this act was to increase corporate measurability, transparency, accountability and reliability. The SOX act made the risk assessment of information a necessity for the companies. The SOX act also increased penalties for any violations of the legislations by any party. A brief summary on the historical development of corporate governance and its effects in US after 60’s is given by Gregory Jackson with the following Figure 2 (Jackson, 2010):

A Historical Overview of Corporate Governance in the USA

	1960s-1970s	1980s	1990s	2000s
	Managerial Capitalism	Investor Capitalism	"Shareholder Value"	Crisis of "shareholder value" paradigm
Ownership	Dispersed, individual	Institutional investors	Institutional investors	Institutional investors
Market for Corporate Control	Weak	Strong	Medium	Medium
Boards	Insider - "advising board"	Insider- "advising board"	Outsider- "monitoring board"	Outsider- "monitoring board"
Executive Remuneration	Fixed	Stock options	Stock options	Stock options
Gatekeepers	Weakly regulated	Weakly regulated	Weakly regulated	Strongly regulated

Figure 2: *Historical Development of Corporate Governance in U.S.*

In summary, US history includes a complex timeline of corporate governance development were vast amounts of acts, legislations and regulatory bodies were practiced. However corporate governance is a subject matter which needs to be constantly improved and adopted to the changing environment of the businesses across the globe. Henceforth it is a fact that regulation and deregulation synthesis is a continuous and an inevitable progress of corporate governance on the history and the future of US.

2.2.2. Corporate Governance in UK

Through the history of corporate governance in UK, the improvements and developments on regulatory legislations have accelerated on 1980's which was soon after the rise of corporate scandals. One of the main corporate governance acts in UK is considered as the Cadbury Report which was issued in 1992. The settled understanding of corporate governance became prominent in UK after a long period of time than it took place in US. Thus, the US is accepted as the ancestor for the initial practices of corporate governance with their first definition of the term on 1970's. A word on the corporate governance for UK case was suggested by Secretary and Chief Executive of The Institute of Chartered Secretaries and Administrators, Barry Baker on 1980 August "*Governance is a Middle English word which the Americans have brought back to us in the expressive phrase 'corporate governance'* -

the purposes and method of how we structure and control our companies large and small.”. (Midgley, 1982). Even though the term was used several times before, corporate governance in UK became popular after 1980’s and the discussions have climaxed on the beginning of 1990’s. A graph which illustrates the usage of the term “Corporate Governance” in Financial Times after 1970’s is given on Figure 3 by Cheffins as follows (Cheffins B. R., 2015)

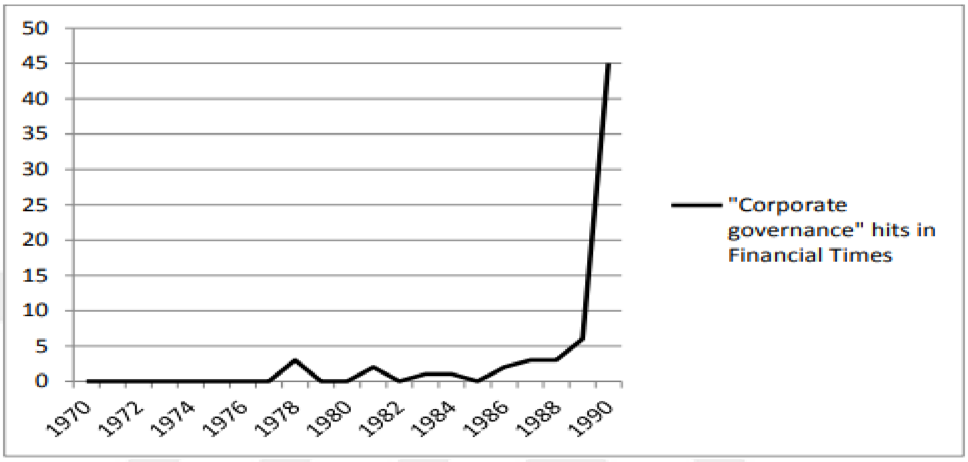

Figure 3: *Usage of “Corporate Governance” term in Financial Times*

The reason why Britain discussed and applied corporate governance after a later period than US relies on different elements. The key elements are supposedly differences on share ownership patterns, financial market transactions and policies, political order and so on. At the beginning of 1990 a dramatic attention was given by the authorities and business executives on the urging need for corporate governance practices after a critical fraud activity which has happened in a London Stock Exchange listed company Polly Peck International plc. After realizing this need the Cadbury Committee, was launched on 1991 May by London Stock Exchange authorities. The committee accommodated key members of the society which is able to add value on the formation of a key corporate governance code for U.K., including key Certified Public Accountants, the Financial Reporting Council, an independent regulator backed by the government.

The Cadbury Report was announced into the public on 1 December 1992. The aim of committee is clearly defined by the members on Cadbury Report as; “*The Committee’s objective is to help to raise the standards of corporate governance and* *the level of confidence in financial reporting and auditing by setting out clearly what it sees as the respective responsibilities of those involved and what it believes is expected of them.”*. (Cadbury & Cadbury Report Comittee, 1992). The Committee aimed to define and improve the corporate governance codes to maintain integrity within the financial markets and protect the market from any fraudulent activities. After the definition of code the roles of board structure, shareholder, managers, internal and external audit committees, financial reporting and presentation are clearly defined. Thus it could be stated that the Cadbury Report of 1992 was a milestone for the corporate governance practices in UK. On the other, hand the clear analysis of Cadbury Report paved the way of development for many other corporate governance practices across the world. After the internalizing the understandings of Cadbury Report, improvements on the defined corporate governance codes have been performed by the UK authorities.

Corporate governance principles of UK have evolved by time thanks to the reports of Greenbury Committee (1995), Hampel Committee (1998), Turnbull Committee (1999) and by the works of Paul Myners (2001) and Robert Smith (2003) and Derek Higgs (2003). Today UK officials use a “Combined Code” for the application of corporate governance principles. The code is an extended version of the core corporate governance codes which were defined back on Cadbury Report (1992). Combined Code integrates key drivers of corporate governance by defining the importance of Leadership, Effectiveness, Accountability, Remuneration, Relations with Shareholders and Relevant Financial Disclosure. With the help of combined works and developing codes it could be said that UK was able to identify their unique definitions of corporate governance practices. As discussed in the earlier parts of the thesis there are differences in the application of corporate governance codes across different nations. An example for the comparison between US and UK systems in terms of corporate governance is discussed in Figure 4 by Aguilera, Williams, Conley and Rupp (2006):

	UK	US
Ownership	Engaged Less dispersed than US	Not as engaged Exit strategies Impatient capital More dispersed than UK
Ownership type	Institutional investors (insurance companies and pension funds)	Institutional investors (investment companies)
Dual leadership	Mostly	Rarely
Institutional investor engagement	Cadbury Report and Combined Code encourage engagement	Large public pension funds engage
Stakeholder relationships	"Hidden world of informal monitoring"	Scarce and few mechanisms in place
Stock market in 2004:		
Firms listed	2692 (LSE)	2308 (NYSE); 3294 (Nasdaq)
Market capitalization as percentage of GDP	150%	120%
Stock market velocity of shares	Similar	Similar
M&A activity	High	High
Hostile takeover regulation	Robust Little regulated	Inactive Highly regulated
Litigation	Low	High
NGO involvement	High	Moderate
CSR disclosure	Operating and Financial Review (OFR) suggested as best practice Pension Act (2000) requires pension funds to disclose how social, environmental and ethical issues are taken into account in investment strategies Association of British Insurers and National Association of Pension Funds encourage portfolio companies to disclose information about social issues	No legal requirements Some voluntary guidelines, such as the Global Reporting Initiative, being implemented by some companies

Figure 4: *Differences between Corporate Governance Practices in U.S and UK*

In conclusion UK was able to adopt effective corporate governance codes into their financial system after drastic implementations suggested by Cadbury Report (1992). On the other hand, to maintain stability with the changing environment across the globe, the defined corporate governance codes were encouraged by the authorities to be continuously and fairly developed by relevant professionals. The effectiveness of UK on their international adoption of corporate governance codes was suggested by Mallin, Mullineux and Wihlborg as follows: "*The adoption of internationally accepted accounting and auditing standards has helped ensure that the UK has a high level of transparency and disclosure in the corporate and financial sectors.*" (Mallin, Mullineux, & Wihlborg, 2005). Considering the continuously developing and powerful corporate governance codes in UK are helpful to support the well-being of the government, financial sector, businesses, investors, managers, tax-payers and ultimately for the economy.

2.2.3. Corporate Governance in China

The rapid growth in the industrialization, productivity and technology has triggered leading Asian economies to develop as emerging markets. Across the leading economies of Asia, China is an important emerging market with their dominant potential of human resource (labor), technology & know-how, geographic area and capital. The rapid growth in the economy and expansion of financial markets forced China to consider recognition of modern corporate governance codes. The need of growth in the economy shifted the understanding of China's planned economy into the market economy. New ideology of China, market economy, led the nation to establish complex capital markets and change the state owned enterprises into modern businesses. Combination of these macro-economic changes has triggered the necessity of implementation for a modernized corporate governance comprehension. The Chairman of China Securities Regulatory Commission, Shang Fulin stated the historical progress of corporate governance in China on an OECD report as: *"Corporate governance in China has been explored and established in the process of state-owned enterprises reform and private enterprises growth. Corporate governance experience and model with Chinese characteristics have come into being in light of the actual situation in China. It has developed under the joint effort of the government and market participants, with the former playing a leading role in the construction and improvement of the corporate governance legal framework. Although China has started the creation of a legal system for corporate governance rather lately, the system has developed fairly quickly and increasingly full-fledged."*. (Fulin, Editoral Committee, Drafting Team & OECD Experts Team, & Consulting Committee, 2011). Due to highly concentrated, pyramid ownership structure in East-Asian nations the process of structural reforms was challenging.

As an emerging market China performed late reforms on their financial system. On the other hand, with those late reforms, the authorities were able to introduce modern, stable and operative corporate governance mechanisms. Considering this environment, the Chinese authorities have planned to imply modernized corporate governance mechanisms in to the system. The most critical recognition of corporate governance principles in China was realized with the report and analysis which has been conducted by Securities Regulatory Commission (CSRC) in 2001.

In order to understand the corporate governance developments on China, it is beneficial to understand the detailed historical progress. The Chinese enterprises were owned and managed by the government until 1978. In line with this condition, the independence and autonomy of managers in terms of business activities, transparency, and share of relevant information and monitor of businesses were not considered as a scope of necessities of the financial market. The economic reforms were progressed in China after the National Congress of 11^{th} Communist Party of China which took place in 1978. After this major political change, decentralization of state owned businesses have started.

From the beginning of 1979 until 1984, the Chinese government has started implementing programs and reforms by decentralizing the laws and regulations, to encourage the management of state owned enterprises by giving them chance to make more autonomous decisions. Between the time period of 1984 and 1992, Chinese officials have made critical reforms to the system. The initial idea of separation of ownership and management for state owned enterprises was suggested by Chinese authorities on 1984.

Later on in 1986, Central Committee of the Communist Party of China and State Council have issued works on defining the role and responsibilities of manager, the position of owner and democracy by employees in terms of management. In 1992 the Chinese State Council decided to delegate independent CEO like managers to the state owned enterprises in order to shorten the transformation of the nation from planned economy into a market economy. In 1993 the purpose of state owned businesses was declared by defining ownership and management structure, rights and obligations and separation of enterprises from the government. Chinese officials also presented the Company Law which acted as a building block on the construction of modernized system.

2001 was an important date for China with their participation to the World Trade Organization (WTO) and adoption of OECD Principles of Corporate governance into the system. In 2002 CSRC and the National Economic and the Chinese Trade Commission decided to issue a common code of corporate governance for the listed companies. The current corporate governance code is practiced after the reforms of 2004 Opinions on Promoting the Reform, Opening and Steady Growth of Capital Markets, 2006 Company Law, Securities Law and the Criminal Law, 2007 Regulations on Listed Companies' Information Disclosure, 2008 Regulations on Major Asset Reorganization of Listed Companies and the Basic Standard for Enterprise Control, 2009 Law on the State-Owned Assets of Enterprises and many other acts which added value to the corporate governance principles in the Chinese financial system.

To conclude, the late Chinese reforms on corporate governance were successful to transform the old fashioned understandings into a modernized system managed with effective corporate governance principles. Currently China uses continuously developing corporate governance principles to meet the demands of changing world.

2.2.4. Corporate Governance in Japan

Japan is another important nation to discuss in terms of corporate governance by being one of the leading economies of Asia. Japanese understanding of corporate governance considers a combination of various different aspects including investing in relations, harmony in leadership (keiretsu) & management, efficiency with the core corporate governance principles. The Japanese system accommodates unique characteristics within. To describe the unique characteristics on his paper Mitsuaki Okabe states that: "*What are the characteristics of a typical Japanese corporation relative to corporations in other countries? As discussed later, these characteristics have certainly been changing since the late 1990s. However, since after World War II until the 1980s, numerous researchers have documented that Japanese firms have three distinctive features compared to, for instance, American corporations…*" (Okabe, 2010).

The three components for the characteristics of Japanese businesses are discussed by Okabe as follows: *Growth orientation of the Japanese firm, De facto dispersion of company ownership and Traditional Japanese firms have a large number of domestic subsidiary firms and related firms, which they heavily rely for production and other business activities* (Okabe, 2010). The first characteristic of Japanese considers business growth in terms of size rather than profit maximization. Thus it could be stated that the enlargement of business is a signal of success considering in terms of Japanese understanding. The second characteristic relates with the importance given by Japanese on the ownership structure. Traditionally Japanese consider all the stakeholders which play a role in the business are considered as the owners. The third and final characteristic relates with the "bonding behavior" of the large Japanese firms with smaller subsidiaries. The bonding generates a synergy within the Japanese economy which accelerates the know-how transfer across different firms to next level. Considering all of these facts, the statement for Japanese understanding of corporate governance is that it accommodates a unique way of modeling the system.

In terms of corporate governance, World War II holds a great importance for the developments on the Japanese system. After the war, Japanese have rebuilt their infrastructure and economy. On the rebuilt stage Japanese have modeled unique corporate governance principles. With their rapid growth in the economy in 1980's the Japanese model of corporate governance became widely popular. However the model was challenged by the drastic macro-economic developments across the world.

After this major event the Japanese officials have made reforms on adapting the corporate governance principles. In 1998 Japan Corporate Governance Committee, established a common corporate governance code to the Japanese system. The stated codes accommodated a harmony between Japanese holistic view of business and the modernized corporate governance policies. Just like many other nations Japanese have internalized the understanding of continuous improvement on corporate governance policies considering the changing global environment. The current notable characteristics of Japanese corporate governance are defined by Yao as: "*With regard to the ownership structure, first, shareholdings are often held by a main bank or a keiretsu partner in order to avoid the principle-agent problem. Second, relationship banks in Japan can play a more prominent role in the management within corporations. They can intervene in the management of firms especially in times of financial distress, dispatch representatives to the board of directors and initiate restructuring activities. Third, the employment system is founded on two main elements: first, lifetime employment, in which workers spend* *their entire career at the same firm, slowly working their way up the ranks; second, seniority-based pay (age-based pay), which links wages to length of tenure rather than ability."* (Yuzuo, 2009). The Japanese model of corporate governance aims to align the interests of owners, managers, debtors and employees on the same line which would ultimately result with the expansion of the firm in terms of size in the market.

In conclusion, all of the historical legal, political, financial and cultural developments of Japan have lead to their unique way of application for the corporate governance mechanisms. Similar to any other developed corporate governance mechanism, the Japanese method aims to develop and optimize the national constraints and the financial system while considering the changing macro-economic factors across the globe.

2.2.5. Corporate Governance in OECD

The Organization for Economic Co-operation and Development (OECD) was founded after the OECD convention of 14 December 1960. The foundation was launched to its operations on 30 September 1961 with participation of 18 European countries, United States and Canada. The aim of OECD is to develop the economic and social prosperity of society by implementing policies stimulates cooperative world trade. The OECD states their originating members and the 3 core principles through following statements (OECD Statistics Canada, 2000):

"*1) To achieve the highest sustainable economic growth and employment and a rising standard of living in Member countries, while maintaining financial stability, and thus to contribute to the development of the world economy;*

2) To contribute to sound economic expansion in Member as well as non-member countries in the process of economic development; and

3) To contribute to the expansion of world trade on a multilateral, non-discriminatory basis in accordance with international obligations. The original

Member countries of the OECD are Austria, Belgium, Canada, Denmark, France, Germany, Greece, Iceland, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States.”.

Through this perspective, OECD acts as an international regulatory body for both member and non-member states. The organization regularly generates reports on the processes of sustainable development, capacity development, environment & clean growth, humanitarian policies, multilateral effectiveness and private sector growth by implementing useful corporate governance policies. In order to understand the history of OECD members it is beneficial to consider the name and entry date of each member. Considering that the data for the entry dates of OECD member states has been shared on the OECD website with the following Table 1: (OECD, 2018).

Table 1: *Entry dates of all OECD member nation*[3]

Country	Year	Date	Country	Year	Date
UNITED KINGDOM	1961	2 Mayıs 1961	LUXEMBOURG	1961	7 December 1961
DENMARK	1961	30 Mayıs 1961	ITALY	1962	29 March 1962
CANADA	1961	10 April 1961	JAPAN	1964	28 April 1964
UNITED STATES	1961	12 April 1961	FINLAND	1969	28 January 1969
NETHERLANDS	1961	13 November 1961	AUSTRALIA	1971	7 June 1971
BELGIUM	1961	13 September 1961	NEW ZEALAND	1973	29 Mayıs 1973
IRELAND	1961	17 August 1961	MEXICO	1994	18 Mayıs 1994
TURKEY	1961	2 August 1961	CZECH REPUBLIC	1995	21 December 1995
GERMANY	1961	27 September 1961	HUNGARY	1996	7 Mayıs 1996
GREECE	1961	27 September 1961	KOREA	1996	12 December 1996
SWEDEN	1961	28 September 1961	POLAND	1996	22 November 1996
SWITZERLAND	1961	28 September 1961	SLOVAK REPUBLIC	2000	14 December 2000
AUSTRIA	1961	29 September 1961	CHILE	2010	7 Mayıs 2010
SPAIN	1961	3 August 1961	SLOVENIA	2010	21 July 2010
PORTUGAL	1961	4 August 1961	ISRAEL	2010	7 September 2010
NORWAY	1961	4 July 1961	ESTONIA	2010	9 December 2010
ICELAND	1961	5 June 1961	LATVIA	2016	1 July 2016
FRANCE	1961	7 August 1961			

[3] List of OECD Member countries, the data was taken from the database which is distributed by OECD official website.

Currently there are 35 different nations across the world as OECD members. With its diverse combination of different nations, OECD is a multinational regulatory body which works for the welfare of the world by suggesting and improving effective policies.

In terms of corporate governance principles, OECD holds an important impact by providing unified codes. The Corporate Governance Principles which were formed by OECD aimed to improve the legal, institutional and regulatory infrastructure and as well as to give advices for financial markets, investors, businesses and any party which key principles of corporate governance were initially offered by the OECD Council Meeting on 27-28 April 1998 and the effective date for the offered principles was on 1999. According to the initial report of OECD there must exist efficient use of 12 key principles of corporate governance which will be discussed on section 2.1.6 of the thesis. In 2002 OECD Council Meeting agreed on assigning Steering Group representatives to research on the developments of OECD countries to assess the effective use of the corporate governance principles.

A revision on corporate governance principles was realized by OECD in April 2004. The revised version extended the OECD's vision on a global domain considering every nation of the world by touching upon the economic benefits of good corporate governance practices within a system. To maintain a sustainable economy for emerging and developing non-OECD nations the act of OECD 2004 was crucial by providing them consultation through their economic transition stage. Starting from its foundation, OECD aims to research and develop effective policies. The OECD organization is successful in terms of constantly modernizing the corporate governance and increasing public awareness.

In summary, with its propositions on laws, regulations and policies, OECD is a semi-binding regulatory body which continues its policy research and development activities in order to maintain economic integrity between the nations and provide necessary corporate governance policies to stimulate a sustainable economy within each system.

2.2.5.1. Core Principles of Corporate Governance Defined by OECD

OECD defines 6 core principles which are counted as a must on every financial system to ensure high quality corporate governance practices. The core principles of corporate governance which were defined to the public by OECD are stated as follows (Jesover & Kirkpatrick, 2005).:

I) Ensuring the basis for an effective corporate governance framework

II) The rights of shareholders and key ownership functions

III) The equitable treatment of shareholders;

IV) The role of stakeholders;

V) Disclosure and transparency

VI) The responsibilities of the board

The detailed definitions of each core principles in terms of OECD on corporate governance are described as follows (Jesover & Kirkpatrick, 2005):

I) The corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities.

II) The corporate governance framework should protect and facilitate the exercise of shareholders' rights.

III) The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.

IV) The corporate governance framework should recognize the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.

V) The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.

VI) The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.

The 6 core principles which have been defined by OECD, consider the basic requirements for maintenance of effective corporate governance practices in terms of political, legal, institutional and regulatory framework. Considering through the definitions of core principals by OECD, it could be stated that the Commission focused on the importance of monitoring and control of board members and managers to reduce agency conflict. On the other hand, OECD focused on reducing any possibilities of information asymmetry and the regarding information costs.

In conclusion the OECD focused on a sustainable economic and financial system by considering effective policies on the goodwill of every actor within the system. In order to maintain integrity within the system legal and regulatory bodies must provide independent and effective corporate governance policies, while shareholders, board of directors, managers and stakeholders understand their importance and comply with the policies considering an ethical behavior. On the other hand, the corporate governance policies should support presentation of accurate financially relevant matters on a timely basis.

CHAPTER III
CORPORATE GOVERNANCE IN TURKEY

3.1. Introduction to Corporate Governance in Turkey

Within the content of the research area of this thesis, Turkey is the nation that will be considered as the main focus point to analyze the effects of corporate governance practices. Thus Turkey is considered on a separate section than Chapter II. Through this section of the thesis an introductory analysis of Turkey will be conducted.

Turkey is considered as an emerging market which has an average growth of around 5% annually (after 2002). In terms of economic policies and reforms Turkish government aims to maintain a stable economy while reaching a level of homogeneous and sustainable Gross Domestic Product (GDP) growth. However, the growth of the Turkish economy heavily relies on foreign capital investments. Due to this condition in Turkish economy faces with volatility risk. In order to understand the economic growth an analysis on GDP growth was conducted.

Figure 5 below illustrates annual change in GDP growth as % of Turkey between years 1961 and 2016. The data of the prepared graph was taken from the World Bank. It is also possible to make a comparison in terms of annual GDP growth % of Turkey, OECD members and World (Worldbank, 2018)**:**

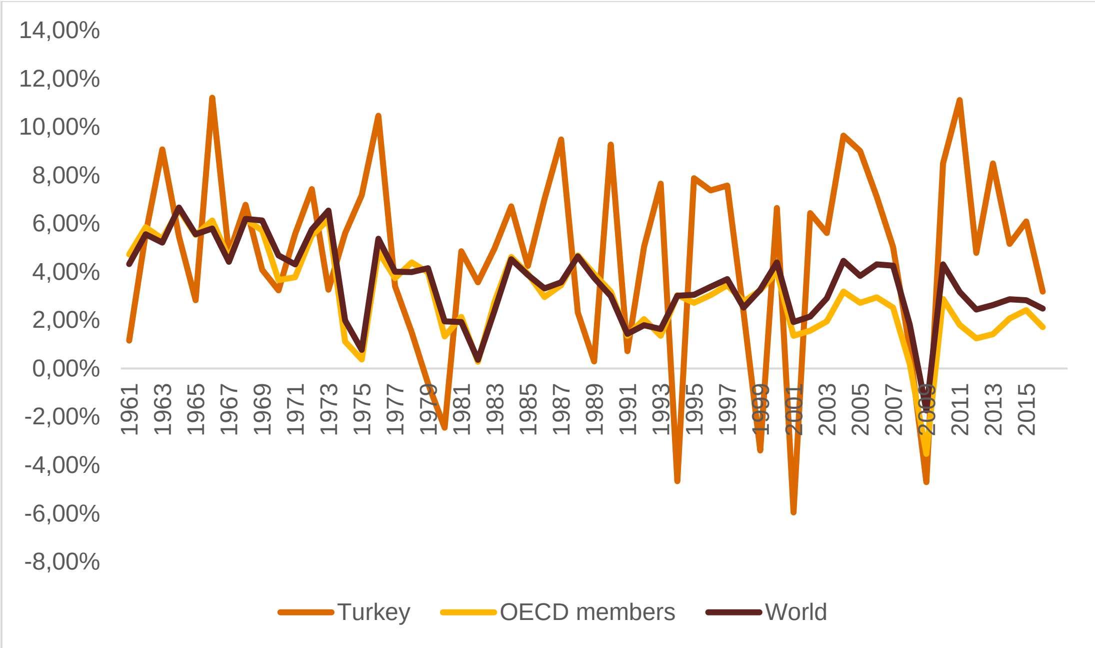

Figure 5: *Annual GDP growth % of Turkey, OECD members and World*

In terms of policy reforms on the economy, after 1980's[4] Turkey effectively uses regulation-deregulation synthesis to adapt the macroeconomic changes. Currently there exists complex network of effective Turkish regulatory bodies which complies with OECD policies for financial systems, including Banking Regulation and Supervision Agency 2001, Competition Authority 1997, Istanbul Stock Exchange 1985, Energy Market Regulatory Authority, Capital Markets Board, 1982, Chambers of Independent Accountants and Certified Public Accountants, and Sworn-in Certified Public Accountants, 1989, Information and Communication Technologies Authority and Public Oversight, Accounting and Auditing Standards Authority 1999.

3.2. Corporate Governance in Turkey

3.2.1. Background Information

Application of corporate governance principles on Turkey dates back to a long period of time. As discussed in Section 2.1.5, Turkish nation is a member OECD since 2 August 1961. Turkish authorities have started to focus on the

[4] Note: Turkeys Before economic policies before 1980's were not stable due to state interventions.

importance of reforms on corporate governance to maintain a sustainable growth and stability within the economy. Capital Markets Board (CMB) is one of the key regulatory bodies of Turkey which is the authority in terms of regulation and supervision for the financial markets. CMB began its operations in 1982 after the establishment of Capital Markets Law (CML) in 1981. The mission of CMB is stated on the official website as: "*To make innovative regulations, and perform supervision with the aim of ensuring fairness, efficiency and transparency in Turkish capital markets, and improving their international competitiveness.*"[5]. (Sermaye Piyasası Kurulu, 2018).

Due to insufficient policies, in the history line of Turkey there have been critical examples of financial, economic and political crises especially between the years 1980 and 2002. Especially the market abuses have sky rocketed after the initial trading of stocks have progressed in 1986. Considering the macroeconomic developments and increase on the number of fraudulent activities CMB decided to launch the initial principles on corporate governance in July, 2003. With the launch on OECD principles of corporate governance in April 2004, detailed work has been performed by the Committee of CMB to integrate core principles of OECD into the Turkish system.

Another major policy on 2004 was the requirement on Istanbul Stock Exchange Listed firms to present corporate governance compliance statements on their yearly disclosures. An amendment on corporate governance principles was conducted by CMB on February, 2005. The amendment included improvements on Shareholder Rights, Periodical Financial Statements and Reports in Public Disclosure and the Company Policy Regarding Shareholders. The principles primarily targeted the publicly traded companies. However currently Turkish regulatory bodies aim to maintain transparency, monitor, control and integrity within the economy, effective corporate governance policies on every business which operates in both public and the private sector. The considerations of CMB principles of corporate governance are on the same line with OECD principles.

[5]The related statement was the updated version of Turkish CMB officials.

The 4 sections of CMB principles cover Shareholders, Disclosure and Transparency, Stakeholders and Board of Directors. The summary of all sections are discussed as follows; (Capital Markets Board, 2014)

The first section of CMB report considers the core principles of corporate governance in terms of shareholder rights. The rights of shareholders include evaluation of relevant information, monitoring, and right to participate, right to vote, right to obtain dividends. Minority rights are also discussed on this chapter to ensure shareholder protection. On the other hand, subjects related with record keeping and suggestions on free transfer of shares are provided by CMB.

The second section of CMB report considers the core corporate governance principles in terms of disclosure and transparency. Considering this content the information distribution policies regarding the shareholders are discussed. Through their standard setting process, CMB considered the updated developments on global financial environment and harmonized those concepts for the case of Turkey. The second section includes the standards which requires corporations to disclose periodic financial statements and reports, within the borders of functional standards.

The third section of CMB report concerns with the corporate governance principles on stakeholders. The definition of stakeholder is considered in this section. Principles which are related with stakeholder rights and corporate responsibilities are discussed through this chapter.

The fourth section of CMB report finalizes the principles by presenting the understandings on functions, duties, structure and obligations of BOD and corporate committees.

3.2.1. Corporate Governance Principles

In our thesis the corporate governance principles of CMB of Turkey are taken as a milestone of Turkish understanding of corporate governance. Considering this, the corporate governance principles of CMB in their report of II-17.1 COMMUNIQUÉ ON CORPORATE GOVERNANCE on an article-by-article basis are summarized and to be presented in this section as follows: (Capital Markets Board, 2014)

Shareholders

According to corporate governance principles of CMB the facilitation of shareholder rights are determined through the "investor related" departments within a corporation which provides a protection of shareholders rights of obtain and monitor of the necessary information of the corporation which is up-to-date, accurate and relevantly disclosed.

The presentation of transparent information shall be on an effective channel (including the website of the corporation). The related regulation on information presentation through general assembly is defined by CMB as "*Following information shall be announced conspicuously in the corporate website of the corporation and at PDP, at least three weeks before the general assembly meeting excluding the days of announcement and the meeting, together with the documentation which shall be submitted to the shareholders for their examination as per Article 437 of the Turkish Commercial Code dated 13 January 2011 and numbered 6102 and with the notifications and explanations that the corporation shall make in accordance with the relevant legislation.*" (Capital Markets Board, 2014). The transparent information should contain the relevant data on; total number of shares (including the types of shares and voting rights), corporate structure, changes in management structure, information on the significant matters of the accounting period which affects the future of corporation, general assembly activities and discussions, documented proposals of shareholders which is presented to the Investor Relations

Department and consideration of any factors which holds an importance in the agenda.

It is suggested by CMB that the agenda must include relevant items which are under separate topics and which does not cause any different interpretations. The general assembly meeting is suggested to be conducted in the places where majority shareholders take place in order to reduce the inequality between shareholders and optimize costs. The responsibility of chairman of meeting is to be prepared across all relevant items of the meeting, and objectively inform the attendees with the relevant information of Turkish Commercial Code, Law and legislations. It is also suggested by CMB that chairman should be attentive in terms of defining the points of general assembly meeting in an objectively manner by providing equal chances to the shareholders while they are expressing opinions and raising questions.[6] It is suggested that the related party transactions of any kind (which depreciates the conflicts of interest) are to be included in the agenda as a separate item where the relevant and detailed information on the matter should be recorded on the minute's part of meeting. The participation of auditors, members of BOD, any related individuals, managers and any officials whom responsible through the process of financial disclosure should be ensured in order to sustain the information symmetry by their responses.

In terms of the transactions of corporations in terms of asset, service and obligation transfer are suggested to be disclosed within the latest financial statements while considering the correct calculation method for each item which is defined by CMB. The related information on these transfers shall be presented on the general assembly and to be approved by the members. For the transactions which consider donations, CMB suggests that the relevant information should be provided within general assembly and the transactions shall occur with the approval within the meeting. On their report, CMB suggests that corporations may prefer to conduct the general assembly meetings open to public which includes both stakeholders and

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[6] Note: Commercial secrets are not directly responded in the general assembly. The complicated questions within general assembly meeting are to be responded after the written proposal within 15 days. The discussions of general assembly meeting are announced to the public within 30 days at the latest date of general assembly.

media. However the participants should not have the right to distribute the private information where a pact may be conducted within this content.

Through their definitions the rights of shareholders were also concern of CMB. Within this content CMB aims the corporations to provide, each shareholder the right to exercise his/her own voting rights with the most proper manner. Through this process CMB suggest the corporations to avoid the actions which complicate or risks the exercise of voting rights by the shareholders. On the other hand, CMB suggests that privileges of voting rights, which prevents the representation rights of holders of publicly traded shares, and cross ownership (with control relationship), should be avoided through voting process. In order to reduce any interest conflicts and to fairly distribute the shareholder rights, protection of minority rights is an important concern within corporate governance principles. Thus CMB suggests a maximum attention on the exercise of minority rights. In the report of CMB the definition of minority rights are stated as follows; *"Minority rights may be defined in the articles of association for shareholders holding less than one twentieth of the capital of the corporation. The scope of minority rights may be enlarged in the articles of association."* (Capital Markets Board, 2014).

The dividend rights of shareholders constitute a sensitive notion. Thus a corporation should clearly state their dividend distribution policy. The stated policy should be approved by the shareholders on general assembly and the information should be announced to the public via relevant transmission sources to reduce any noise. The dividend policy is suggested to be designed with minimum information forecast of the shareholders in order to increase market efficiency and to ensure information symmetry. The design of dividend policy should also consider a balance in dividend distribution in order to reduce any conflicts of interest. Any proposals of professional managers, BOD, on the dividend policy should be considered through general assembly meeting. To provide market efficiency the corporations are suggested by CMB not to complicate free transfer of shares.

Public Disclosure and Transparency

One of the main aim of corporations with good corporate governance practices is to provide information symmetry into the markets with proper information distribution strategies. CMB suggests that corporate website should present at least 5 year based terms of up-to-date information including trade "*registry, shareholder and management structure, share types and structure, corporate articles and the related amendments of Turkish Trade Registry Gazette, material information disclosures, financial statements, annual reports and any other related documents which relates with public disclosure, agendas of general assembly, dividend distribution policies, code of conduct in terms of ethics and answers to frequently asked questions"* (Capital Markets Board, 2014).

The structure of shareholders which includes the names and ratio of ownership, privileged individuals shares which exceeds 5% and cross ownership relations shall be organized and disclosed in within the required period which is stated by CMB. The relevant information is mandatory to be disclosed via public statements within the content of capital markets legislations. In order to reduce the possibility of investor misunderstandings, the English translations of any subject matter through statements should represent true, accurate and relevant meaning of the relevant information which is consistent with the Turkish version. Any information on the website of corporations shall be prepared in terms of foreign languages, the content which is translated from Turkish version should fairly be translated and presented for the usage of international investors.

The presentation of annual report is another matter of fact for CMB in which considers the disclosure of relevant information. The detailed annual report should be issued by BOD to ensure information symmetry within the markets. The presented annual reports should include relevant information, while considering the principles of corporate governance. According to CMB suggestions the annual reports stated by the corporations with good corporate governance must include, presentation of the information on responsibilities of BOD members and key management and their independence declarations, members of committees (including meeting frequencies and evaluation of BOD in terms of efficiency), the attendance schedule of board members and BOD meetings count, identification of significant changes on the amendments, presentation of significant lawsuits and the possibility of provisions, information on conflicts of interest and related corporate actions, cross ownership condition with an excess direct capital of 5%, information on social and professional rights of employees and corporate social responsibility actions. (Capital Markets Board, 2014) The inference from the definitions of CMB is that, any information which is suitable for public presentation should be counted as a public disclosure. Hence, the efficient use of corporate governance principles in terms of public disclosure would benefit the transparency of a corporation.

Stakeholders

The third perspective of corporate governance is given by CMB as "Stakeholders". The definition of stakeholders in terms of corporations is stated by CMB as "*Stakeholders are persons, institutions or interest groups that are related with the achievement of goals or activities of the corporation such as employees, creditors, clients, suppliers, syndicates, several non-profit organizations.".* (Capital Markets Board, 2014) Alongside with shareholders it is a necessity for the corporations to protect the rights of stakeholders. In general the rights of stakeholders are not fully protected by the legislations and contracts. Thus corporations should utilize an effective code of conduct which acts as a right protective policy for stakeholders. It is suggested by CMB that effective compensation of stakeholders must be aligned and disclosed as a corporate policy in case of a violation of stakeholder rights. On the other hand the corporations should form relevant and just policies on employee compensation. The corporations with effective corporate governance policies should use effective channels in order to equally distribute the relevant information on the actions for protection of the rights to the stakeholders. Information on stakeholder rights and the corporate codes should also be presented to the corporate governance committee and/or audit committee to ensure its effectiveness with an independent monitoring mechanism. In order to reduce any interest conflicts that may arise between stakeholders, the corporation shall aim to generate balanced mechanisms which ensures the independent protection of the stakeholder interests & rights.

In order to maintain integrity within the corporation it is necessary to factor stakeholders on the management decisions of a corporation. It is suggested by CMB that models could be developed with the monitor of internal regulatory mechanisms, where the opinions of stakeholders are taken on the corporate decision which affects the stakeholders. The corporation’s policy on human resources should consider the following essential concepts; preparation of beneficial career plans to the employees, equal opportunities to individuals, fair evaluation by a written criteria document, equal distribution of rights, developing improvement plans on employee knowledge, experience and technical capabilities, fair distribution of the corporate information to the employees, notification of employee representatives in employee related decisions, timely announcement of job definition, segregation of duty and the performance & compensation methods to the employees, fair measurement of performance while preventing discrimination of beliefs, race, language and gender, insurance of physical and emotional rights, recognition of freedom on collective bargaining and generation of a safe working condition. (Capital Markets Board, 2014). The corporate human resources plays a critical role on harmonizing these concepts and generating an efficient code of conduct which complies with the ideology of business ethics.

CMB also focuses on the importance of customers and suppliers as important stakeholders. In order to strengthen the relationship of corporations with the suppliers and the customers effective policies should be implied by the corporations. The corporations are responsible for the satisfaction of customers via corporate marketing and sales campaigns on goods and services. On the other hand the demands of customers on purchases are to be met in an urgent and efficient manner. Through their operations the corporations should comply with the regulated quality standards. In terms of distribution of confidentially information corporations should be careful while meeting the demands of suppliers and customers. However it is the responsibility of a corporation to distribute the relevant information to suppliers and customers with an effective channel.

In each step it is a necessity for the corporations to consider the ethical rules and corporate social responsibility. Thus the corporations shall operate considering an ethical code of conduct. The corporations should also be sensitive on their social impacts by recognition of international human rights, environment, consumers and public health. (Capital Markets Board, 2014).

Board of Directors

The final section of CMB regulation covers the importance of BOD through the operations of a corporation. The function of the BOD is defined on the report of CMB as; "*Board of directors keeps in balance a corporation's risk, growth and return at the most appropriate level through strategic decisions and manages and represents the corporation by firstly protecting the long-term benefits of the corporation through rational and prudent risk management. Board of directors defines the strategic targets of the corporation, determines the manpower and financial resources that the corporation would require, and audits the performance of the management*." (Capital Markets Board, 2014).

The BOD acts as the head of a corporation in terms of corporate decision making. BOD is responsible to conduct their activities by considering the concepts of transparency, accountability, fairness and responsibility. The segregation of duties within BOD should be announced via annual report of the corporation. BOD is responsible in terms of establishment of the relevant committees, internal control systems, information technology control systems and risk management. Monitor of risk management and internal control should be conducted by the BOD at least once a year, the related information should be presented in the annual disclosures. It is an important point which is focused by CMB that separation of authorities within the corporation should be processed. This process is necessary in order to reduce agency conflict, risk of mismanagement and fraud. The suggestion on delegation of authority is stated by CMB as; "*No one in the corporation shall be delegated with limitless decision-making authority.*" (Capital Markets Board, 2014). Another responsibility of BOD is to act as a leader on maintaining an efficient communication bridge between shareholders and the corporation by minimizing the chances of information asymmetry.

In the standards of CMB, the structure of BOD is determined in order to generate efficiency on the corporate processes of monitor, decision making and control. The minimum number for the board of directors is given as more than five whom acts as the rapid organizers and decision makers of the corporation.

In order to comply with the corporate governance principles it is suggested that the majority members of BOD should be consisted of members without executive duty. On the other hand there shall be independent members of BOD, and the number of independent board members should not be less than one third of the total BOD members [7]. The service term of independent members is given by CMB as three years, and if the members are nominated after three years may be re-elected after three years. The independent members of board shall qualify; not to have relationship of employment at an administrative level[8], not to have any commercial relation with the corporation (including voting and control rights)[9], not have been a shareholder (5% or more) with significant authority through the framework of business contracts (including audit, tax, internal audit rating and consulting services), to have professional education and experience regarding the business operations, should not be a full time employee on regulatory institutions, resident of Turkey be subjected to Turkish Income Tax Law, comply with ethical standards, a person shall not be independent member of BOD of more than three corporations (Capital Markets Board, 2014). The list of independent member candidates should be presented to nomination committee. The Nomination Committee of a corporation should evaluate the independent member candidate proposals considering the criteria provided by CMB. After the controls the decision shall be taken on a general assembly where the period is defined by CMB. The elected independent members should be on duty before the next general assembly. In cases where codes of independence are distorted by the independent member, information should be given

[7] Note: In case of 5 BOD members, the independent members cannot be less than 2.
[8] Note: The subject duty should not be the case for the candidate within 5 years.
[9] Note: Corporate governance principles suggests that the independent member should not have any relations with corporation including his/her close relatives.

to BOD and the necessary actions regarding the resignation of independent member should be taken. Corporation should consider a balance between male/female ratio by a target which is determined by CMB as at least 25%. At least one member should have the qualifications, knowledge and experience to monitor audit activities. The detailed explanations on independent members are described in the articles of the report of CMB.

The procedures on the meetings of BOD by CMB suggest that, the meetings should meet the responsibilities of BOD in a frequent and efficient manner. The chairman of board is responsible to clearly and comprehensively inform the members by the documents and agenda timely before the next meeting. The members whom are not eligible to attend the meeting have the right to submit their opinion in a documented form. It is suggested by CMB that each member of BOD has one right to vote. All of the BOD meeting procedures should be on a written form for the purposes of documentation. Board members are responsible to allocate the necessary time in terms of the businesses of the corporation in terms of the internal and external duties.

In order to increase the efficiency on monitoring duties of the corporate activities it is necessary to form Committees within the structure BOD. The CMB suggests corporations the names of the necessary committees as; *"Audit Committee" (except for banks), "Early Detection of Risk Committee" (except for banks), "Corporate Governance Committee", "Nomination Committee, Compensation Committee" (except for banks) in order to fulfill its duties and responsibilities in a reliable way. However, in case that a separate nomination committee and compensation committee cannot be established due to the structure of the board of directors, corporate governance committee shall fulfill the duties of such committees."* (Capital Markets Board, 2014). CEO should not be authorized in these committees to strengthen the principles of monitoring. Similar with the CEO case, the board members should not have any authorization through these committees. The committees of corporations shall be composed of at least two members, whom are specialist on their area. Professional consultancy may be benefited by the committees from independent parties, the payment of these consultancy services are realized by the corporation and stated in the annual report. Similar to any other CMB principles of corporate governance, the committees should clearly document their work and submit them to the BOD meetings.

The responsibilities of each committee hold a great importance on corporate governance of a corporation. At this point, the responsibilities of the Audit Committee is defined by CMB as; "*The Audit committee shall be in charge of the supervision of the corporation's accounting system, public disclosure of the financial information, independent auditing and the operation and efficiency of internal control and internal audit system. Election of the independent audit institution, initiation of the independent audit process by preparing the contracts of independent audit and the work of the independent audit institution at all levels shall be conducted under the supervision of the audit committee."* (Capital Markets Board, 2014). Audit committee is also responsible to decide on the independent audit services and share the information with BOD. Audit committee should design a methodology for the evaluation of the policies of the corporation on accounting, internal control and independent audit. On the other hand the audit committee should evaluate policies on timely and accurate distribution of annual & interim financial reporting to ensure transparency. The committee is responsible to search and evaluate for any findings regarding the operations of the business, in at least four times a year. The results of the analysis of committee will be presented through the annual statements of corporation.

The second important committee which has been suggested by CMB is the Corporate Governance Committee. The purpose of corporate governance committee is to apply effective policies which reduce any conflict of interest while ensuring the compliance with corporate governance principles. The committee is responsible to give information to the board on corporate governance activities within the corporation. On the other hand the committee acts as a body which supervises the investor relations.

The third type of committee which has been suggested by CMB is the Nomination Committee. The nomination committee of a corporation is responsible to ensure transparent mechanisms on the processes of evaluation of BOD members and the executives. The committee should regularly evaluate the productivity of BOD, and present their reports to the BOD for any suggestions on improvement.

The fourth necessary committee which has been suggested by CMB is the Committee of Early Detection of Risk. In line with its name, the committee shall act as a body for the early detection of risks which may be in the form of corporate threats, development and continuation of the business. The committee should work through the risks of a corporation at least once in a year and present their documented reports to the BOD. With the help of this committee it is possible for a firm with good corporate governance to take necessary actions for any deficiencies before it is too late.

The last of the proposed committees by CMB is the Remuneration Committee. The responsibility of remuneration committee is to manage the design appropriate mechanisms in terms of remuneration of BOD members and the executives. The committee should consider the long term goals and objectives of a corporation and provide supervision through remuneration of BOD and executives. In line with any other committee, the remuneration committee shall document its advices and present them to the authorities.

The last section of CMB in terms of BOD considers the financial rights of BOD members and executives. It is stated that BOD is the responsible of a corporation in terms of navigating the business in line with the corporate goals and objectives by designing effective controlling and monitoring mechanisms for operational and financial performance. The members of remuneration should advice policies with documented reports on the BOD members (including the independent members) and any payment and compensation plans. The corporation is responsible for not lending money in any terms to the members of BOD or executives. The reports after remunerations should be disclosed to the public through annual public reports to comply with the principle of transparency.

With their report, the CMB of Turkey aimed to clearly state all of the disclosures which are necessary for business in terms of Shareholders, Board of Directors, Stakeholders and Public Disclosure and Transparency on Corporate Governance Principles.

3.3. Details on Corporate Governance Index (XKURY) of Turkey

The stock market of Turkey, BIST, uses a corporate governance measurement index which is called as BIST Corporate Governance Index (XKURY). XKURY considers measuring the price and return performances of listed companies in Borsa Istanbul Stock Market (BIST). XKURY considers listed companies which are not under the watchlist and companies which have corporate governance rating above 7/10 (The rating for each section must be above 6.5).

The corporate governance rating of companies is conducted by rating agencies which are assigned by the Capital Markets Board (CMB) of Turkey. Corporate Governance Index calculation of BIST operationalized on 31 August 2007. Academic studies are generally performed on XKURY to measure the relationship of XKURY with financially relevant dependent variables. The detailed literature review is provided in the next chapter.

The corporate governance rating schedule and regarding definitions which are taken from an independent rating agency, called as Saha Rating, are presented with the following Table 2[10] as (SAHA Corporate Governance and Credit Rating Services, 2015):

[10] The table was conducted with the most recent data provided by Saha Rating on 2018.

Table 2: *Corporate Governance Rating Definitions of Turkey*

Rating	Definition
9–10	The company performs very good in terms of Capital Markets Board's corporate governance principles. It has, to varying degrees, identified and actively managed all significant corporate governance risks through comprehensive internal controls and management systems. The company's performance is considered to represent best practice, and it had almost no deficiencies in any of the areas rated.
7–8	The company performs good in terms of Capital Markets Board's corporate governance principles and has qualified to be included in the BIST's (Borsa Istanbul) Corporate Governance Index. It has, to varying degrees, identified all its material corporate governance risks and is actively managing the majority of them through internal controls and management systems. During the rating process, minor deficiencies were found in one or two of the areas rated.
6	The company performs fair in terms of Capital Markets Board's corporate governance principles. It has, to varying degrees, identified the majority of its material corporate governance risks and is beginning to actively manage them. Management accountability is considered in accordance with national standards but may be lagging behind international best practice. During the ratings process, minor deficiencies were identified in more than two of the areas rated.
4–5	The company performs weakly as a result of poor corporate governance policies and practices. The company has, to varying degrees, identified its minimum obligations but does not demonstrate an effective, integrated system of controls for managing related risks. Assurance mechanisms are weak. The rating has identified significant deficiencies in a number (but not the majority) of areas rated.
<4	The company performs very weakly and its corporate governance policies and practices are overall very poor. The company shows limited awareness of corporate governance risks, and internal controls are almost non-existent. Significant deficiencies are apparent in the majority of areas rated and have led to significant material loss and investor concern.

CHAPTER IV

EMPIRICAL ANALYSIS ON CORPORATE GOVERNANCE

In this section, we attempt to evaluate the relationship between Borsa İstanbul Corporate Governance Index (XKURY) and the level of transparency revealed by stock market returns and liquidity.

4.1. Literature review

In order to understand the broad vision and context of the research area of corporate governance it is essential to consider the studies which have been conducted in literature. Thus through this section of the thesis, an analysis of the studies on literature in terms of the relationship of corporate governance compliance with respect to other independent variables is conducted. The summary of various analyses on corporate governance and the corresponding findings will be discussed as follows.

A study conducted by Caliskan and Aydin (2017) analyzes the volatility of XKURY between the years 03.03.2014 and 10.03.2017. The researchers aim at evaluating the risk of XKURY in terms of volatility from the movement effects of asymmetric information. The findings of the study reveal that there is an existence of long term volatility on XKURY rather than short term volatility. The long term volatility of XKURY is explained by the researchers with the characteristics of XKURY data. On the date of research, March 2017, XKURY data was formed out of 50 firms. All of the firms considered within XKURY are regularly graded by the CMB licensed institutions as firms with successful corporate governance practices. Considering transparency theory it is expected from the companies with effective corporate governance practices to have lower volatility on short term.

The researchers argue that while finding their results the best model was reached by the estimations of SWARCH 2,2 model.

In his paper, Kahveci (2016) conducts a semantic analysis of the annual reports tones of Borsa Istanbul quoted companies with XKURY and its impact on corporate performance. On his analysis, Kahveci primarily considers the calculation of efficiency scores of the businesses by using the factors of assets and number of employees 2014 data of the firms as inputs and the average market price, market capitalization, book value per share and price/book value per share as outputs. On the next step, Kahveci adds his model the data of corporate governance ratings for the 45/50 XKURY listed companies in order to measure the impact of good corporate governance practices on the efficiency scores of companies[11]. The analysis of model shows that implementation of good corporate governance practices and their future expression tones on corporate governance in their annual reports ends up with a positive impact on the efficiency scores.

The research conducted by Değer and Aydoğan (2017) measures effective corporate governance practices and financial performance company with the data between years 2007 and 2015. On their analysis the researchers consider corporate governance scores of 38 (XKURY listed) companies. The results of the analysis show statistically significant and positive relationship between financial performance (ROA) and market based Tobin's Q ratios (market values and performance) and the corporate governance scores 38 companies listed in XKURY. Additionally, the researchers conclude that companies, which apply good corporate governance practices, have higher accounting reliability, which appreciated the investor confidence and attracts capital inflow. It is concluded by the researchers that corporate governance practices acts a safeguard mechanism for stakeholders, while increasing the corporate performance and efficiency of the market.

The paper by Dağlı et al. (2012) evaluates the relationship between XKURY and risk & return between the period of September 2007 and November 2009.

[11] (Note: Kahveci used 45 companies due to lack of English annual reports for 5 XKURY listed companies for 2014.)

Through the analysis daily data on returns are taken from the Istanbul Stock Exchange (ISE) monthly journals and the data for risk free rate (Rf) was taken from the monthly statistics of Central Bank of The Republic of Turkey. To measure financial performance, Sharpe portfolio performance index (total risk measure) and Treynor and Jensen indexes (systematic risk measure) are used. Through the analysis the core principle of finance "*direct positive correlation between risk and return*" is measured. The result of good corporate governance mechanisms generates information symmetry and reduces the market volatility. This condition is stated by the researchers as "*…well-organized corporate governance implementations do not cause higher returns."*. As expected the conclusion of the analysis is that it is less risky to invest the companies which are listed in XKURY, which could also be interpreted as there is a negative correlation between effective corporate governance practices and the market risk.

On their study Varshney et al. (2012) investigate the relationship between corporate governance index and firm performance in India. The researchers measure this relationship by generating a corporate governance index based on internal and external control efficiency measure for 105 Indian companies. To test firm performance, the researchers apply Economic Value Added (EVA) measurement as a basis. The econometric model results with a significant positive correlation between the Corporate Governance Index and EVA. Thus the researchers conclude their paper by stating that there is an existence of a positive relationship between Corporate Governance Index and firm performance, when the performance measurement tool is in terms of EVA basis.

A research was conducted by Cengiz (2016) aims at measuring the relationship between the value of corporate governance rating and firm performance. On the other hand, Borsa Istanbul 100 Index listed companies are compared by measuring the performance differences of the companies which are listed in XKURY and the ones without rating. The conclusion is that the companies which are listed in XKURY have higher financial performances in the aspects of Return on Assets (ROA), Return on Equity (ROE), Net Profit Margin and Market Book Value compared to the companies without corporate governance index listing.

Ataünal and Aybars (2017) conduct an empirical analysis on the market and operating performances of firms and the implied corporate governance mechanisms, for a period between 2007 and 2015. The researchers find a positive correlation between the corporate governance rating and firm performance which consists of stock market performance which is measured by Tobin's Q and operating performance which is measured by ROA. Additional they find that application of good corporate governance practices generates a positive impact on shareholders stakeholder, public disclosure and transparency. This condition results with a positive impact on the market performance. Through their analysis the researchers find board structure was statistically insignificant.

Kula and Baykurt (2017) evaluate comparative analysis of corporate governance rankings by considering multiple-criteria decision making tools for 56 companies listed in BIST XKURY, as of 2014. The researchers state that BIST XKURY index is a new index in the stock exchange, which is effective since 2007. Considering the possible contradictions between difference corporate governance rating methods, the researchers offer a caution in the evaluation process of the companies by XKURY.

The paper by Aydin and Caliskan (2015) evaluates potential relationships between corporate governance and dividend policy. The research is conducted with a sample of 19 companies which are listed in XKURY over the period 2007 and 2014. The empirical results of researchers suggest that there is an insignificant relationship between corporate governance and dividend policy. On the other hand, the researchers observe positive relationships between foreign ownership and dividend policy, between firm size and dividend policy. On the other side, the researchers find negative relationships between ownership concentration and dividend policy and managerial ownership and dividend policy ROE and dividend policy.

On their analysis Gompers et al. (2003) build a model in order to evaluate the corporate governance index[12] and corporate performance for 1.500 large firms, during 1990s. Corporate Governance Index (G) was used to represent shareholder

[12] Note: The corporate governance index on this paper was built by the researchers.

rights. The findings of the researchers on firms with higher shareholder rights are: higher firm value, sales growth, profits and lower capital expenditures and corporate acquisitions. The researchers conclude that there exists a positive correlation between corporate governance and equity returns.

The paper by Pekcan et al. (2012) evaluates the magnitude and relationship between XKURY and the other three indexes of BIST; XU30, XU100 and XUTUM. Even though the researchers find a strong positive correlation in terms of direction of XKURY and other indexes, it is stated that *“the XKURY index is not a Granger reason for the other indices” and “the other indices are not Granger reasons for the XKURY index”*. Hence the conclusion is that it is not feasible on evaluating the investment decisions to XKURY by observing the movements of XU30, XU100 and XUTUM indexes.

On their paper Tuzcu and Fıkırkoca (2005) aim at analyzing how Istanbul Stock Exchange listed firms react to demands and expectations of stakeholders. Through the analysis, the characteristics of Turkish corporate governance model is assessed as an example of emerging markets and compared with Anglo-Saxon and Continental Europe models. The findings of Tuzcu and Fıkırkoca are; Turkish corporate governance performance signals to a certain degree of institutional isomorphism and the workers are key stakeholders in the Turkish corporate governance model and there is an existence of a hybrid corporate governance model for Turkish which is a mixture of Anglo-Saxon and Continental Europe understandings.

Basım and Meydan (2007) compare 73 empirical studies on corporate governance and firm performance by the classifications on board of directors, ownership, management, audit, shareholder rights and transparency. The researchers state that there has been lack of research on corporate governance in 2007 which limits the data source. The findings of researchers with the limited data are that there is an evidence for the firms which practice corporate governance codes, would support the principles of transparency and as well as generate a higher performance.

Gurarda et al. (2016) conduct an analysis on the corporate governance and ownership structure for 22 publicly traded Turkish companies. On their findings the researchers suggest that earnings, company size and financial leverage positively impacts corporate governance rating. On the other hand, return on equity and family control have negative impact on corporate governance rating.

A study on the relationship between performance and corporate governance conducted by Needles et al. (2012) analyze High Performance Companies (HPC) and Ordinary Companies (ORD), which are operating in Turkey, in terms of corporate governance. It is found by the researchers that high performing companies applied superior corporate governance practices compared to ordinary performing companies. Thus the higher performing companies score higher on applications of good corporate governance than ordinary companies.

Akbar et al (2016) consider the relationship between corporate governance compliance and firm performance. To measure corporate governance compliance, the researchers use a Corporate Governance Index as a basis for measuring the possible effects on firm performance. After their analysis on corporate governance and performance, the researchers suggest to take into account three intrinsic factors of: unobservable heterogeneity, simultaneity and the dynamic corporate performance for further research.

Chung et al. (2008) evaluate the empirical relationship between corporate governance practices and stock market liquidity. A suggestion by the researchers is that the companies which apply good corporate governance are more likely to have a liquid secondary market on their shares. The reason for this case is that good corporate governance mechanisms generate financial and operational transparency, which reduces information asymmetry. The researchers also suggest that good corporate governance enhances the firm value by positively affecting the stock market liquidity. The researchers conclude by stating that their findings included that companies with good corporate governance have narrower spreads, higher market liquidity and less price impacts on trade (due to transparency).

4.2. Data, Hypotheses and Methodology

In this section the presentation of the data which has been utilized for this study and the methodological approaches will be processed as follows:

The sample of this study includes all firms listed in Borsa Istanbul, which have experienced inclusions to or exclusions from XKURY between April 29th, 2013 and November 30th, 2017. As all data pertaining to inclusions and exclusions have been retrieved from Bloomberg, the starting and ending dates have been determined with respect to Bloomberg's data availability. In this regard, our sample consists of 76 firms, of which 63 have experienced inclusion while only 13 have experienced exclusion. Table 3 lists these firms year-by-year.

As can be seen from Table 3, most of the inclusion cases [more than 75% (48/63)] have been experienced in 2013. Moreover, financial firms [51% (32/63)] and manufacturing companies [35% (22/63)] dominate the XKURY inclusions throughout the years. This is also true for exclusions where both industries account for almost 93% (12/13) of all companies. Other firms that have been included to and/or excluded from XKURY belong to wholesale and retail, mining, construction, transportation and communication, and technology sectors.

Index inclusion or exclusion cases are potential candidates for signaling new information about the future performance of a firm. This new information is so positive or negative that the price impact is expected to be permanent. While this argument might be acceptable for price indices, it is hard to believe that it is also valid for a price-irrelevant index such as XKURY. Since XKURY is an index for firms that comply with corporate governance principles, the price impact of inclusion or exclusion may differ from that of price indices. Investors, rather, would have the perception of transparency when a firm is included to or excluded from such an index. In this regard, inclusion (exclusion) would mean increased (decreased) level of transparency.

Table 3: *Inclusions to and Exclusions from XKURY*

			Industry						
Year	**Action**	**#**	**Manufacturing**	**Wholesale & Retail**	**Mining**	**Construction**	**Transportation & Telecommunication**	**Technology**	**Financial**
2013		48	18	2	1	1	1	2	23
2014		5	2				1		2
2015	**Inclusion**	6	2						4
2016		1		1					
2017		3							3
Total		**63**	**22**	**3**	**1**	**1**	**2**	**2**	**32**
Year									
2013		2	1						1
2014		3							3
2015	**Exclusion**	5	1	1					3
2016		1	1						
2017		2							2
Total		**13**	**3**	**1**					**9**

Note That: The sample covers the period from April 29th, 2013 and November 30th, 2017.

Since corporate governance brings forth transparency in the market of a given stock, market efficiency would improve and it would be less possible to earn abnormal returns for investors. In this regard, we do not expect to see significant abnormal returns in inclusion cases in the short-run. However, abnormal price impacts should occur in exclusion cases since investors would believe that the level of transparency is deteriorated. Therefore, the following hypothesis pursuing the transparency effect is formulated:

Hypothesis 1

Inclusion (exclusion) to (from) XKURY decreases (increases) the possibility of abnormal returns/losses in the stock market.

On the other hand, as a natural outcome of improved efficiency in the market, a stock's market liquidity would also increase. We use bid-ask spreads of each stock as a proxy for liquidity. We expect that spreads would tighten in inclusion cases while they would widen in exclusion cases. In this regard, our second hypothesis is put forth as follows:

Hypothesis 2

Inclusion (exclusion) to (from) XKURY tightens (widens) abnormal spreads in the stock's market.

In this study, standard event study methodology is conducted to analyze the short-run effects of XKURY inclusions and exclusions on abnormal returns and spreads. An event study is concerned with the impact of an event on a specific dependent variable. In the majority of applications, event study methodology is commonly associated with return analysis, where the dependent variable is the stock price of a company, manifesting itself in abnormal returns (Woon, 2004)

The methodology basically relies on market efficiency in that there is good reason to expect that impacts of an event will be reflected in stock prices in a short period of time in relatively efficient markets (MacKinlay, 1997). Hence, it is used to measure market efficiency and is very common in finance.

The abnormal return is mostly defined as the deviation from the expected return, which is formulated as: (Yıldız, Karan, & Pirgaip, 2017)

$$AR_{i,t} = R_{i,t} - ER_{i,t} \tag{1}$$

In Equation (1), $AR_{i,t}$, $R_{i,t}$ and $ER_{i,t}$ represent the abnormal return of the firm i in time t, the return of the firm i in time t and expected return of the firm i in time t, respectively. We calculate the expected return using the following market model:

$$ER_{i,} = \alpha_{\mathrm{i}} + \beta_{\mathrm{i}} R_{m,} \tag{2}$$

To calculate the abnormal returns for each day in the event period, first we estimate α and β regressing the daily stock returns with the market returns covering 100 trading days before the event period [-10, -110]. Then we use these α and β estimates to calculate the expected return of the stock for each day in the event period as it is expressed in Equation (2). We use BIST100 index as the market proxy. We calculate cumulative abnormal returns belonging to various event periods by aggregating abnormal returns of stocks in the event period. We also calculate mean cumulative abnormal return (MCAR) of our sample by averaging the cumulative abnormal returns of the firms in a given event period. The event period covers 20 days [-10, +10], where 10 days for the pre-inclusion/exclusion period and 10 days for the post-inclusion/exclusion period. We cumulate abnormal returns from the Day -10 to Day -1 and also from Day 1 to Day 10 separately to observe the cumulative market reactions before and after the event.

For the spreads, however, we use the following Ordinary Least Squares (OLS) model (Affleck-Graves, Callahan, & Ramanan, 2000):

$$S_{i,t} = \alpha_I + \gamma_i D_i + \varepsilon_{i,t} \tag{3}$$

The representations are determined as follows, $S_{i,t}$ is the spread for stock *i* on day *t*; α_1 is a scalar intercept term; D_i is an indicator variable equal to 1 on the event date; 0 otherwise. As we have multiple day event windows, a separate indicator variable is included for each day in the event window. γ_i is the abnormal spread on the event date; $\varepsilon_{i,t}$ is the random disturbance term. This model effectively equals taking the mean of daily spreads in the event period [-10, -110]. Thus, it is a mean-adjusted model. Because of large cross-sectional differences in the measures of spread, the abnormal spread during the event period is standardized (by the standard error of the estimate). This is calculated as follows:

$$SAS_{i,e} = \gamma_i / S.E.\ (\gamma_i) \qquad (4)$$

4.3. Empirical Findings

<u>Return Effect of Inclusion</u>

Table 4 presents the mean abnormal returns (MAR) and mean cumulative abnormal returns (MCAR) around the inclusion day (Day 0).

From Table 4, we observe that the event day abnormal return is about 0.21% and is not statistically significant. In the pre-event period, a negative reaction reveals itself just prior to the inclusion day. In the post-event period, the negative reaction survives for a three-day period in which the abnormal return (-0,32%) becomes significant at 5% level on the second day after inclusion. At 4^{th} and 7^{th} days, positive abnormal returns have been accomplished. After the analysis no significant evidence was found for mean cumulative abnormal returns. However, we witness mostly negative reactions in both pre-event and post-event periods which make us think that investors' opportunities to earn abnormal returns have started to decline even before the stocks are included in XKURY and this pattern has improved after inclusion. Almost the same pattern is observed for non-parametric tests.

Table 4: Abnormal return of stocks included in XKURY

Day	MAR(%)	*t*(MAR)	MCAR(%)	*t*(MCAR)	Wilcoxon tests	
-10	-0,05439	-0,37265	-0,05439	-0,37265	-0,466	-0,466
-9	-0,11279	-0,84672	-0,16718	-0,74731	-0,958	-0,691
-8	-0,09099	-0,61658	-0,25817	-0,94614	-1,253	-1,020
-7	**-0,16950***	-1,64955	-0,42767	-1,42014	-1,178	-1,164
-6	**0,17843***	1,72384	-0,24925	-0,83321	1,465	-0,602
-5	0,14532	0,85870	-0,10392	-0,32883	0,068	-0,246
-4	**0,40512****	1,99893	0,30120	0,80275	**2,074****	0,589
-3	-0,08060	-0,74632	0,22059	0,54547	-0,849	0,288
-2	0,03013	0,18164	0,25072	0,59058	-0,746	0,445
-1	**-0,23120***	-1,69328	0,01952	0,04750	-1,479	-0,021
0	0,21424	0,80664	0,23376	0,44413	-0,192	0,068
1	-0,10289	-0,56265	0,13087	0,22850	**-2,013****	-0,685
2	**-0,32221****	-2,36125	-0,19134	-0,34368	**-2,547****	-1,095
3	-0,13799	-0,84524	-0,32933	-0,56965	-0,972	-0,972
4	**0,23221****	1,98945	-0,09712	-0,15302	**2,198****	-0,678
5	-0,13417	-1,01398	-0,23129	-0,35899	-1,506	-0,712
6	-0,03221	-0,22810	-0,26350	-0,42456	-0,801	-0,835
7	**0,32036****	2,19446	0,05686	0,09480	**2,376****	-0,301
8	-0,09907	-0,57569	-0,04221	-0,06755	-1,020	-0,424
9	-0,20841	-1,59766	-0,25062	-0,39726	-1,691*	-0,787
10	-0,18408	-1,44506	-0,43471	-0,66658	-1,801*	-1,383

Note that the event day is denoted as Day 0. MAR(%) and MCAR(%) represent the mean abnormal return and mean cumulative abnormal return, respectively. t(MAR) and t(MCAR) represent the t values. 6th and 7th columns of the table shows non-parametric Wilcoxon signed-rank test statistics of MAR and MCAR which tests whether the z value is significantly different than zero. ** and * denote the significance level at 5% and 10% respectively. Sample includes 63 observations.

Mean cumulative abnormal return results covering all trading days in the event period [-10, +10] is depicted in Figure 6 as follows.

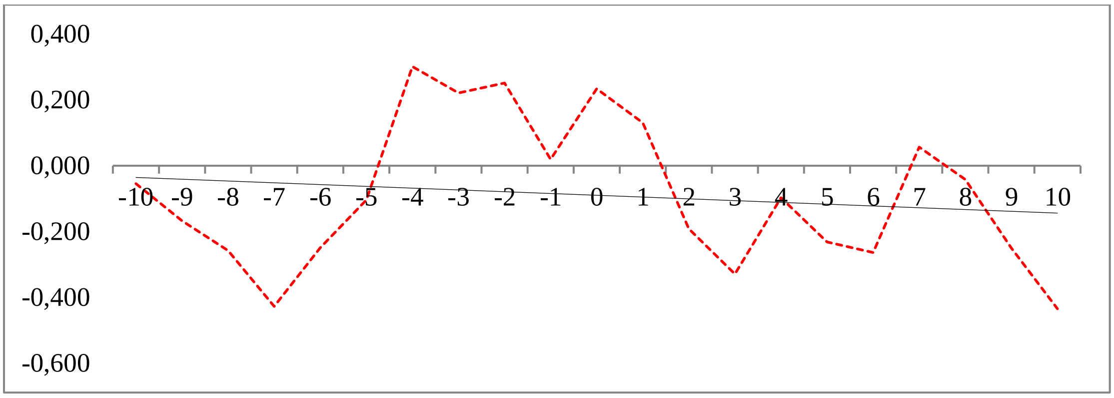

Figure 6: *Mean cumulative abnormal returns for the stocks included to XKURY*

As it is seen in Figure 6, there is a decreasing trend in abnormal returns for the stocks which are included to XKURY. It could also be seen that there is an existence of sharp increases after the inclusion.

Spread Effect of Inclusion

The impact of inclusion on the spreads of equities can be tracked from Table 5 which is presented on the analysis below. Data in Table 5 reveal that spreads have started to tighten before the event date, but the impact has been statistically insignificant. However, starting from 2 days after inclusion, the significance of spread reduction is clear insomuch as it has lasted even 10 days after event date.

Table 5: Abnormal spread of stocks included to XKURY

Day	SAS(%)	*t*(SAS)	Wilcoxon test
-10	-0,31427	-2,11243	**-2,013****
-9	-0,16520	-1,11854	-1,253
-8	-0,18007	-1,26225	-1,513
-7	-0,12654	-0,77479	-1,458
-6	0,00528	0,02874	-0,876
-5	0,30351	1,42394	0,863
-4	0,00573	0,02726	-0,561
-3	-0,22897	-1,18281	-1,362
-2	-0,16607	-0,89774	-1,109
-1	-0,14943	-0,72397	-1,417
0	-0,15804	-0,84140	-1,465
1	-0,17431	-0,95435	-1,390
2	**-0,41549****	-2,27312	**-2,266****
3	-0,24532	-1,24483	-1,308
4	**-0,39446****	-2,07681	**-2,109****
5	**-0,39249****	-2,04863	**-2,054****
6	**-0,38986****	-1,98622	**-1,924***
7	**-0,35068***	-1,75900	**-1,773***
8	-0,25992	-1,29137	-1,623
9	**-0,32028***	-1,65096	**-1,657***
10	**-0,46733****	-2,52850	**-2,287****

Note that the event day is denoted as Day 0. SAS(%) represents the standardized abnormal return. t(SAS) represents the t values. 3rd column of the table shows non-parametric Wilcoxon signed-rank test statistics of SAS which tests whether the z value is significantly different than zero. ** and * denote the significance level at 5% and 10% respectively. Sample includes 63 observations.

We have observed the behavior of mean abnormal spreads in Figure 7 as follows;

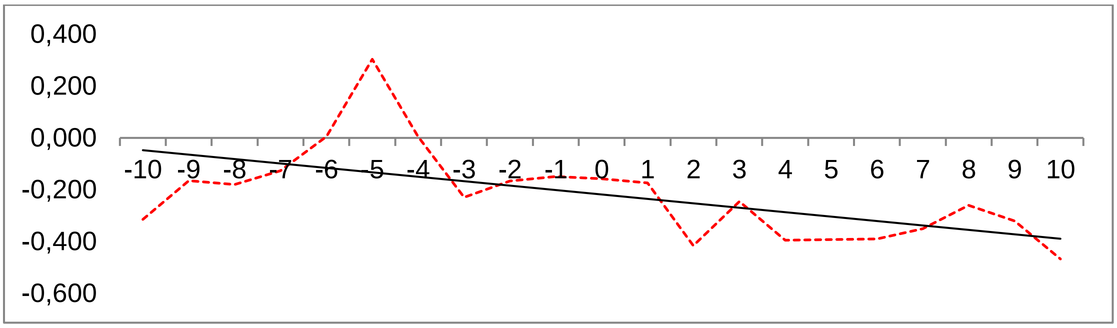

Figure 7: Mean abnormal spreads for the stocks included to XKURY

The analysis of Figure 7 suggests that the spreads have started to tighten even before the event date. The observed tightening of the spreads has been improved after inclusion.

Return effect of exclusion

Table 6 presents the mean abnormal return (MAR) and mean cumulative abnormal returns (MCAR) around the exclusion day (Day 0). The analysis for return effect of exclusion is conducted via following table:

Table 6: Abnormal return of stocks excluded from XKURY

Day	MAR(%)	*t*(MAR)	MCAR(%)	*t*(MCAR)	Wilcoxon test	
-10	0,23493	1,17533	0,23493	1,17533	0,594	0,594
-9	-0,17391	-0,97520	0,06102	0,21767	-1,223	-0,245
-8	-0,09512	-0,64318	-0,03410	-0,09983	-0,594	-0,524
-7	0,09424	0,53652	0,06014	0,16956	0,314	-0,105
-6	0,23443	0,71798	0,29457	0,53695	0,664	0,594
-5	0,49149	0,80486	0,78606	0,81993	0,314	0,454
-4	**-0,61574****	-1,96803	0,17032	0,19244	**-1,852***	0,175
-3	0,12870	0,45529	0,29902	0,32648	0,454	0,664
-2	-0,25300	-0,75779	0,04602	0,05630	-1,363	0,454
-1	**-0,37494****	-2,38826	-0,32892	-0,37888	**-1,782***	-0,105
0	-0,47490	-1,17008	-0,80382	-0,85017	-0,943	-0,804
1	**-0,83600***	-1,81571	-1,63982	-1,42446	**-1,852***	-1,293
2	-0,27230	-0,53309	-1,91211	-1,19550	-0,594	-1,433
3	-0,30757	-0,84791	-2,21968	-1,53195	-1,153	-1,642
4	0,13386	0,39232	-2,08582	-1,56275	-0,384	**-1,782***
5	-0,36288	-0,61609	**-2,44870***	-1,75682	-0,943	**-1,712***
6	-0,10167	-0,36880	**-2,55037***	-1,85233	-0,734	**-1,712***
7	**-0,52428***	-1,89864	**-3,07465****	-2,34592	-1,642	**-2,132****
8	**-0,52634****	-2,10384	**-3,60099****	-2,53509	**-2,132****	**-2,201****
9	0,14405	0,47078	**-3,45694****	-2,24589	0,804	**-2,062****
10	**-0,47276***	-1,88315	**-3,92970****	-2,31930	-1,293	**-1,922***

Note that the event day is denoted as Day 0. MAR(%) and MCAR(%) represent the mean abnormal return and mean cumulative abnormal return, respectively. t(MAR) and t(MCAR) represent the t values. 6th and 7th columns of the table shows non-parametric Wilcoxon signed-rank test statistics of MAR and MCAR which tests whether the z value is significantly different than zero. **, and * denote the significance level at 5% and 10% respectively. Sample includes 13 observations.

Through the analysis from Table 6, we observe that the event day abnormal return is about -0.48% and is not statistically significant. In the pre-event period, a negative reaction reveals itself just prior to the exclusion day. In the post-event period, the negative reaction is highly significant in most of the days at 5% level. These findings suggest that investors cannot earn abnormal returns; rather they are punished due to exclusion from XKURY. This is also apparent in the non-parametric analyses.

Mean cumulative abnormal return results covering all trading days in the event period [-10, +10] is depicted in Figure 8.

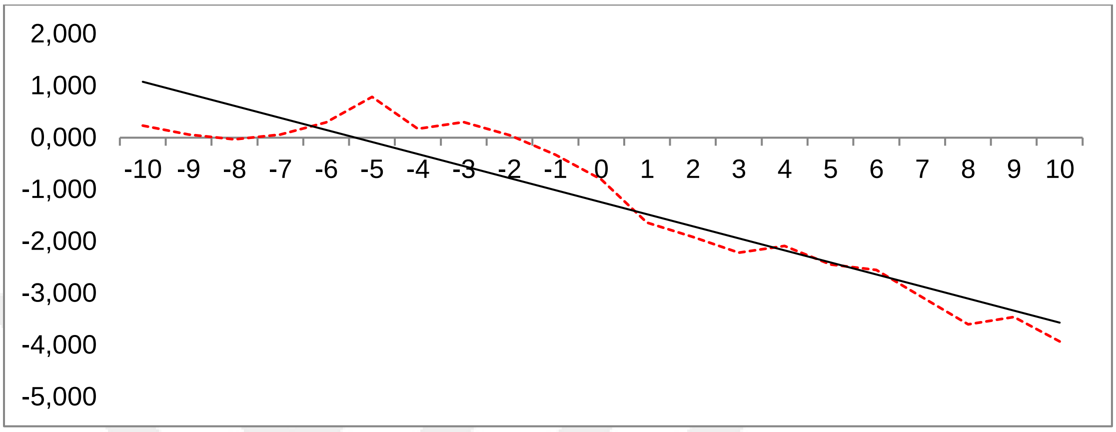

Figure 8: Mean cumulative abnormal returns for the stocks excluded from XKURY

As it is seen in Figure 1, there is a sharp downward-sloped trend in abnormal returns, especially after the exclusion date.

Spread effect of exclusion

The impact of exclusion on the spreads of equities can be observed from Table 7 as follows;

After the analysis of the data in Table 7 it is revealed that spreads have started to widen after the event date but the impact has been statistically insignificant. However, in most of the days upon exclusion the spread is has been getting wider and wider.

Table 7: Abnormal spread of stocks included to XKURY

Day	SAS(%)	*t*(SAS)	Wilcoxon test
-10	-0,40185	-0,95788	-0,874
-9	-0,39634	-1,04278	-1,013
-8	-0,63274	-1,75898	-1,572
-7	-0,59671	-1,66858	-1,572
-6	-0,38427	-0,98175	-0,943
-5	-0,47936	-1,11271	-0,943
-4	-0,56391	-1,40780	-1,363
-3	-0,50807	-1,25882	-1,083
-2	-0,52064	-1,39423	-1,293
-1	-0,45039	-1,27359	-1,083
0	-0,39375	-1,14394	-0,943
1	-0,12445	-0,23076	-0,943
2	0,09451	0,15388	-0,245
3	-0,15140	-0,30635	-0,384
4	0,09093	0,14103	-0,314
5	0,32969	0,52244	0,175
6	0,35958	0,62559	0,314
7	0,45583	0,72597	0,035
8	0,67957	0,89184	0,035
9	0,84741	1,22187	0,594
10	0,58040	0,96265	0,454

Note that the event day is denoted as Day 0. SAS(%) represents the standardized abnormal return. t(SAS) represents the t values. 3rd column of the table shows non-parametric Wilcoxon signed-rank test statistics of SAS which tests whether the z value is significantly different than zero. ** and * denote the significance level at 5% and 10% respectively. Sample includes 13 observations.

We can observe the behavior of mean abnormal spreads in Figure 9.

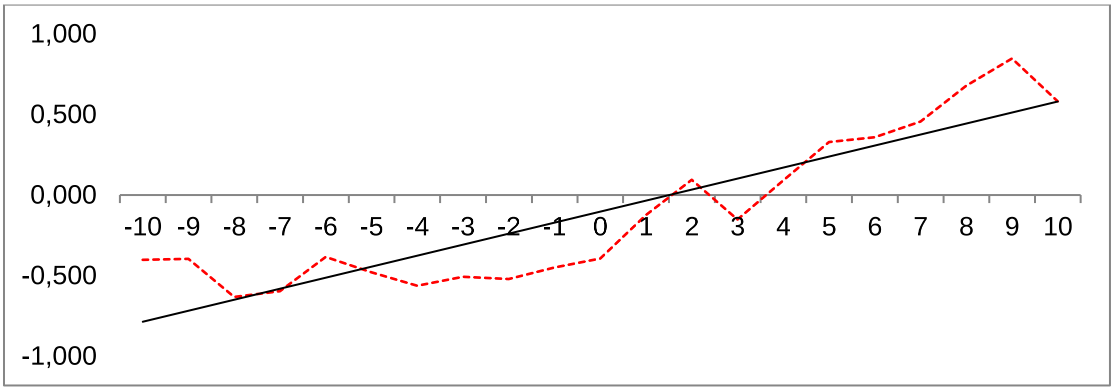

Figure 9: Mean abnormal spreads for the stocks excluded from XKURY

Figure 9 suggests that spreads have started to widen after exclusion though the impact is statistically insignificant.

Our findings show that inclusion to XKURY has a positive impact on abnormal returns but for most of the time this impact is blurred. However, its negative impact on spreads is highly clear and significant. In other words, spreads are tightening after inclusion. Exclusion from XKURY has a significant and negative impact on abnormal returns, and a positive impact, though insignificant, on spreads, meaning that they are widening, as expected.

4.4. Limitations of Study

In order to understand this study as a whole it is essential to consider potential limitations that may arise due to natural courses of the research process. Corporate Governance Index XKURY, of BIST is a measurement method which is generated by the defined compliance by Turkish regulatory bodies and the authorized agencies. There may be a risk of wrong additions and disposals of the firms from the XKURY which may have lead us to insufficient measurement.

All of the firms in this study are considered within the scope of Turkey. The data on corporate governance, consisted of the companies which are listed on BIST Thus the results which are found through this study are applicable for Turkish cases. However different results may be reached through application on this methodology to similar cases on different nations.

Furthermore, a potential bias in event studies is that the event itself may not be the reason of a given result in substance. In this regard, other variables should be taken into account in order to explore other factors that have impact on abnormal returns or liquidity, such as firm-specific variables. This is considered for future research.

CHAPTER V

CONCLUSION

The rapid change in world and globalization have triggered the change in the understanding of business in terms of; governments regulatory bodies, laws & regulations, corporations, taxpayers, shareholders, managers, stakeholders and any other actors which plays as an actor within an economy. In this thesis, the definitions, theories, historical developments and Turkish method of application on corporate governance is discussed and analyzed within the market based content. Additionally, various studies and their findings in the literature are considered through the analysis process of corporate governance and its effects on certain areas. The harmonized understandings after analysis were integrated and placed for the case of ISE firms which are operating in Turkey. Thus the results which are attained from the analysis are expected to be unique within the content of the study.

Within this content as an initial step of the study, data which includes all firms listed in Borsa Istanbul in terms of inclusions and exclusions from XKURY for the date period between April 29th, 2013 and November 30th, 2017. The main hypotheses for the analysis are formed as *"Inclusion (exclusion) to (from) XKURY decreases (increases) the possibility of abnormal returns/losses in the stock market"* and *"Inclusion (exclusion) to (from) XKURY tightens (widens) abnormal spreads in the stock's market"*. Considering these hypotheses a standard event study methodology was formed in order to efficiently summarize and evaluate the data. Impact of the inclusion to and exclusions from XKURY on abnormal returns and spreads are considered as a basis for the event study.

The results of the findings have indicated a limited positive impact of inclusion to XKURY on abnormal returns which disappears immediately. Positive impact is clearer in spreads as they are tightening significantly. Moreover, the exclusion from XKURY results with negative impact on spread tightening and as well as abnormal returns. The increase (decrease) in transparency and information symmetry explains an important portion of the reduction (increase) of abnormal returns (losses) after inclusion (exclusion).

The study which has been conducted through this thesis aimed to analyze the relation between the inclusion and exclusion to corporate governance index XKURY of BIST and the market measurement. The findings of study were understandable within the broad content of researches on corporate governance. In order to deepen the understandings within the study area it is advised for the researchers to analyze the concept with different methodologies and models.

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WORK EXPERIENCE

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