

The Effects of the New Turkish Commercial Code on the Transition of Capital Stock Companies to Corporate Governance

Prof. Dr. A. Sait Sevgener
Asst. Prof. Dr. Kadir Dabbağođlu

Haliç Üniversitesi
İşletme Fakültesi
Turkey

Abstract

The corporate governance approach has been developed with a view to ensure that enterprises turn into reliable and sound bodies. Enterprises need well-organized and well-functioning internal control systems in order to create reliable and sound structures. The main purpose of the study is to research the issue of how successful a legal regulation will be for the establishment of an effective internal control system and, thus, for taking the first step towards transiting to the corporate governance. This is an empirical study conducted on family-owned companies and small and medium sized enterprises to reveal and explain on statistical basis the relationship between the transition periods for corporate governance of such company types, with the accounting and auditing practices performed for that purpose and introduced by the new commercial code, which will enter into force in turkey in 2012.

Key Words: Corporate Governance, Commercial Code

1. Concept of Corporate Governance and Its Definition

Corporate governance, in the broadest sense, is the organization of any institution formed by people in order to achieve a certain aim. In a narrower sense, it means all types of laws, regulations, codes and practices that allow a corporation to create economic value for its shareholders in the long run, work efficiently, and attract human and financial capital, while respecting the values of the society to which it belongs. Corporate governance is the entire set of rules that shape the relationship between company shareholders, company executives, beneficiaries and stakeholders who invest in the company¹. Furthermore, corporate governance is not only based on increasing the efficiency of the stakeholders in the partnership governance, it also includes different elements such as the relationship with groups other than stakeholders, as well as enlightening the public². Corporate governance encompasses the relationship between top management (the ones who have a say) responsible for the strategic governance of the enterprise, and the stakeholders who consider themselves as beneficiaries of the enterprise for certain reasons, as well as the employees, the suppliers, the clients and other social institutions, in addition to performing their duties and responsibilities³. Corporate governance is the combination of compulsory and voluntary practices that enable the increase of welfare by providing economic gains for shareholders in the long run, which attract human resources and financial resources without doing harm to the public interest and the beneficiaries of the company, which results in more efficient work⁴.

As evidenced, there are different definitions of the concept of corporate governance. Yet, the most prominent point is that corporate governance is the rules and arrangements that need to be put forward by taking into account all parties that are in direct or indirect interaction with the company, as well as the beneficiaries who constitute the company, the executives, and the employees. Corporate Governance is a concept quite different from the management of the company and the operation of the activities such as routine production, marketing and sales activities.

¹ Macey, J.R. ve O'Hara, M.: **Corporate Governance of Banks**, 2000, New York, FRBNY Economic Policy Review s.4

² Pashi, Ali: **Anonim Otaklık Kurumsal Yönetimi**, 2005, İstanbul, Çağa Hukuk Vakfı Yayınları s.14

³ Ülgen, Hayri ve Mirze, Kadri: **İşletmelerde Stratejik Yönetim**, 2004, İstanbul, Literatür Yayınları, s.423

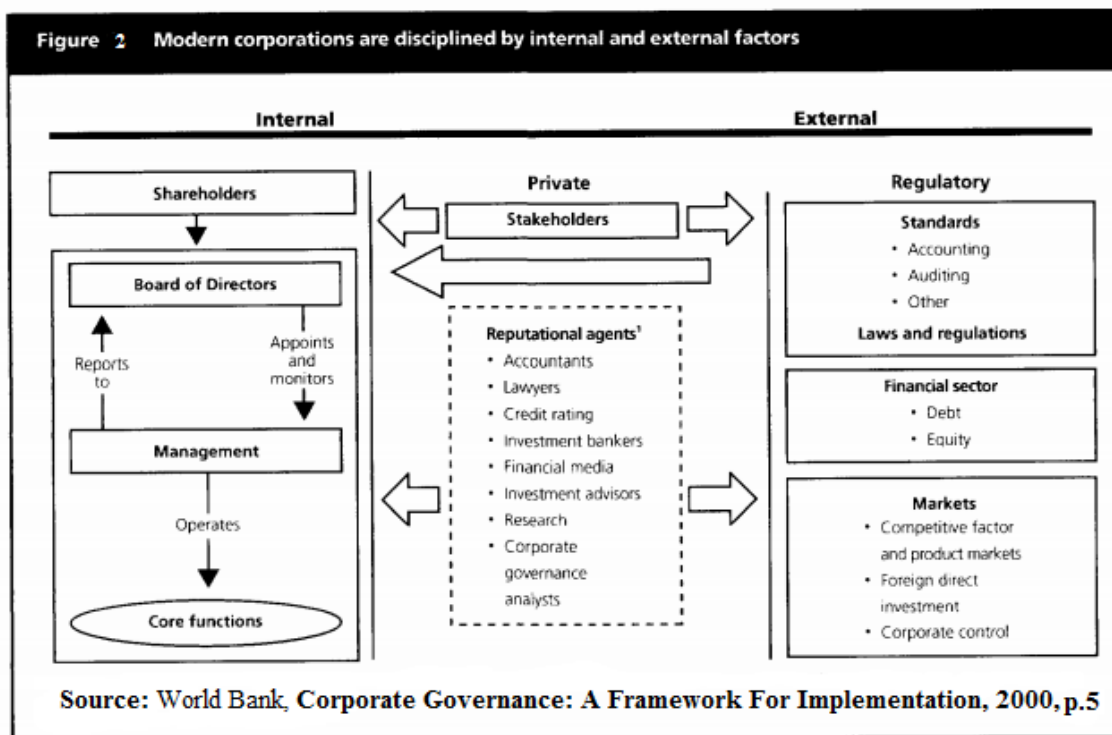
⁴ Doğan, Mustafa: **Kurumsal Yönetim**, 2007, Ankara, Siyasal Yayınevi s.3

Corporate Governance originates from the common point of providing parallelisms in international competition, supporting macroeconomic policies with microeconomic policies, while transparency is increased at the same time, and the protection of the stakeholders and various beneficiaries' interests⁵.

What determine the corporate governance environment of a country are the general conditions of that country, the level of development of the capital market, and company practices. The factors related to the country are generally its economical situation, financial environment, competition intensity, banking system, the level of development of proprietary rights, and other similar factors. The factors related to the capital market are the regulations related to the market, the infrastructure of the market, the liquidity of the market, the existence of a developed investor group, and especially the application of accounting standards as well as international standards. The prominent topics in company practices are the disclosure of financial and nonfinancial information to the public, the equality of stakeholders, the practices of the board of directors, the independence of boards of directors and the financial interest provided to them, the structure of the capital, free float rates, the liquidity of the common stocks, the participation rates of the stakeholders in the decision-making process, the environmental awareness of the company, and the level of social responsibility⁶.

2. Corporate Governance Mechanisms

In order to better understand corporate governance, one needs to examine the complicated factors that affect the operation of a company. Simplified internal and external factors of the corporate governance framework are shown in Figure 1.



Corporate governance is largely seen as the result of executive-shareholder conflict, but in reality, there are many internal and external factors that shape the corporate governance mechanism of a company. Intra-company mechanisms are also called internal governance mechanisms. These mechanisms are under the control of intra-company powers and are shaped by these powers. Extra-company mechanisms are also called external governance mechanisms. These mechanisms are carried out via powers outside the company and by the market conditions⁷.

⁵ Şehirli, Kübra: **Kurumsal Yönetim**, 1999, Ankara, Sermaye Piyasası Araştırma Raporu s.8

⁶ Sermaye Piyasası Kurulu, **Kurumsal Yönetim İlkeleri**, 2005, sy.2

⁷ Gürbüz, A.Osman ve Ekircan Yakup: **Kurumsal Yönetim Türkiye'deki Durumu ve Geliştirilmesine Yönelik Öneriler**, İstanbul, 2004, Literatür Yayınları, s.9.

3. Importance of Corporate Governance in the Economy

The scandals of Enron, WorldCom, Tyco in the US, Parmalat in Italy -although each of them arose from different causes- pointed out that an accurate and good corporate governance is very important. It is also a known fact that the banks that went bankrupt in Turkey caused about \$40 billion in damage to the economy of the country⁸.

The chain of events that started with the Enron scandal and continued with the companies that were involved in fraud by presenting their financial statements fraudulently or misleadingly, showed the necessity for better corporate governance in countries that were considered to have "almost perfect" capital markets. As for developing countries, corporate governance gains even more importance in these countries due to the reasons such as weak legal systems, poor quality information, and serious trust issues. Developing legal and financial studies point out the importance of the protection of the investors for accelerating and strengthening the access of investors in financial resources⁹.

4. Legal Regulation Regarding Corporate Governance in Turkey

In Turkey, the Commercial Code that had been in effect since 1956 was replaced with the new Turkish Commercial Code (NTCC) No.6102 on January 13, 2011. New arrangements brought by the law on issues of minority rights, audits, rights/authorities and responsibilities between the members of board of directors and shareholders are all arrangements that oblige and put forward the commitment to the principles of fairness, transparency, accountability and responsibility, which are the milestones of corporate governance.

The NTCC stipulates that the rights bestowed by law or a prime contract for all stakeholders, including the minority and foreign stakeholders, shall be protected adequately and as required. The same code further stipulates the lawful implementation of contracts between the beneficiaries to a partnership and the partnership itself, and the prevention of conflict of interests. This way, the NTCC is in line with the principle of fairness that suggests "company managers, while carrying out their activities, should be in equal distance from all the parties who are affected by the decisions made"¹⁰.

The NTCC requests the disclosure of all financial/nonfinancial information -except for confidential business information and information not yet disclosed to the public- about the company in a clear, understandable and interpretable way at any time, and in a low-cost accessible way. This regulation takes its source simply from the principle of transparency that suggests "the public should be informed about all topics related to the company including the structure of the corporate governance, the financial situation, the financial performance and the capital structure."¹¹

The accountability is explained as follows in OECD corporate governance principles: Corporate governance framework should provide efficient monitoring of the business organization and strategic guidance of the partnership by the board of directors, and oblige the board of directors to bear accountability to the company stakeholders. The NTCC adopted this principle as a whole. The principle of accountability means the compatibility of all activities of the company management carried out in the name of the company, to the legislation, the prime contract and the intercompany regulations¹². Within this scope, while this principle harmonizes the accounting practices of the companies with international accounting standards, it also makes auditing obligatory, and stipulates a tight control mechanism for auditors. It is known that the common characteristic of the corporate scandals in the USA and Europe is the inadequacy of corporate governance mechanisms responsible for preventing these scandals. The criticisms particularly focused on the independent auditors responsible for auditing the companies in the name of all company shareholders.¹³

⁸ Darman, Manışalı Güler: **Küresel Ekonomilerde Kurumsal Yönetim Anlayışı ve Türkiye**, Ankara, 2008, ICC Milletlerarası Ticaret Odası Yayınları.

⁹ Kaymaz, Önder, Alp Ali ve Aktaş Ramazan: **İyi Kurumsal Yönetim Yapıları ve Üç Temel Ayağı: İç Kontrol, Risk, Yönetimi ve Muhasebe Uygulamaları**, İstanbul, 2008, İMKB Dergisi Sayı 40 s.43-44

¹⁰ Tuzcu, Arcan, Halka Açık Şirketlerde Kurumsal Yönetim Anlayışı İMKB 100 Örneği, Ankara, 2004, Turhan Kitapevi, s.25

¹¹ OECD, **The OECD Principles of Corporate Governance**

¹² SPK, **Kurumsal Yönetim İlkeleri**, s.3

¹³ Coffee, John C.: **A Theory of Corporate Scandals: Why the U.S. and Europe Differ?** The Centre For Law and Economic Studies, Working Paper no.274, 2005 s.2

The NTCC was affected by the Anglo-Saxon Corporate Governance System, which is the shareholder model and is widespread in the USA and Britain, where capital markets and shareholder culture are developed. The NTCC was also affected by the European Continent Corporate Governance System¹⁴, which is the stakeholder approach, and is observed in Europe and Japan, where capital markets are under the control of the banks. As of 2012, capital companies in Turkey are required to harmonize with the NTCC and adopt corporate governance principles by making the necessary arrangements in their prime contracts, organizational structures and accounting systems.

5. Study on the Effects of the New Turkish Commercial Code on the Transition of Capital Stock Companies to Corporate Governance

Purpose of the Study

Industrial enterprises on the SME scale are those likely to be most affected by the regulations introduced by the NTCC, together with the mergers, new products, new modes of competition and continuous and radical changes. The sample mass consists of 543 industrial enterprises with SME characteristics. Since family members occupy middle- and top-level management positions, bearing characteristics of entrepreneur managers, and since the information silo is completely in question, such enterprises have been deemed appropriate for the study.

This study aims to measure the effect of a new legal regulation on the transition process for corporate governance principles, and the resistance from = entrepreneurs against such regulation.

To this end, the following hypotheses have been generated with regard to the relationship between the NTCC and the transition process for corporate governance.

Hypothesis 1:

There is a positive relationship between the legal regulations introduced by the NTCC and the effectiveness and efficiency of the transition process for corporate governance throughout the country.

Hypothesis 2:

There is a positive relationship between the effectiveness and efficiency of the transition process for corporate governance, the dominant partner and, thus, the informational and cultural background of the family in the entrepreneur position.

Hypothesis 3:

If the corporate governance principles are not adopted on a cultural basis, the effectiveness and efficiency of the regulations introduced by the NTCC weakens at a significant level.

Research Method

Qualitative data about the transition process for new legal regulations have been collected in a planned manner and through one-to-one interviews with the dominant partner of each enterprise, holding the position of the head of the board of directors or the company director. In case of their presence, top managers and second and third level managers, who report directly to the aforementioned person, have been defined as a part of such interviews, provided that they are second-generation family members. Second-generation members of the family in the manager position and holding the dominant role are, therefore, potential participants of this study. One to three participant individuals have been identified in every enterprise. The combination of second and third level directors was balanced among the enterprises, their titles and responsibilities have been revised and, consequently, 792 potential participant samples have been created in order to ensure comparability. A questionnaire was used to determine the scope and degree of consensus with the participation to the process of the management's transition to corporate governance in every enterprise, and useful questionnaires have been collected from all participants. Copies of the questionnaires are kept by the author.

Basic Statistical Information for the Participants

Distributions of gender, educational background, duration of employment, and positions of the employees of the companies subject to the research have been provided in the table below.

¹⁴ Şehirli, Kübra, a.g.e. s.2

Gender	F	%	Years of Employment	F	%
Male	701	88,51	1-3	145	18,31
Female	91	11,49	4-10	168	21,21
Total	792	100,00	10-20	205	25,88
			20-More	274	34,60
Educational Background	F	%	Total	792	100,00
Doctorate	21	2,65			
Master's	35	4,42	Position	F	%
Undergraduate	421	53,16	Owner - CEO	500	63,13
High School	315	39,77	Owner - CFO	150	18,94
Total	792	100,00	Owner - Production Manager	142	17,93
			Total	792	100,00

Validity Analysis

The validity of a scale is the analysis of the extent to which a scale measures a concept described by a theoretical model. Estimations are made on the basis of three different validity principles as to substance and structure. The estimation validity is the correlation degree between the quality measured by the scale and the observed quality. The substance validity is the measurement of the extent to which the substance of the scale applies. The structural validity is related with to the extent to which the theoretical reasons behind the estimation and substance validity of the scale can be determined. There is no specific coefficient to constitute the basis of the validity analysis, as in the case of reliability analysis. For this reason, validity analysis is primarily performed with theoretical analyses¹⁵. Specialist academicians of this subject have been interviewed for the purpose of ensuring substance validity in our scale. As a result of the results obtained, some additions and modifications have been applied to the questionnaire, since some questions may cause misunderstandings or may imply multiple meanings. Furthermore, content validity is available, as the study is based on literature.

Reliability Analysis

Reliability analysis is the measurement degree through which a test or scale measures whatever it desires in a coherent and consistent manner. The "Cronbach Alpha" coefficient is the frequently used reliability coefficient¹⁶. Reliability analysis aims at setting forth the reliability of the instruments based on scales built on total points (Likert scale). The Cronbach Alpha coefficient ranges between 0 and 1. Results of the reliability analysis pertaining to the variables are provided below:

VARIABLES	NUMBER OF QUESTIONS	ALPHA CO σ
All Variables	65	0,9463
Variables for Corporate Governance	32	0,8351
Variables for Legal Regulation	33	0,8976

Variable Measurement and Research Results

Hypothesis 1

The 5-point Likert scale questions have been used in the questionnaire in order to display the relationship between the new Turkish Commercial Code and the effectiveness and efficiency of the transition process for corporate governance throughout the country, as well as the relationship between the same Code and corporate governance. On these grounds, answers given to the questions about the awareness of new legal regulations and those about corporate governance principles have been averaged. These two averages have been subjected to a correlation analysis within the scope of the SPSS statistics program. The Spearman Correlation analysis has resulted positively as **0.754, at a significance level of 0.01**. It can be concluded that such a result reasonably supports affirming the hypothesis and, thus, HYPOTHESIS 1 is acceptable.

¹⁵ Kurtuluş, Kemal: **Pazarlama Araştırmaları**, İÜ İşletme Fakültesi Yayın No. 28, İstanbul, 1996, s.22

¹⁶ Altunışık, R., Coskun, R ve Yıldırım, E., **Sosyal Bilimlerde Araştırma Yöntemleri**, Sakarya Kitabevi, Sakarya, 2005, sy.45

Hypothesis 2

The 5-point Likert scale questions have been used in the questionnaire in order to display the relationship between the effectiveness and efficiency of the transition process for corporate governance, the dominant partner and, thus, the informational and cultural background of the family in the entrepreneur position. The indicated questions focus on the benefits, advantages, costs and corporate governance awareness, as well as the belief on the necessity of such governance. The answers are subject to a correlation analysis in the SPSS statistics program. Spearman Correlation analysis yielded positive results with **0.823, at a significance level of 0.01**. It can be concluded that such a result reasonably supports affirming the hypothesis and, thus, HYPOTHESIS 1 is acceptable.

Hypothesis 3

Multi-choice questions with five alternative answers have been used for the purpose of presenting the relationship between the effectiveness and efficiency of the transition process for corporate governance, by culturally adopting the corporate governance principles. These questions focus on strategic planning on how the harmonization process with the new Turkish Commercial Code and how the process will be managed. The answers are subject to a correlation analysis within the SPSS statistics program. Spearman Correlation analysis yielded positive results with **0.896 at a significance level of 0.01**. It can be concluded that such a result reasonably supports affirming the hypothesis and, thus, HYPOTHESIS 3 is acceptable.

6. Conclusion

Companies have launched various projects with the intention of harmonizing the corporate governance principles to be brought to the agenda with the new Turkish Commercial Code that enters into force in July 2012. The revision of organizational structures and making an effective internal control system eligible for their systems are of priority among the aforementioned. The modernization of software under enterprise resource planning (ERP) is of secondary importance. Another process, projected and governed in this regard, is redesigning the websites, including financial data, and restructuring the accounting information systems in a way to ensure reporting is in compliance with international accounting standards, and thus, is audited. All of the aforementioned components emerge as a result of the positive relationship between the new legal regulation and the transition process for corporate governance.

A concrete indicator of an efficient and effective finalization of the transition process for corporate governance is the existence of an effective internal control system to be established at the end of the process. If such a system fails to be established, the effectiveness of the transition to corporate governance cannot reach the sufficient level. The rate of governance support provided to the professional staff of the enterprises by investors, which is essential for establishing an effective internal control system, is almost zero in Turkey. The enterprises in Turkey are mainly family-owned businesses. It is not possible to be relieved of the family-owned business characteristic by acquiring legal entity status by becoming a legal corporation. The fact that the investor is engaged in the execution procedure, intensely gives rise to the “entrepreneur manager” concept, which prevents the formation of a professional staff in need of support, thus, making the provision of support out of question. Given the low rate of going public, it is quite obvious that enterprise and, thus, corporate governance cultures have not yet reached a sufficient level in Turkey. This situation constitutes a serious handicap in terms of effectiveness and efficiency in realizing the corporate governance principles introduced by new legal regulations.

What is aimed with the new legal regulation is to make corporate governance principles dominant throughout Turkey. However, the enterprise culture of the entrepreneur mass of the country has not yet developed enough to serve such a purpose. This is why establishing an effective internal control system, as required by corporate governance, in enterprises where investor groups lacking corporate governance awareness are dominant, in particular SMEs, and efficiency in transition to corporate governance will not be fully ensured. Another matter affecting such a result may occur if the investors fall outside the scope of the new Turkish Commercial Code and intend to adopt private company status, which completely results from the enterprises’ lack of size as required by the corporate governance principles and, thus, the entrepreneurs’ lack of the required enterprise culture.

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