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Corporate Governance of State-Owned Enterprises: the Turkish Case

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Abstract

As a developing and multi-side interested topic, corporate governance of state-owned enterprises takes attention of both academicians and practitioners at national and international level. Turkish state-owned enterprises (SOEs), historically played important roles in Turkish economy, operate in many key industries even following a few decades of active privatization policy. Like their international counterparts, the Turkish SOEs are subject to both criticism and appreciation from different interest groups for their economic and governance performance. Aimed at framing the corporate governance of the SOEs in Turkey, the research adopts a descriptive approach based on qualitative analysis of deep interview and secondary data. The article shows that i) it was not a question of being public or private enterprise but a decision of having the investment or not that leaded to the establishment of Turkish SOEs, ii) Turkish SOEs played important roles in the development of institutional framework, iii) in order to improve the corporate governance performance of Turkish SOEs necessary amendments include implementation of the state's active shareholding policy, restructuring board composition, empowering the boards and performance appraisal. Although the results are valid for Turkish context, practical implications may provide insights for other emerging countries.

Keywords: Corporate governance, State-owned enterprises, Turkish SOEs, State ownership.

1. Introduction

State-Owned Enterprises (SOEs) show characteristics of both private and public company and are viewed as '*hybrid organizations'* (Bruton et al, 2015, p.92). Although there is no universally accepted definition of SOE, it is mostly distinguished by government ownership or managerial control (as contrasted with private corporations) and production of market output, which is economically priced (as contrasted with public goods) (Lienert, 2009). As a special type of government intervention to markets, it is directly producing market output by governments instead of buying or financial sponsorship. OECD (2005/a) points to some prerequisites for market success such as efficient methods of contract enforcement, effective regulation and guarantee against confiscation or over-taxation; otherwise SOE are needed.

Corporate governance showed an increasing trend in recent decades because of the need and demand for professionalism and transparency and the scandals of corporate failures and corruptions (Martin et al, 2011, Windsor, 2014; Pagano & Immordino, 2012). Good practices of corporate governance support decision-making process, which leads to better allocation of resources in corporation and in economy (Bojanic, 2012). Additionally, good practices improve the company performance and access to capital for enterprises especially in emerging economies (IFC, 2005). Earlier studies on listed corporations, non-listed and state-owned enterprises have been influential. OECD released guidelines for SOEs in 2005 and revised them in 2015, while EcoDa launching guidance and principles for unlisted companies in 2010.

Having inherited some SOEs from the Ottomans, the Turkish Republic, although prioritizing private entrepreneurship, had initiated an extensive state entrepreneurship program since the beginning of the 20th century until the implementation of privatization policy supported with IMF and the World Bank in the mid-1980s. The liberalization reforms on economic policy of 24th January 1980 adopted two main strategies regarding to SOEs: i) adaptation of SOEs to the competitive markets, and ii) active privatization. In 1984, many amendment laws for the governance structure of SOEs and for privatization were introduced but the execution of them mostly failed or interrupted by political debates and/or legal cases. Because of the fierce resistance, the size of privatization squeezed to $ 9.5 billion before 2003 and jumped to $58.9 billion after 2003. Meantime, the number of SOEs dropped dramatically from 44 in 2000 to 22 in 2017. (Treasury, 2016, 2017; Privatization Administration, 2017).

Following international developments, Turkish Government plans to '*reform governance of state-owned enterprises in a way that will lead to competitive structure in line with good governance practices'* (Prime Ministry, 2016). The Treasury accordingly plans to apply corporate governance principles and to improve effectiveness of SOEs and the work on that is on progress (Yesilbas, 2016).

This research examines the characteristics and the structure of corporate governance of SOEs in Turkey qualitatively using deep interview technique. The main results include: i) SOEs both supported and were affected by the institutional governance context of the economy, ii) the success of an enterprise is not a matter of ownership but application of active shareholding policy, iii) the establishment of SEOs was not a choice of a public over private company but a decision whether to have the investment or not, iv) there is a need of restructuring of corporate governance structure of Turkish SOEs regarding the framework, state's shareholding policy and its execution, and some other issues. The paper makes a modest contribution to the growing literature on corporate governance of SOEs by analyzing the Turkish practice.

The next section involves a review on corporate governance and the Turkish SOEs, followed by the methodology section, finding/discussion section, and lastly conclusion.

2. Background

2.1 State-Owned Enterprises in Turkey

History of SOE in Turkey goes back to the Ottoman rein. Missing the industrial revolution, early examples of SOEs were to produce mostly goods of military needs. Having inherited some SOEs from the Ottomans after the proclamation of the republic in 1923, Turkey accepted an economic strategy relying mainly on private sector. Due to the failure of development by private sector, the strategy reversed by 1930's. In order to produce key inputs in the country the government established a number of SOEs in mining, banking, agriculture and transportation industries (Ozcan, 2008).

Against the goal of privatization, after the early 1960 Turkey followed a planned development model in which the number and scope of SOEs expanded with a goal of rapid industrialization. During this period, dispersedly managed factories and production fields were restructured to gain advantages of scale. This planned and state-dominated corporation period with partial success was abandoned in the early 1980s by the support of IMF and World Bank, and Turkey turned to market mechanism and private investment.

The liberalization reforms on economic policy of 24th January 1980 followed two main strategies regarding to SOEs: i) adaptation of SOEs to the competitive markets, and ii) privatization of SOEs. In 1984, a new decree in law amending the governance structure of SOEs and many new laws for privatization were introduced but their execution were interrupted by political debates and/or legal cases. As a result, the size of privatization was minimum at $ 9.5billion until 2003. On the other hand, the number of SOEs halved from 46 (2003) to 23 (2016) with privatized companies accounted. Additionally, in the financial sector, the Turkish Treasury owns 6 banks, 3 with minority shares and a few other enterprises operating under separate laws, and a large number of enterprises under local administrations or municipalities (Treasury, 2016, 2017; Privatization Administration 2017).

The decree in law no.233 (DL.233) draws the main framework for SOEs, though it does not apply to the state-owned banks and a few SOEs which operates under separate laws. According to DL.233, SOEs shall consist of two main types: i) enterprises aiming for public interest or working as monopoly, ii) enterprises operating in economic area with commercial principles.

The General Report by TCA (2016), which also includes banks and others regulated with separate laws, summarizes the latest contribution of SOEs as follows: employment of 194k, investments over TL10 billions, sales revenues over TL115 billions, and total assets of TL720 billions. Regarding the sectoral distribution, energy sector comes first with 9 SOEs, following agriculture, transportation and communication.

2.2 Definitions, perspectives and approaches on corporate governance

Corporate governance basically involves "management and control systems" (Caddburry, 1992, pp. 15). Further definitions are tailored depending on the focal perspectives adopted. From the financial perspective, corporate governance is seen as a set of measures/methods to guarantee the rights and returns of financial investors (both creditors and shareholders). From the economic perspective, corporate governance is expected to optimize the use of economic resources among different projects by designing proper contracts and economizing transaction costs. From social perspective, corporate governance is expected to balance the controversial interests of individuals, corporations and society. Finally, ethical perspective seeks to find a moral balance between profit maximization and ethical values.

As Mallin (2011) summarizes, corporate governance involves mainly the following mechanisms to reach the above goals: i) internal systemic control mechanisms, ii) connections between the corporation and management, board, shareholders and stakeholders, iii) mechanisms for that corporation is managed in line with the shareholders' or stakeholders' interest, and iv) information flow and accountability.

However, these are mainly valid for private corporations and additional mechanisms for SOEs are needed: mechanisms for addressing externalities (in response to market failures) and market competition (in response to government failures).

Given the wide scope of corporate governance, different approaches are adopted including theoretical, ethical and practical. We summarize the leading approaches in Table 1 as found in the literature.

Table 1. Comparison of main corporate governance approaches

Approach	Corporation	Focus on
Agency theory	Nexus of contracts	Design and incentives of principal agent contract to reduce agency cost
Transaction cost theory	Hierarchical mechanism	Economizing transaction cost under conditions of asset specificity, uncertainty and frequency
Resource dependency theory	Owner and user of resources	Interchanging resources between business units
Resource based view	Competitive, unique unit	Valuable, rare and non-substitutable resources leading uniqueness
Business ethic	Unit producing for human needs	Corporate citizenship for sustainability and self-limitation beyond legal rules
Feminist ethic	Network of relations	Attention, empathy and not harming to stake to stakeholders
Practical	Profit making legal entity	Rules and regulations, shareholder activism, BofD, audit

Focusing on the agency contract, this approach takes corporation as nexus of contracts (Fama & Jensen, 1983). Shareholders and managers as two different parties seek for their interest, and by design, it is the contract that motivates agents to achieve targets (Jensen & Meckling, 1976; Eisenhardt, 1989). Due to the nature of opportunism and asymmetric information between parties, transactions are inherently incomplete and subject to maladaptation (Williamson 1981, 1996; Akerlof, 1970). Given the asset specificity, uncertainty and frequency regarding to transactions, corporations usually prefer economizing transaction cost (Williamson, 1981, 1988, 1996). The interconnected structure of business requires corporation to exchange their resources. As the owner user of the resources, corporations are dependent on both suppliers and customers (Pfeffer & Salacnik, 1978, Hillman & Dalziel, 2003; Boubaker & Ngyuen, 2014). Having tangible, intangible and capability resources, resource-based approach takes corporation as a unique unit in competition with others (Barney, 1986, 1991, 2001, Chrisholm & Nielsen, 2009).

Business ethic approach takes the corporation as a unit of production for human needs and adds that greedy is the source of economic, social and ecological problems including business failures (Schmitz, 2014; Vega & Primeaux, 2014). Therefore, it recommends pursuing ethical values, beyond legal limits, to show good corporate citizenship (Zimmerli et al, 2007; Sison, 2007). As a network of relations, corporations are expected to give attention to stakeholders, and in an empathetic way, business should not harm others (Machold et al, 2008; Liedtka, 1996).

Practical approaches, accepting the profit making nature of corporations, highlight laws and regulation in a jurisdiction to yield effective mechanisms on rights, responsibilities, and accountability. Guidance and principles mainly includes issues related to shareholder activism, composition and remuneration of board of directors (BofD) and audit (OECD, 2015, EcoDa, 2010).

3. Methodology

The research deals with corporate governance of SOEs in Turkey with a priority to understand current practices and identify drivers and obstacles in the process. In order to do so semi-structured deep interviews were conducted with eleven interviewees all of whom are directly or indirectly involved in the process. Sampling of key players, including state agencies, directors, managers and auditors, followed a purposive approach seeking to cover major involving parties, namely shareholder state and SOEs. The structured part includes questions about SOEs, corporate governance, state as a shareholder, and enterprise practices with a focus of board of directors. The interviews were open-ended conversations with a special question of what other aspects need attention. Considering ethical limitations interviewees are not named, instead passages quoted are labeled with the interviewee number.

Daiser et al. (2017) mentions the need of such an approach for analysis of SOE oriented corporate governance; OECD (2007, p.10) also states that the best approach to assessing corporate governance practices is to rely on '*reasonable observer'*. Having the advantages of '*practitioner-researcher*' (Saunders et al. 2007 p.144) the research followed a qualitative approach with exploratory and descriptive design for examination and presentation of main relations and actors.

Although practical implications might be applicable for other emerging economies, conclusion and findings of the research limited with the Turkish context with a focus of non-financial SOEs of central government. Additional limitations may arise from the methodology and the researchers' practitioner experience on external audit of SOEs. However, we must emphasize that the latter is significantly expected to have been eliminated due to the extensive and direct experience of the both researchers in this paper[1].

4. Findings and discussion

In the course of establishment of SOEs, Turkey's initial plan was contrarily to rely on private sector and/or to privatize existing SOEs but the institutional context did not let the private sector for such investment. In addition, the lack of effective contracting and regulation, the national capacity and local capabilities did not support the investment. '*SOEs, beyond production, did bring culture to location of establishment. There was no one for construction or operation*' (interviewee, 11). Therefore, it was a hard job for private enterprises to invest in a location that does not have required capabilities. Given the institutional context and local capabilities, from government perspective it was not a decision of private or public. As the private sector could not play the role expected, it was simply a decision of having the investment or not.

Another finding relates the capability development effect of SOEs. Turkish SOEs did not only produce goods and services but also supported the improvement of business capabilities. In Turkey, SOEs were the first to have formal chart of accounts which was the basic instructions of accounting standards. Another aspect was to develop managerial capabilities, which were also scarce. '*For a factory investment,* a *private investor asked for transferring an SOE manager* (interviewee, 03). Having supported the development of institutional baseline, SOEs have become subject to privatization as private sector could play their role on the baseline.

According to main legal framework, DL.233, SOEs are expected to operate under market conditions, however, some other rules and regulations enforce SOEs to operate against. For example, the law of procurement requires SOEs to follow strict procedures. Such requirements have three main results: i) it takes longer to supply comparing the private counterparts, ii) it does not allow SOEs to develop long run partnerships with suppliers, and iii) SOEs need to have extra capability to follow regulations rather than market orientation. Another example is about employment regulations. Turkish SOEs should follow special rules and regulations for officers, which does not allow hiring and firing decisions to be market-oriented. In other words, SOEs do not have the ability of responding market trends either up or down. Additionally, the job security, together with similar salary policy for all officials across all SOEs, leads weak motivation for performance. '*As low performing employees get the same pays and benefits, it is de-motivation for all'* (interviewee, 08). These examples support the finding that SOEs are not operating under market conditions and have legal disadvantage against their competitors. On the other hand, SOEs enjoy the benefits of access to cheap, if not free, finance from budget resources. Therefore in Turkish practice, SOEs have both advantageous and disadvantageous elements against competition in marketplace.

Before analyzing the framework of Turkish SOEs, table, adapted from Cox, (2011), below shows the main actors of corporate governance.

[1] The first researcher is senior auditor with 20 years of experience on Turkish SEOs and the second researcher was the former chairman of regulator for the Turkish capital markets and corporate sectors.

Table 2. Main actors in corporate governance of Turkish SOEs

Shareholder State		
Treasury	**Sectorial Ministry**	**Parliament**
Financing and receiving dividend, selection of 1 member of BofD	Selection of CEO, deputies, and 5 members of BofD	Audit and absolution
Ministry of Development	**Cabinet**	**State Personnel Dept.**
Investment decisions	International operations	Employment regulations
High Planning Council	**Turkish Court of Accounts**	**Others**
Salary limitations	External audit	controls, audits,etc.

BofD - State-Owned Enterprises		
Two from executives	CEO holds chair	3 non-executives
Business strategy and policies, oversight on operations, disclosure of financial and annual reports		

Corporate governance of SOEs mainly involves the relations between the shareholder state and the board of directors. In Turkish case, a number of state offices involves in shareholding function. Firstly, the Treasury exercises financial rights and liabilities, including capital or other budgetary transfers and dividend payments over SOEs. It also holds right to select one member to SOEs BofD. Sectorial ministry is the main shareholding actor in terms of selection of CEO and deputies together with four members of BofD. Parliament examines the annual audit report by Turkish Court of Accounts to make a decision of absolution. The Ministry of Development has votes on investments of government including SOEs. All international activities of SOEs require pre-approval of the cabinet. State Personnel Department regulates the employment related cases such as personnel assessment and promotions. Specifically the salaries of employees and remuneration of BofD members including CEO have subject to limitations of High Planning Council. As is seen from the long list, a number of government units intervene in SOEs in terms of shareholding, that is, shareholding rights and responsibilities dispersed among different units. From a theoretical standpoint, such dispersion increases the inevitable agency cost over SOEs, as each of them might follow differing objectives. Under heavy control of shareholder state, Turkish SOEs practically aims at *'public interest rather than profitability' (interviewee, 08)*. Such goal setting reflects on the corporate culture, capabilities and competences of SOEs all of which have deep influences on internal corporate governance mechanisms.

OECD (2015) and World Bank (2014) recommend having an active shareholding policy, which in turn requires a clear view on ownership and principles on how to execute shareholding rights. Without an active shareholding policy, the aim of shareholding for each SOE is not well defined; hence, SOEs struggle with goal settings between profit and externalities, lack of key performance indicators. Lack of ownership policy also results in cross-purposes and ineffective usage of shareholder rights. An important question regarding shareholding is to define cost of capital. Mainly influencing project appraisal and capital structure decisions, in private enterprises it is the expected rate of return for shareholders. '*Inflation rate'* (interviewee, 10) or '*treasury bond rate*' (interviewee, 06) are recommended but both shows risk-free rates. Lack of effective rate for cost of capital, Turkish Court of Account misses an important element to audit performance of SOEs.

The SOE part of corporate governance framework focuses mainly on BofD, including board composition, nomination and selection, remuneration, and performance evaluation. By regulation, BofDs of Turkish SOEs consist of one chair, who is also CEO, and five members, two of whom are among executives namely deputy CEOs. In order to decrease agency cost, agency theory suggest BofD to monitor activities of agents including CEO (Jensen & Meckling, 1976, Fama & Jensen, 1983). Taking into account the significance of executives in BofD, the board composition does not support responsibility of oversight on operations.

As it provides an extra payment, membership of the SOEs BofD is taken as '*bonus payment tool*' (interviewee, 10) for high-level bureaucrats among either Treasury or sector ministries. Although it may be an effective motivation for performance of government officials, such a nomination and selection process leads BofD to miss the required talent and competencies for strategic direction. In addition, it causes conflict of interest for BofD members who are expected to use shareholder rights; although there are arguments that bureaucrats can influence government to support SOEs (Adam, 2009).

Regarding to political representation in BofD's, interviewee 01 mentioned the CEO and the chair of an SOE is someone '*who have power to resist local political demands*'. Contrary to OECD (2005) recommendation, political experience may provide the power to boards for optimizing conflicting expectations of stakeholders. On the other hand, political representation may lead ineffective spending of resources.

As the regulation of DL.233 requires all SOEs to have same sized BofD, one chairman and five members, it does not reflect the size and the complexity of the activities. Therefore, ESK having 1092 employees, TL623m revenues and TL331m assets and TEIAS having 8046 employees, TL22.608m revenues and TL12.948m assets both have BofD of six members.

Lack of key performance indicators and limitations of BofD over strategic tools (due to state intervention to financial, investment and employment) leads weak responsibility and accountability of BofDs. Depending on accountability and responsibility situation, there is not formal performance appraisal system for BofD and performance based remuneration policy. The expressions of '*if you want to get high salaries you need to work for private sector*' (interviewee, 09) and '*it is not only the money"* (interviewee, 02) show that financial incentives are not effectively used but ethical values are in consideration. The ethical and moral dedication can prove very strong, and when combined with professionalism could lead to great successes, as in the case of the Turkish Airlines, a listed company and whose board is effectively appointed by the government. Those corporations that delivered high performance in recent years also showed the importance of professionalism and influence of market for corporate control. Though they are not covered in this research, the state-owned banks also show high performance, and one needs to question the general acceptance that success depends on ownership. Taking into account the fact that privately owned multinational enterprises failed during the recent crisis were bailed out by governments, it is arguably a matter of shareholder activism.

We also want to draw attention to semantics of corporate management and corporate governance. As in the Turkish language, they may have the same expression and therefore there is a need to emphasize the difference. Moreover, it is generally seen as a responsibility of the managers or directors to set good practices of corporate governance, though it requires contributions from all stakeholders.

5. Conclusion

Supporting the prevailing argument that good corporate governance results in improved performance of enterprises, the research makes a few contributions from the Turkish practice on corporate governance of SOEs. In the Turkish context, given existing economic structure and institutional framework, the establishment of SEOs was not a deliberate choice of a public over private company, but simply a question whether to have the investment or not. This was dictated by the fact that the private sector did not have the required financial, human, institutional and operational capacities at that time. The SOEs contributed to the improvement of institutional framework for both private and public sector. Additional to corporate governance practices of private enterprises, practices of SOEs should take into account externalities and competition in the marketplace. It is possible to improve performance of SOEs in Turkey by amending corporate governance arrangements such as: i) implementation of active shareholding policy, ii) alterations on board composition, iii) authorizing the boards to active usage of strategic directing tools, iv) training to main actors on corporate governance.

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