

The Rise of “Independent Board Members” in TURKEY

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ABSTRACT

With regulations on corporate governance set forth by the Capital Markets Board, in line with the developments taking place worldwide, an obligation to have independent board members on the board of directors is born. While improving the corporate governance standards of a company, this regulation also positively contributes to the economy of the country as a whole through positively affecting its foreign direct investments. Since independent board members are expected to take influential roles in the key areas of a company such as strategy setting, performance evaluation, risk taking and human related issues; an effective independent board member should possess technical as well as interpersonal skills. The main purpose of this paper is to analyze the significance of “independent board members” that has a substantial role in the implementation process of corporate governance rules in Emerging Markets like Turkey.

Keywords: Independent Board Member, Board of Directors, Corporate Governance

Jel Classification: G34, K22.

Türkiye’de “Bağımsız Yönetim Kurulu Üyeleri”nin Yükselişi

ÖZET

Dünyada gerçekleşen gelişmelere paralel olarak, Sermaye Piyasası Kurulu’nun, kurumsal yönetim ile ilgili yürürlüğe koyduğu yönetmeliklerle birlikte, yönetim kurulunda bağımsız üyelerin bulunması zorunluluğu getirilmiştir. Bu yönetmelik, şirketlerin kurumsal yönetimlerini iyileştirdiği gibi, doğrudan yabancı yatırımları da pozitif bir şekilde etkileyerek ülkelerin bütününe ekonomisine de olumlu bir şekilde katkı sağlamaktadır. Bir şirketin kilit noktaları olan stratejisinin oluşturulması, performans değerlendirilmesi, risk alınması ve personel ile ilgili işlerde bağımsız yönetim kurulu üyelerinin önemli bir rol alması beklendiğinden, etkili bir bağımsız yönetim kurulu üyesinin hep teknik hem de kişiler arası yeteneklerinin olması gerekmektedir. Bu makalenin amacı Türkiye gibi gelişmekte olan ülkelerde kurumsal yönetim kurullarının uygulama sürecinde önemli bir görev alan “bağımsız yönetim kurulu üyelerinin” önemini analiz etmektir.

Anahtar Kelimeler: Bağımsız Yönetim Kurulu Üyesi, Yönetim Kurulu, Kurumsal Yönetim

JEL Sınıflandırması: G34, K22

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1. INTRODUCTION

The corporate scandals of the early 2000s and the introduction of the Sarbanes-Oxley act of 2002 (“SOX”), paved the way for a global settlement of the “corporate governance” concept, which was initiated in the USA, followed by almost all countries around the world. Corporate Governance consists of principles, which put guidelines on the relationship between a company and its stakeholders to achieve optimization of the benefits received by the stakeholders from the company and namely aims to minimize agency problems. The formation and structure of the “Board of Directors”, are perceived to be very important aspects of corporate governance principles. It is generally assumed that it is the “Board of Directors” that shape the future of corporations with its effective and operative decisions not only through managerial skills but also through objective governance.

Objectivity in governance is expected to be accomplished by talented, experienced, profound, and independent members in the board (Elson and Gyves, 2003). It is expected that the higher the independence in the board of a company, the better the governance in that company. Assuming the greatest responsibility for the effective implementation and integration of corporate governance principles in a company, the Board of Directors should initially capture the principles regarding its own composition, giving special attention to competency, objectivity and mainly “independency”. In actualizing the corporate governance principles regarding board of directors, which will augment efficacy, quality and performance through diversifying governance structures, it is extremely important that the board of directors is formed such that non-executive and independent members co-exist.

A non-executive and independent board member is a real or a legal person, who is assigned as a member of the Board of Directors of a company without holding any of the company’s shares. Independent board members are not partners of the Company, but still carry all of the responsibilities a board member carries, owning all the rights of a board member and assuming all the liabilities and risks associated to the board membership. Notwithstanding this, the main roles of independent board members can be named as “monitoring executive activity” and “contributing to the development of strategy”. Given the fact that the existence of non-executive and independent board members has such a vital role for the sustainability of a company, the main purpose of this paper will be to explore the “rise of independent board members in Turkish corporate life” in detail.

The composition of a company’s board of directors and the presence of independent board members have an important impact on corporate governance in a direct way and to the economy in an indirect way, especially in emerging markets. With the surge up in the number and effectiveness of independent board members in the boards; extent and quality of corporate governance is improved. A country and its economy depend to a great extent on the corporate houses as standards of corporate governance influence the behavior of foreign investors (Gupta, 2013). According to the findings of Gupta (2013); there is a level of confidence that is associated with a company that is known to have good corporate

governance. The presence of an active group of independent directors on the board contributes a great deal towards ensuring confidence in the market. Moreover, corporate governance is known to be one of the most important criteria that foreign institutional investors increasingly depend on when deciding on which companies to invest in. It is also known to have a positive influence on the share price of the company. Having a clean image on the corporate governance front could also make it easier for companies to source capital at more reasonable costs. Gupta (2013) also argues that better corporate governance certainly attracts more investments along with less hustles to foreign direct investments and it is the “corporate governance” that decides on the growth of industries and economies. Therefore the existence of independent board members within a company contributes to the corporate governance of a company, which positively and gradually affects the economy of the country as a whole.

Notwithstanding this, the key objective of this paper is to analyze the existence of independent board members from all angles, including academic studies conducted in this area, as well as the rules and regulations set forth by the Capital Markets Board of Turkey and the new Turkish Commercial Code and also the international applications in this area in addition to the national procedures. The ultimate aim is to obtain a compact analysis that presents “the rise of the independent board members” and to demonstrate not only the roles and responsibilities of an independent board member; but also the personal skills and attributes a board member should possess.

The remainder of the paper is organized as follows: While a quick glance at the concept of corporate governance in general and specifically in Turkey is given in the first two sections; the types of board members, their roles, responsibilities and personal skills are analyzed in detail in the next four sections; continuing with the possible role conflicts faced by the independent board members. In the final section, the regulations imposed in Turkey for the independent board members are analyzed in detail, followed by the Conclusion.

2. CORPORATE GOVERNANCE

Company scandals that have been experienced worldwide, the USA taking the lead, boosted in 2001 with the Enron and WorldCom scandals (Brickey, 2003). The most effective steps regarding corporate governance were taken initially in the USA following the Enron case, with the implementation of Sarbanes-Oxley act of 2002, as a result of which essential reforms were put into practice (Zhang, 2007). Zhang (2007) states that SOX has been widely considered the most-far reaching securities legislation since the Securities Acts of 1933 and 1934. SOX not only imposes additional disclosure requirements, but more importantly, proposes substantive corporate governance mandates, a practice that is unprecedented in the history of federal securities legislation (Romano, 2004). Most of the countries realized the inadequacy and weaknesses of their own current audit regulations and initiated the adoption

process of implementing corporate governance principles into life. In this context, with SOX, “independent board membership” has become a focus point of corporate governance in USA.

On the other hand, given the strategic importance embedded in the concept of “corporate governance”; Global Corporate Governance Forum (GCGF) has been incorporated as a multi-donor trust fund facility located within the International Finance Corporation (IFC), co-founded in 1999 by the World Bank and the Organization for Economic Cooperation and Development (OECD). GCGF is the leading knowledge and capacity building platform dedicated to corporate governance reform in emerging markets and developing countries. The Forum offers a unique collection of expertise, experiences, and solutions to key corporate governance issues from developed and developing countries. IFC findings demonstrate that the Forum took the initiative in preparing the codes of the member countries taking into consideration each country’s legal structure, economic conditions and quotation liabilities of their stock exchanges.

Pass (2004) defines “corporate governance” as being concerned with the duties and responsibilities of a company’s board of directors in managing the company and their relationships with the shareholders of the company and other stakeholder groups. Since the main reason for the international financial crisis and the company scandals has been the inadequate implementation of corporate governance regulations not only in private but also in public sector companies; the importance of corporate governance surged up further more; pushing all countries to construct their own principles in this area.

3. CORPORATE GOVERNANCE IN TURKEY

Similar to the standards adopted in developed countries; the implementation of corporate governance in Turkey has become a key success factor in the business world. In line with the developments taking place worldwide, in Turkey; the Capital Markets Board published the “Rating Activity in Capital Markets and Principles Disclosure regarding Rating Corporations” in 1999 in order to cover the corporate governance issues for the first time in Turkey. OECD, who also initially published the corporate governance principles in 1999, revised them in 2004. The Capital Markets Board of Turkey, who was very proactive with its relations with the World Bank, OECD and GCGF, was extremely effective in Turkey’s selection as a pilot country. The Capital Markets Board took the above-mentioned organizations’ works as its basis; in addition to which it took ideas and suggestions from representatives of Borsa Istanbul and Turkey’s Corporate Governance Forum, many academicians and private sector representatives, as well as public institutions, as a result of which “Corporate Governance Principles of Turkey” has been published in 2003, which was then amended in 2005, 2011 and finally in 2014 by the Capital Markets Board.

With these principles, the purpose of the CMB of Turkey has been to prepare recommendatory rules and principles for privately and government-owned companies and especially public companies. Such a Regulatory Framework has been prepared and published

for the companies that become prominent in the evolving, changing Turkish markets and that catch foreign investors' attention in order to help them establish and realize a management insight that contributes them to continue their business within international standards and to establish an equal, transparent, accountable and responsible management insight and the free entrance into international finance sources. With the introduction of these Principles and Rules to the capital markets it started to be adopted by many companies from 2003 to date. Despite the fact that these Rules have been adopted by many companies; especially in the finance sector, their application had not been a compulsory requirement, remaining as a voluntary directive practice.

In order to reinforce these principles as legal and obligatory requirements; the following has been added to the roles and responsibilities of CMB with the Statutory Decree No: 654 announced at the Additional Official Gazette dated 11.10.2011, No: 28081 ("Statutory Decree No: 654"): With the ultimate aim of determining and announcing the corporate governance rules in capital markets and help to improve the investment environment, it has been mandatory to abide by the principles in full or partially for those public companies traded in the stock exchange; taking into account the ratio of being publicly quoted, the number and quality of investors, the indexes and trading density within a specific time.

Following these developments, the Rules have been converted into a communiqué by the CMB through taking into account domestic and global financial developments with the authority granted to it by this Statutory Decree No: 654. "The Communiqué Regarding the Designation and Application of Corporate Governance Rules, Serial: IV, No: 54' has been initially published and announced at the Additional Official Gazette dated 11.10.2011.

With these revisions some of the principles which had loose ends and captured the idea of "implement and explain if not implement"; has been changed into legal enforcement for the first time with the ultimate aim of making the regulations more strict. The form and minimum requirements with respect to the disclosure in the annual report shall be determined by the CMB.

According to article 6 of the Communiqué dated 30.12.2011 and numbered 28158, the companies traded in the ISE shall disclose in the annual report whether the Rules have been complied with or not; the reasons of non-compliance on the basis of "comply or explain" principle (if any); the conflict of interest which may arise in case of non-comply and whether the company is planning to change its corporate governance principles in accordance with the Rules.

According to the enforceability provision of the Communiqué stated above, the Communiqué shall be enforceable on the date of the announcement and shall apply to the actions that started before and continues at the time of announcement.

As per the fundamental activities conducted as part of “compliance with corporate governance and reporting”; many activities need to be undertaken including IFRS reporting standards, rotation of audit firms, incorporation of committees responsible from audit, publication of corporate governance principles and the obligation of “Corporate Governance Compliance Report”, which became necessary due to the “Comply or Explain” approach. In the first few years of the implementation process, inadequate explanations prevailed, whereas the CMB made it necessary to make the explanations apart from legal requirements.

The final version of this Communiqué, i.e Communiqué on Corporate Governance (Communiqué), which is set forth by the Capital Markets Board of Turkey, has been published in the Official Gazette dated January 3, 2014 and numbered 28871. As per the “Communique on Corporate Governance” (dated 03.01.2014 and numbered 28871); Corporate Governance Principles is mainly composed of four sections including “shareholders”, “stakeholders”, “transparency including information provided to public” and finally “Board of Directors”. The ultimate goal of corporate governance principles is to regulate the disposition of rights and obligations of the companies’ board of directors, managers, auditors and the decision mechanism of the companies.

In each of these four sections stated above, CMB requires that the Company specifically touches upon them and if there is no compliance with the principles, the reasons should be specifically stated. The purpose of this paper is to explore further the notion of “independent board members” in Turkey and analyze the requirements that are brought with the introduction of independent board members to the board of companies. According to Capital Markets Board, the companies traded in ISE 30 Index (excluding banks) are obliged to apply the principles set forth with the Communique dated 03.01.2014 which covers these principles. The fact that the number of independent board members increased from 673 in 2012 to 840 in 2015, while total number of board seats surged up from 2766 in 2012 to 2916 in 2015, clearly suggests the tendency of the companies to implement the regulations set forth by the Communique dated 03.01.2014 (Woman on Board – Turkey, 2015).

On the other hand, as has been stated by Borsa Istanbul, “BIST Corporate Governance Index” aims to measure the price and return performances of companies traded on Borsa Istanbul Markets with a corporate governance rating of minimum 7 over 10 as a whole and a minimum of 6.5 for each main section. The corporate governance rating is determined by the rating institutions incorporated by CMB in its list of rating agencies as a result of their assessment of the company's compliance with the corporate governance principles. Corporate Governance Index started to be calculated on August 31, 2007 with only 5 companies. As of 2015’s year end 50 companies are included in the index based on the Borsa Istanbul data, which clearly demonstrates the importance given to “corporate governance”.

4. TYPES OF BOARD MEMBERS

In all of the companies ranging from small family institutions to large multinationals, board of directors and general manager or chief executive officer (CEO) of the company sets the strategy of the company in order to maximize the profit of shareholders. The General Manager of the company establishes this strategy together with the management team. Once the outline is approved by the Board of Directors it is put into practice by the management of the company. The results are then evaluated by the Board of Directors together with the general manager. The Board of Directors needs a mechanism in order to exclude this process from the subjective judgments of not only stakeholders and shareholders; but also processes; which is why as has been stated in the 1992 Cadbury Report of UK, it is widely accepted that non-executive directors have an important contribution to make proper running of companies and therefore proper running of the economy as a whole. The Cadbury Report of the UK, which has been published by the Cadbury Committee in 1992, recommended a “Code of best practice” relating to the appointment and responsibilities of executive directors, the independence of non-executive directors and tighter internal financial controls and reporting procedures. The Report states that non-executive directors should bring an independent judgment to bear on issues of strategy, performance and resources including key appointments and standards of conduct. Hence the inclusion of “Independent Board Members” in the Boards of companies adds great value to the sustainability of the operations of a company.

In its broadest sense, board members can be separated into two major groups, as can be depicted from Table 1 below. The first one is “executive”, comprising of executive members, who have the right to execute; while on the other hand the second group is “non-executive”, which does not have the right to execute but should audit and guard the executive members.

Table 1. Types of Board Members

	Executive	Non-Executive
Independent	-	Does not have any relation with the Company except for the Board Member
Not Independent	CEO / General Manager	<ul style="list-style-type: none"> • Family Members (in case of a family company) • Product or Service supplier • Professional members from related companies • Managers who have been working in the execution of the Company in the last 2 years

As has been indicated in the Cadbury Report (1992); in good corporate governance practices; the differentiation between “executive” and “non-executive” board members is extremely important. Since an executive board member works in the company full time and

also is responsible for the administration and management of the company; s/he has to wear two hats at the same time. When acting as the board member; s/he has to leave aside the fact that s/he is also an executor and should focus on controlling and governing the company as a whole, in a strategic manner. It often creates doubt as to whether an executive board member while carrying executive tasks, can also be independent and objective. In order to minimize this possible contradiction; it is essential that non-executive board members are also seated in the Board of a company with the ultimate aim of catching the most objective and independent perspective.

As can be observed from Table 1 above, non-executive board members can also be further differentiated into two sets: Independent vs. Not-Independent. Non-independent (i.e. dependent) and non-executive board members can be family members, product or service suppliers, and professional members from related companies or managers who have been working in the company in the last two years. Non-executive and independent board members are not in the management team of the company, in addition to not having any kind of relationship with the company, which is the ultimate goal of the rules set by the Corporate Governance principles.

“Non-executive and independent board members” are also sometimes referred to as “part-time” or “outside” directors; but the names “non-executive” and “independent board members” will be used interchangeably to refer to “non-executive and independent board members” in the rest of this paper for the ease of use.

5. ROLE OF THE “INDEPENDENT BOARD MEMBER”

According to Forbes and Miliken (1999), independent board members (i.e. non-executive directors) are the formal link between the shareholders of a firm and the managers entrusted with the day to day functioning of the organizations. On the other hand, Geletkanycz and Hambrick (1997, p.662) describe the non-executive directors as boundary spanners, spanning the boundary between the organization and its environment, feeding back information about stakeholders’ wants and needs, whilst simultaneously feeding out information to stakeholders about the organization. Furthermore, Johnson and Greening’s (1999, p.568) research found that non-executive directors have both profit goals, which are in line with the agency theory and wider non-profit goals. They have a strong “stakeholder orientation”, recognizing that the organization has responsibilities to groups other than the shareholders (Wang and Dewhurst, 1992).

Despite the numerous definitions of roles carried by the independent board members, in its broadest terms, Higgs (2003) summarizes the roles of the independent board members in four sections as follows:

1. **Strategy:** Independent board members should support the development of company strategies in a positive way and if needed should question and scrutinize the general manager and the Board of Directors about a topic. Especially in the process of strategy

development, the independent board members should back up in terms of thinking beyond the industrial and intellectual boundaries, through constructively challenging and contributing to the development of strategy.

2. **Performance:** In board meetings, independent board members should inspect in detail whether or not the previously set goals are reached and should also monitor whether management information systems produce accurate and regular reports.

3. **Risk:** Primarily taking into consideration financial risk, independent board members should ask for action in areas where there are threats in terms of continuity of the business and moreover independent board members should ensure that the financial information reported by the company is accurate and that financial controls and systems of risk management are robust and defensible.

4. **Human:** Not only in the recruitment process of senior managers, but also in the process of building a back-up and if necessary in removing the senior managers and in succession planning, independent board members should play an active role and should focus on the right choice of actions taking an independent approach. Independent board members are also responsible for setting appropriate levels of remunerations of the executive directors.

According to Higgs (2003), executive and non-executive directors have the same general legal duties to the company. However, as the non-executive directors do not report to the chief executive and are not involved in the daily running of the business, they can bring fresh perspective and contribute more objectively in supporting, as well as constructively challenging and monitoring the management team. The role of the non-executive director is therefore both to support executives in their leadership of the business and to monitor and supervise their conduct. Furthermore, based on the findings of Dravis (2007), as boards adapt to the model of actively monitoring executive performance, the role of independent, non-employee directors has necessarily expanded. At the same time, independent, non-employee directors do not control the information or other resources of the corporation, including inside and outside counsel who are typically engaged by management. Thus, one challenge for independent directors is to ensure that they have adequate information and resources for the jobs they are performing.

It is assumed by Higgs (2003) that the independent board members, who have no relationship with the major shareholders, the company and the managers, will act on behalf of the minority shareholders and they will be able to represent them. It is also believed by Higgs (2003) that the independent board members are able to make independent and objective evaluations on issues that would create conflict of interest, like salaries, performance valuation, handover of the company management and audit. Derived from this assumption; it is generally accepted that committees regarding salaries, nomination, and risk control and audit should be comprised of independent members. It is acknowledged that independent members have an extremely essential role for the protection of benefits of minority shareholders, for holding the managers responsible and for increasing transparency not only

in companies with one major shareholder, but also in companies with many shareholders where the capital is widespread among them.

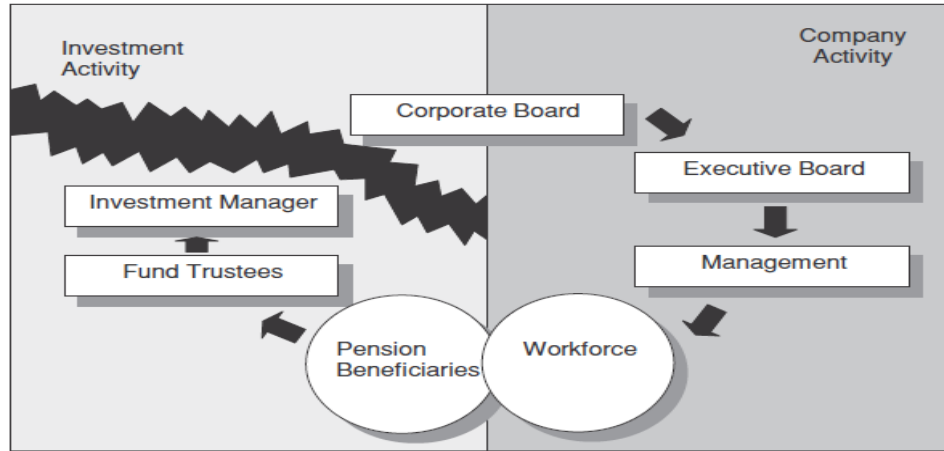
Furthermore, Higgs (2003) also states that a major contribution of the non-executive director is to bring wider experience and a fresh perspective to the boardroom. Despite the fact that independent members of the board need to have close relationships with the other executives and in the meantime be well-informed of the company, all non-executive directors also need to be independent of mind, feel free to challenge, question and not feel pressure from the other executives. The backbone of corporate governance principles relies on the fact that all board members both non-executive as well as executive directors, need to be independent in this sense.

On the other hand, according to Pass (2004), the board of directors is responsible for the governance of its companies. The shareholders' role is to appoint the directors and to satisfy themselves that an appropriate governance structure is in place. According to Pass (2004) the responsibilities of the executive directors include, setting the company's strategic objectives, providing the leadership to put them into effect, supervising the management of the business and reporting to shareholders on their stewardships. On the other hand, non-executives are generally appointed on a part-time basis and they perform various duties including acting as the company's chairperson and sitting on various key committees, including the nominations committee, the remuneration committee and the risk control and audit committee. Pass (2004) defines "non-executives" as being "guardians" of the corporate good and acting as "buffers" between the executive directors and the company's outside shareholders, i.e. they monitor executive actions and question executive decisions and are required to ensure that the company is acting in a "responsible" way and in the best interests of the shareholders and other stakeholders.

6. RESPONSIBILITIES OF THE INDEPENDENT BOARD MEMBERS

The basic responsibilities of an independent board member are chairing or leading committees, such the audit, compensation, governance and nomination committees, increasing the accountability of management, ensuring that there is an opportunity for sound risk management policies, becoming a strategic advantage for the company and representing minority shareholders, creating an environment for innovation and becoming instrumental in leading mergers and acquisitions activity.

In general, while all directors have a responsibility to carry out their duties without conflict; a special responsibility is placed on independent directors to ensure that all decisions are arrived at in the best interests of the company and all shareholders are treated fairly. Having independent directors allows the company to have best-in-class leadership within an industry vertical.

Figure 1. Importance of the Role of the Independent Board Member

Source: Hermes

As can be depicted from Figure I above, Steele (2008) states that within the scope of company activity, corporate boards including the independent board members are responsible for the governance of their companies, while executive boards (or committees) are responsible for the management and performance of the company. Both have a significant responsibility for generating shareholder value. Companies have workforces who will ultimately be pension beneficiaries. The pension fund trustees invariably delegate the management of the fund to professional investment managers and they invest in companies, either listed on stock markets or privately held through private equity or venture capital funds/companies. Steele (2008) states that this is where the cycle breaks down, as few investment managers are interested in engaging effectively with the companies in which they have invested to improve their performance, thus driving up shareholder value for the benefit of all parties as current and future pensioners. Unfortunately, they are mere 'renters' of shares, selling them at the slightest hint of trouble and thus passing the problem on to another investment manager.

While the role of the independent board members is perceived as vital and complex (Steele, 2008); institutional investors expect independent board members to bridge the gap between themselves and the companies in which they invest. Independent board members are expected to carry the responsibility of being both the promoters and the custodians of shareholder value through the application of effective corporate governance, whilst at the same time fulfilling their duties as directors of the company. It is essential to note that the law does not recognize any distinction between executive and non-executive directors. Steele (2008) also states that independent board members have the responsibility of encouraging the development of the company, 'the upside', while at the same time monitoring risk to the company, 'the downside'. Working with the executive directors on these areas should lead to greater success for the company and hence enhanced shareholder value which, as Figure I demonstrates, flows through better pensions for everyone.

Looking at the responsibility of an independent from a legal perspective in Turkey; it can be clearly stated that the legal responsibility of independent board members is the same as

other members of the board. Turkish Commercial Code (TTC) has brought a regulation on the liabilities of board members. Under Art. 553 of the TTC, the liability of the board of directors is limited by law and by the articles of association. Pursuant to this article, in the event the founders, board of directors' members, administrators and official liquidators breach their duties arising from the law and the articles of association by their "fault", they shall be held responsible for damages they cause to the company, shareholders and company receivables. Therefore, it is possible to set forth that, where the board members, of their own fault, breach their responsibilities arising from the law and the articles of association, they shall be held liable.

It is essential to emphasize that an independent board member is a real or a legal person assigned as a member of the Board of Directors without holding any shares of the Company. These directors are not partners of the company but have all the rights of a board member and assume all liabilities and risks intrinsic to the board membership.

Differentiated Succession in Legal Liability: As per the former TCC, liabilities of the directors were several where, for example, a liability action would be litigated against one of the 5 directors and the entire damages would be collected from that director if the court ordered so. In such cases the sentenced director would indemnify the damages and then recourse the other directors in proportion with their defaults and therefore would be held liable for his/her own default only.

However, pursuant to the differentiated succession rule introduced by the new Code, default rates shall be determined prior to conclusion of the case and each director shall be held responsible for his/her share of default which has caused the damage taking into consideration the conditions reigned in occurrence thereof.

Liability of the Independent Director for Public Debts: Directors shall be held liable for the tax debts and the debts to the Social Security Administration to a specific extent regardless of whether they are the shareholders of the company or not. As to the tax debts, the company should be in default of paying a part of or the entire tax debt for the directors to be held liable. The directors cannot be personally held responsible for collection of the company's tax debts before all other remedies towards the company have been exhausted.

On the other hand, the director should personally be in default in accrual of the tax debt which means that the tax debt should have arisen during the office term of the director and the director should have been authorized to bind and sign on behalf of the company.

And as to the debts to SSI, the company should again be in default of paying a part of or the entire tax debt to SGK and the directors should be in default in accrual of the debt and authorized to bind and sign on behalf of the company.

It should be pointed out in terms of both the tax debts and the debt owed to SSA that the “differentiated succession” rule defined above is not applicable to the public debts where the liability of each director should be considered a default-based, personal, unlimited and several.

Expiration of Liability: Liabilities of an independent director expire upon discharge from liability and/or due to prescription as is the case for the shareholding directors.

The Board of Directors is discharged from liability at the General Assembly. The shareholders who affirm discharging of the board from liability with their votes lose their right to sue the directors for any of their liability. Other shareholders’ right of litigation expires after six months, following the date of discharge at the General Assembly.

It should be noted here that the liabilities of the directors arisen from the foundation of the company and capital increase cannot be removed by way of compromise and release unless 4 years elapse after the registration date of the company. Furthermore, removal of liabilities arisen from the foundation of the company and capital increase by way of compromise and release cannot be approved at the General Assembly if 10% of the shareholders representing the registered capital and 5% of the shareholders of a publicly-held company use dissenting votes.

Criminal Liability of the Directors: To this end, a dual separation can be made in terms of criminal liability: cases requiring an administrative fine and cases requiring a punitive fine.

As is known, an administrative fine is only a sanction payable in cash whereas a punitive fine results in imprisonment if not paid. A combination of an administrative fine and a punitive fine is usually applied when a director fails in performing his/her duties with due care. For example, activities, financial status, origins and progression of transactions found to be unrecorded in a traceable and comprehensible manner as reported by an independent auditor require an administrative fine whereas any failure in delivering the document requested by the government agencies may result in imposing a punitive fine, which may be converted to the imprisonment of the director if not paid in full.

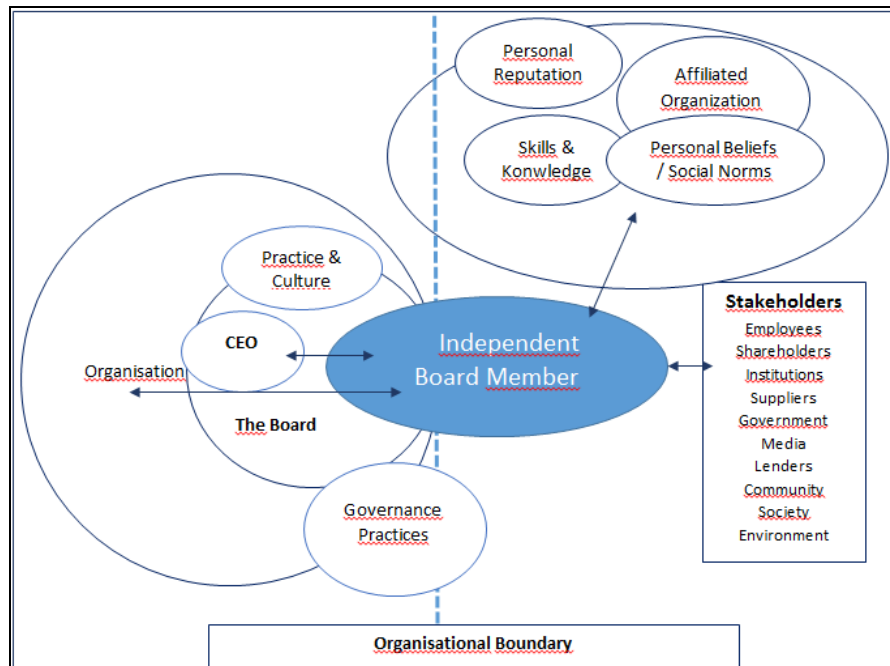
Some transactions or acts of director including violation of confidentiality, forgery of official documents, intentional falsification of commercial ledgers, misstatement of capital transactions when founding a corporation, and the collection of monies from the public by giving promises for increasing the corporate capital require imprisonment.

The regulation in the new Commercial Code shall eliminate pious transfers of shares to directors and therefore the backlog of transactions and push the companies to adopt the professional management concept and pave the way for improvement of institutionalization in Turkey.

7. ROLE CONFLICT OF THE SHAREHOLDERS

The factors that influence and are influenced by the “Independent Board Members” can be summarized in Figure II.

Figure 2. Independent Board Member Boundary Influencers



Source: Barratt, R. & Kakabadse, N.K. (2002)

As can be depicted from the Figure II above, the factors that influence the independent board members include stakeholders both outside the organization and those within it – as agency theory suggest – the requirements of internal players may also vary significantly from those of the organization and its external stakeholders (Eisenhardt, 1989).

The difference between the requirements and desires of these factors usually leads to a degree of conflict for the independent board members, which brings the requirement of reflexivity in acknowledging both one’s own understanding of the world and at the same time other people’s. The capability of the independent board members to balance the requirements of these various factors is likely to be affected by the explicit nature or otherwise of expectations within the board (Barratt and Kakabadse, 2002). In case the independent board member is faced with confusing signals about his/her role, the company may be faced with a role conflict, which is a situation usually faced by individuals in frontier positions, including functions that are not part of the daily routines of the business.

Independent board members are in a very special position, which necessitates safeguarding various internal and external interests. Taking into consideration that they have great knowledge of the complex business environment and that they are located outside the organization gives them a unique and an independent vision of the company, which increases

the organizational well-being. Through their boundary spanning role, independent board members can both inform and educate the executive as to the perceptions of others; their effect on the wider environment, the long term consequences of their actions may as a result facilitate more reflexive organizational behavior, leading through to enacted responsiveness and more socially responsible corporate citizens (Barratt and Kakabadse, 2002).

On the other hand, the predominant governance theories, including the agency theory (Fama and Jensen, 1983), emphasize the importance of independence to the monitoring role of the board. These theories make the assumption that management is likely to misuse their social relationships and effect the board members to persuade them to realize their wishes. Since the responsibility of the board members' should theoretically be towards the shareholders, an ethical dilemma is born questioning whether socially tied but independent board members should continue to be present on the board. On the other hand, drawing from social ties in organizations, research has shown that social relationships between independent board members and management can improve the level of collaboration (Westphal, 1999) and the level of information sharing between the two parties (Adams and Ferreira, 2007). Such research shows that social factors may indeed boost board involvement and hence improve board effectiveness. Jointly, these theories demonstrate that social ties between independent board members and management could result in adverse or favorable outcomes.

Companies need non-executive directors on their boards, because non-executives are an essential part of integrity and accountability of companies. It is generally observed that the non-executives will safeguard the interest of those shareholders who are not present on the board, themselves. Moreover, non-executive directors will bring valuable external expertise to the business. Non-executive board members often spot risks and opportunities for the company, which might have been overlooked by the company's executives, who are usually occupied with the day-to-day running of the business. Notwithstanding the pros of non-executive directors, there are also some limitations on the success of non-executives. Usually non-executive directors are employed on a part-time basis; hence they may have other work commitments, as a result of which they may not spare enough time for this particular task, hence lacking the necessary time to understand the needs of the company. On the other hand, non-executive directors may also lack the know-how to understand the technical issues of the business and moreover may lack the information on which to make an informed decision. Notwithstanding these aspects, it is generally accepted that the "pros" outweigh the "cons".

8. STRUCTURE OF THE BOARD OF DIRECTORS IN TURKEY

After having analyzed the developments and progress that took place worldwide and after having analyzed the theories constructed on "non-executive directors"; in this section, the regulations on the "Board of Directors" in Turkey is analyzed. As per the Communiqué on Corporate Governance (based on Article 17 of the Capital Markets Law dated December 6, 2012 and numbered 6362), which is published in the Official Gazette on January 3, 2014 and

numbered 28871; structure of the Board of Directors of a Company; which is subject to the Capital Markets Board, should be as follows:

i. The number of members of the board of directors, provided that the number is not less than five in any case, shall be determined in order to ensure that the board members conduct productive and constructive activities, make rapid and rational decisions and efficiently organize the formation and activities of the committees.

ii. A majority of the members of the board of directors shall consist of the members who do not have an executive duty. A non-executive member of the board of directors shall be the person who does not have any administrative duty other than being a board member or any executive unit subsidiaries to himself/herself and is not involved in the daily work routine or ordinary activities of the corporation.

iii. There shall be independent members from among the non-executive board members who have the ability to fulfill their duties impartially.

iv. The number of independent board members cannot be less than one third of the total number of board of directors. In the calculation of the number of independent board members, fractions shall be considered as the following whole number. In any case, the number of independent board members shall not be less than two.

v. The term of office of the independent members of the board of directors shall be up to three years and it shall be possible to be nominated as a candidate and elected again.

vi. A member of the board of directors who meet the following criteria shall be referred to as an “independent member”:

a. Not to have a relationship in terms of employment at an administrative level to take upon significant duty and responsibilities within the last five years, not to own more than 5% of the capital or voting rights or privileged shares whether jointly or solely or not to have established a significant commercial relation between the corporation companies on which the corporation holds control of management or significant effect and shareholders who hold control of management of the corporation or have a significant effect in the corporation and legal entities on which these shareholders hold control of a management and himself/herself, his/her spouse and his/her relatives by blood or marriage up to the second degree.

b. Not to have been a shareholder (5% or more), an employee at an administrative level to take upon significant duty and responsibilities or member of board of directors within the last five years in companies that the corporation purchases or sells goods or service at a significant level within the framework of the contracts executed, especially on audit (including tax audit, statutory audit, internal audit), rating and consulting of the corporation, at the time when the corporation purchases or sells services or goods.

c. To have professional education, knowledge and experience in order to duly fulfill the duties assigned for being an independent board member.

d. Not to be a full time employee at public authorities and institutions after being elected except being an academic member at a university, provided that is in compliance with the relevant legislation.

e. To be residing in Turkey in accordance with the Income Tax Law (I.T.L.) dated December 31, 1960 and numbered 193 (this has been changed to: at least half of the independent board members residing in Turkey will be enough)

f. To be capable of contributing positively to the operations of the corporation, to maintain his/her objectivity in conflicts of interest between the corporation and the shareholders, to have strong ethical standards, a professional reputation and experience to freely make decisions by considering the rights of stakeholders.

g. To be able to allocate time for the corporation's business in order to follow up to the activities of the corporation and duly fulfill the allocated duties.

h. Not to have conducted membership of board of directors more than a term of six years in the last ten years. A person who has been a board member of a company for more than six years within the last 10 years cannot be appointed as an independent board member to the same company for another year.

i. The same person shall not be the independent member of the board of directors in more than three of the corporations as such: the corporation or the controlling shareholders of the corporation who hold the control of the management corporations and in more than five corporations in total which are admitted to the trading on the exchange. This rule can be better explained with an example: The person who is the independent board member of "Company A" cannot be the board member in more than three companies whose management is controlled either by Company A itself or by the shareholders who control Company A. In addition to this, an independent board member cannot be appointed as the independent board member of more than five companies, which are publicly quoted.

j. Not to be registered and announced as a board member representing a legal entity. The independent board member should not have been registered and announced as a legal entity.

- **Nomination of the Independent Board Member:**

The Nomination process of an independent board member is also explained in the Communique, which is as follows:

The Nomination Committee shall evaluate the candidate proposals for independent membership, including those of the management and the investors, by considering as to whether the candidate meets the independence criteria and shall report its evaluations and submit its report to the approval of the board of directors.

Independent board member candidates shall submit a written declaration to the Nomination Committee at the time of his/her nomination, stating that he/she is independent within the framework of relevant legislation, articles of association and the criteria set forth above.

The Board of Directors shall compile a list of candidate independent members within the framework of the report of the nomination committee and send this list to the Board together with the report of the nomination committee and the resolution of the board of directors at least 60 days in advance from the general assembly meeting. In case the Board has an adverse opinion as a result of its evaluations within the framework of the principles stated above, it shall notify the corporation its adverse opinion regarding the list within 30 days. A person who has been subject to the adverse opinion of the Board cannot be submitted as a candidate independent member in the general assembly meeting. The corporation shall disclose at the Public Disclosure Platform (PDP) the list of the candidate independent members and of the candidates who have not been accepted as candidate independent members, at the latest with the announcement of the general assembly meeting. The Resolution of the general assembly of shareholders with regard to the nomination of independent members of the board of directors shall be announced together with the opposing votes and the grounds thereof, via the corporate website of the corporation.

- **Invalidation of the Independence of the Independent Board Member:**

In case of a situation wherein independence is being revoked, this situation and the grounds thereof shall be immediately notified to the board of directors by the independent board member in order to be disclosed at PDP. Such a member shall simultaneously notify in writing this situation and the grounds thereof to the Board. In principle, the member who lost his/her independence shall resign. In order to reinstate the minimum number of members of the board of directors, the nomination committee shall make an evaluation for an election of independent members to the vacant positions in order to be on duty until the earliest general assembly meeting and notify the result of its evaluation to the board of directors. The Board of directors shall elect the independent members from among the candidates in the report of the nomination committee.

The Board of directors shall send to the Board the candidate list determined within the framework of the nomination committee within 30 days as of the date that the independent membership becomes vacant. If the Board has an adverse opinion, it shall notify its adverse opinion to the corporation within 20 days. A person who has been subject to the adverse opinion of the Board cannot be nominated as an independent member. The members elected by the board of directors within this framework shall be on duty until the earliest general assembly.

The provisions set forth above shall also be applicable in cases where the independent member of the board of directors resigns or becomes unable to fulfill his/her duty.

- **Membership of Women**

The Corporation shall determine a target rate provided that it is not less than 25% and a target time for membership of women in the board of directors and form a policy for this target. The Board of directors shall annually evaluate the progress in respect to achieving this

target. If this requirement is not fulfilled by the Company, the reasoning should be stated explicitly in the annual report.

- **Audit / Accounting and Finance Experience**

At least one of the members responsible for audit shall have a 5-year experience on audit/accounting and finance.

- **Economic Independence and Liabilities of Independent Board of Directors' Members**

An independent board member should also be independent in terms of economic standards. If the independent board member expects to receive income from his position on the board of directors, he or she cannot act independently, where the primary concern would shift to increasing income, whereas the primary concern should be withholding objectivity. Independent board members tolerating problems without consideration and their involvement in the operations of the company is not acceptable with respect to the ultimate goal of creating this independent board member position. Hence, the income of the independent board member should be set such that it would ensure the protection of their independence.

On the other hand, the Turkish Commercial Code (TCC) has also stated a regulation on the liabilities of the board member. Under Article 553 of the TTC, the liability of the board of directors is limited by law and by the articles of association. According to the article, in the event of founders', board of directors' members, administrators and official liquidators' breaching their duties arising from the law and the articles of association by their "fault", they shall be held responsible for the damages they cause to the company, shareholders and the receivables of the company. Therefore, in case the independent board members, of their own fault, breach their responsibilities arising from the law and the articles of association, they shall be held liable.

- **Committees Formed within the Structure of the Board of Directors**

The Board of directors shall form a "Risk Control and Audit Committee", "Early Detection of Risk Committee", "Corporate Governance Committee", "Nomination Committee", and "Compensation Committee" in order to fulfill its duties and responsibilities in a reliable way. Committees shall be composed of at least two members. In case there are two members, both of them, and in case there are more than two members, the majority of them shall be comprised of non-executive members of the board of directors. The Chairman of each committee shall be elected from among the independent members of the board of directors.

Under any condition, approval of the majority of the independent board members shall be required in the resolution of the board of directors relevant to granting collateral, pledge, mortgage and surety in favor of third parties for the purpose of conducting their ordinary activities. Board members who are also a related party shall not vote in the board of directors meeting in which this subject will be discussed. In cases where the majority of the

independent board members do not approve such transactions, their grounds of opposition shall be disclosed at PDP.

9. CONCLUSION

The regulation on corporate governance, which is imposed by the Capital Markets Board with the Communiqué numbered 28871, provides the basis for determining and realizing the corporate governance principles in Turkey. One of the basic propositions set forth by the Capital Markets Board with the latest published Communiqués is the assertion concerning the obligation to have both executive and non-executive board members on the board of directors. While the executive board members participate not only in the day-to-day decision making process of the company but also in its operational mechanism, the non-executive board members are liable for determining and overseeing the general policy and strategy of the company whilst not interfering with the daily decision making process. In a nutshell, the executive board members act as if they work for the company, while the non-executive board members are expected to be independent in order to bring objectivity to the company, which has the aim of bringing transparency and accountability not only to the operations of the company, but also to its reporting standards, the ultimate goal being an upsurge in objectivity and transparency, hence improved corporate governance standards of the company.

Another point emphasized in the Communiqué, which needs to be underlined, is the fact that apart from being independent, the non-executive board members are also expected to have occupational education, knowledge, as well as occupational respectability and the experience to complete tasks properly. With the goal of protecting the rights of the beneficiaries within the company and to remain objective, a person who has the capability to make decisions independently, who has strong ethical values and who has the time to deal with a company's business issues should be elected as an independent member of the board, which constitutes a vital aspect of the Communiqué.

The main roles of an independent board member include constructively challenging and contributing to the development of strategy, monitoring the performance of previously set goals, tracking the inherent financial risk of the company, ensuring that the financial information reported by the company is accurate and finally taking an active role in the recruitment process of senior managers, as well as in the process of building a back-up in succession planning.

Furthermore, the key responsibilities of an independent board member are leading the specific committees, which carry significant roles in the conduit of a company, increasing the accountability of management, ensuring that there is an opportunity for sound risk management policies, becoming a strategic advantage for the company and representing minority shareholders, creating an environment for innovation and becoming instrumental in

leading mergers and acquisitions activity, and finally warranting that all decisions are arrived at in the best interest of the company and all shareholders are treated fairly.

In terms of personal skills and attributes of an independent board member, as far as technical aspects are concerned, an independent board member should have a sound understanding of strategy and development of the company, legal, regulatory and corporate governance and finally finance. In terms of interpersonal aspects, an independent board member should question intelligently, debate constructively, challenge rigorously and decide dispassionately.

Non-executive directors are expected to bring an independent judgment to the company to endure on issues of the overall strategy and performance of that company, resources that will be used and finally key appointments and standards of conduct. Furthermore, independent board members not only reduce any shortfalls in the competencies of the Board, but they also convey an objective perspective since they are not shareholders, themselves. Hence, they do not possess any conflict of interest with the family and with the company and they are capable of observing the company from outside, which is why in this still-developing corporate governance environment, the work, time commitment, and responsibilities of independent directors have increased significantly.

The regulations set forth by the Capital Markets Board in Turkey are in line with the regulations worldwide. In order to create objectivity, the Capital Markets Board has set several significant regulations, one of them being independency of the non-executive board members, which has resulted in the assignment of non-partners as directors of a company, which is a revolutionary development in Turkish commercial law. This action is expected to eliminate pious transfers of shares to directors and therefore the backlog of transactions and to push the companies to adopt the professional management concept and pave the way for the improvement of institutionalization in Turkey.

The main purpose of this paper was to analyze the significance of “independent board members”, which has a significant role in the implementation process of corporate governance rules in Emerging Markets like Turkey. In this paper, both the academic literature and the rules and regulations set forth by Capital Markets Board of Turkey and the new Turkish Commercial Code are analyzed and conglomerated. The paper concludes with an emphasis on the significance of “independent board members” which is a direct indicator of the implementation of corporate governance that is earning progressively more importance as time goes by in the Emerging Markets. The importance of the independent board members will rise even further with the ultimate aim of implementing the guidelines set forth with the corporate governance principles not only in Turkey, not only in the Emerging Markets; but all around the world.

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