


CHAPTER III


THEORETICAL ASPECTS OF CORPORATE GOVERNANCE: WHY IT MATTERS IN BANKING SECTOR*

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1.INTRODUCTION

After the global financial crises, corporate bankruptcies and frauds reached to a great extent, it has been concluded that the necessary attention is not given to corporate governance practices on a country or firm basis. Application of corporate governance principles is of great importance in terms of the companies' ability to operate in both domestic and foreign markets and of keeping up with economic or technological changes. Corporate governance; in line with the principles of transparency, accountability, responsibility, and fairness, is a set of rules and practices that put the relations between company management and all stakeholders in a certain order. The company management has to shape its relations with stakeholders within the framework of the four principles mentioned. The countries or companies whose corporate governance practices are not considered effective are greatly likely to lose their appeal to investors and these losses reach significant dimensions. Therefore, corporate governance practices should have an effective structure, especially in the banking sector, which guides the economy to a large extent and provides financing to the real sector.

In addition to the financial crises and corporate scandals resulting from ineffective corporate governance policies, developments such as the markets becoming interdependent as a result of globalization, the increasing weight of corporate investors in company investments, and the acceleration of privatization activities drew attention to the importance of

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corporate governance practices in both the real sector and the banking sector. At this point, corporate governance emerges as a concept that aims to resolve the negative situations and to keep up with the developments.

Due to the functions of banks to stabilize the financial system and contribute positively to economic growth, the scope of corporate governance in banks differs from corporate governance practices in companies operating in the other sectors. The recent realization of large-scale reforms in the banking sector and the fact that banks have an important place in the economies of developing countries have increased the importance of effective corporate governance practices in banks. Considering the emergence process of the concept of corporate governance; it is seen that the negative effects of financial crises, which are one of the most important factors in the emergence of the so-called process, are felt in the banking sector first and then in the real sector. It is possible to express that the importance of corporate governance in the banking sector differs compared to other sectors due to the functions of banks to provide capital financing to companies operating in the real sector and to realize effective resource allocation. In this context, the first step in implementing the effective corporate governance practices in the banking sector in Turkey was taken after the 2001 banking crisis, which negatively affected first the financial sector and then the real sector.

The rest of this chapter is organized as follows: First of all, various definitions related to corporate governance are given, the factors that are effective in gaining importance of corporate governance are clarified, basic principles and objectives of corporate governance are mentioned, and corporate governance structures in different types of ownership are discussed. Then, the study is terminated by addressing the general situation and the importance of corporate governance in banks. Finally conclusion section is presented.

2. CORPORATE GOVERNANCE

In this section, general information about the concept of corporate governance will be presented. In this context, after defining this concept and expressing its common elements, the factors that are effective in the residual importance of corporate governance, and its practices in different ownership structures will be discussed.

2.1. DEFINITION OF CORPORATE GOVERNANCE

It is possible to come across different definitions regarding the concept of corporate governance in the literature because this concept shows difference from country to country. However, the following elements appear as common criteria in all definitions related to the concept of corporate governance (Dogan, 2007: 42):

- Control mechanisms within the company,
- Close relations among the company's directors, the board of directors, shareholders and stakeholders,
- Management of the company by considering interests of all stakeholders,
- More transparent and accountable information produced within the company.

The narrowest definition of the concept of corporate governance was made by Shleifer and Vishny (1997). According to Shleifer and Vishny, corporate governance is a set of activities that will enable the funders to trust the company to get the return they expect from their investments (Shleifer and Vishny, 1997: 737). According to the OECD, the concept of corporate governance is taken from a wider perspective, and the relationship among the board of directors, shareholders, and other stakeholders is expressed as a whole. According to the Cadbury report, corporate governance is a set of practices that allow the balance between economic and social goals. (Dinc and Abdioglu, 2009: 160).

It may be concluded from the suggested definitions that corporate governance is a subject that has been handled carefully all over the world as a concept that covers both internal control and the relationship between the firm and stakeholders (Mallin, 2007: 5). Corporate governance is a concept that clarifies the relationship between shareholders and managers. It is tried to find solutions to proxy problems arising from the differences between corporate governance practices and ownership and control structures (Tarraf, 2011: 95). Effective corporate governance requires a talented and experienced management structure, consistent strategies and business plans, and clear limits of accountability (McDonough, 2002: 1). With a successful corporate governance practice, firms can reduce their capital costs, increase their financing opportunities and liquidity, and find more funding opportunities than capital markets (Ozturk and Demirgunes, 2008: 395).

2.2. CORPORATE GOVERNANCE PRINCIPLES

With the rapid innovations in technology and the establishment of new industries, financial problems in businesses started to grow and with the increasing need for funding, issues such as liquidity and financing of investments started to gain importance. At this point, the interaction between financial performance and corporate governance started in the early 90s, and effective corporate governance practices were seen to be an important factor on financial performance (Usta, 2008: 19). At the same time, corporate governance is of great importance in terms of managing companies well and maintaining their activities at an optimum level of

effectiveness. In this context, it is possible to express some of the basic characteristics of corporate governance as follows (Mallin, 2007: 5-6):

- With corporate governance, an appropriate and robust control system is established within the company and thus companies have the opportunity to protect their assets,

- Corporate governance prevents a single person from having a say in the decisions that should be taken in companies,

- Corporate governance; regulates the relationship between company managers, board of directors, shareholders and other stakeholders,

- Corporate governance focuses on managing firms, shareholders and other stakeholders in a way that meets their interests at the highest level,

- It encourages the application of transparency and accountability concepts that investors place the utmost importance on both corporate governance and corporate performance.

While corporate governance practices differ due to the legal regulations of the countries in which they are located and the company's unique characteristics, all corporate governance models consist of four main principles: fairness, transparency, accountability, and responsibility. These principles are described briefly below (Dogan, 2007: 50):

The principle of fairness; this principle contributes to the determination of internal duties and responsibilities by minimizing representation costs, and reducing conflicts of interest.

The principle of transparency refers to the process of making information about the current situation and events in companies accessible, concrete, and understandable. Transparency contributes to the effective distribution of resources by enabling market participants to obtain the information needed to separate one firm or one country from another and recognize risks (Banks Association of Turkey, 1999: 7). It is possible to express what companies need to do to improve their understanding of transparency within the framework of corporate governance as follows (Baraz, 2007: 96):

- Adopting and implementing a transparent management approach as 'corporate culture',
- Raising awareness about corporate governance and making efforts to create public opinion,
- Managing companies with a sense of responsibility for their work,
- Taking unregistered transactions into the register,
- Forming an audit committee that reports to senior management,

- Preparing understandable and reliable financial statements according to international standards,
- Using the corporate website to share information and keep it up to date,

The principle of accountability refers to the responsibility of the people to whom the resources are allocated or delegated to demonstrate how effectively they use these resources and powers. In firms where corporate governance practices are effectively carried out, company management has several responsibilities towards shareholders and all stakeholders. First of all, shareholders who are partners in the ownership of the company have the right to monitor and control the effective use of the funds invested in the company. It is more appropriate for the board of directors of the company to bind the responsibility and obligation of accountability to certain rules rather than for shareholders to protect their rights individually (Aktan, 2006: 65).

The principle of responsibility refers to the compliance of all activities carried out by the management of the company on behalf of its legal entity with the relevant legislation, articles of Association, Internal Regulations, social and ethical values and its supervision (Pamukcu, 2011: 135). This principle aims to set and implement the right goals to ensure compliance with laws and social values (Dinc and Abdioglu, 2009: 161).

2.3. FACTORS AFFECTING THE EMERGENCE OF CORPORATE GOVERNANCE

Financial crises that have negatively affected the entire world economy led to bankruptcy and caused an economic recession in several countries. This situation have made corporate governance practices the focus of resolving the problems by banks to stop lending operations. The high quality of corporate governance practices has special importance for both companies and countries. Considering the companies; effective corporate governance allows for low capital costs, increased financing opportunities and liquidity, and easier crisis recovery. In terms of countries, corporate governance practices have a certain quality; it enhances the image of the country, prevents capital from going abroad, promotes foreign investments, increases the competitiveness of the economy and capital markets, and enables more efficient use of resources (Solomon and Solomon, 2004: 11).

Many factors play a significant role in the application of principles of corporate governance. Enron scandal in 2002 and various firm scandals may be considered as the so-called factors. The mentioned company collapse adversely affected the large-scale investments of shareholders, employment opportunities in the relevant country, and many managers. The mentioned company scandals in the USA and other developed

countries have not been limited in themselves; they have also affected the developing countries and have negatively reflected on the markets by shaking the trust of investors (Ozsoy, 2011: 11). On the other hand, recent financial crises, the increase in the weight of the institutional investors, and the competition conditions intensified as a result of globalization are also among the main factors in the importance of corporate governance (Gurbuz and Ergincan, 2004: 3). In this section, the effects of the mentioned factors on corporate governance will be emphasized.

2.3.1. CORPORATE SCANDALS AND COLLAPSES

Economic crises and large-scale corporate scandals play an important role in the development of corporate governance. The 'South Sea Bubble', which was experienced in the 1700s and which has gone down in history as the first known management fault, has been very effective in making new laws and regulations in England. In the United States, the issue of corporate governance was first raised after the Asian crisis in 1929, and it was aimed to bring confidence to the business world. The collapse of 'Bank of Credit and Commercial' and 'Baring Bank' accelerated the operations as to corporate governance. Therefore, it is possible to describe the bankruptcy events experienced in these two firms as the events that have the most impact on the development of corporate governance (Uyar, 2004: 154).

Companies have to attract the interest of investors to protect their existing assets and to ensure a certain growth. Investors, on the other hand, pay attention to the companies' financial soundness, profitability, and management quality before investing in a particular area or company. Therefore, the fact that the annual reports, financial statements and other published reports reflect the accuracy and truth one-to-one is of great importance for investors to make an objective and accurate assessment. Although its annual reports and financial statements look pretty good, in the 2000s a large number of large-scale companies in America, Britain, and many other countries faced the risk of bankruptcy. As a result of the corporate scandals in question, the value of shareholders' investments greatly reduced, many employees lost their jobs, and the sectors in which bankrupt firms operate, and finally the economies of the country, were negatively affected by this situation (Mallin, 2007: 1).

Corporate scandals that emerged as a result of accounting frauds allegedly carried out by senior executives of large-scale companies such as Enron, Parmalat, WorldCom, Adelphia, Xerox and Tyco, played a major role in questioning the effectiveness of corporate governance practices. Besides, the bankruptcy of companies that were publicly held in the UK in the early 1990s also made it possible to bring many suggestions on

corporate governance and to conduct various researches on more effective corporate governance practices (Dogan, 2007: 40).

2.3.2. GLOBAL FINANCIAL CRISES

Inadequate corporate governance policies implemented in countries and companies are among the main reasons for the outbreak of recent global financial crises (Gurbuz and Ergincan, 2004: 3). It is stated that the most important factor in the occurrence of system-based crises affecting first the company, then the sector in which the company is located and then the whole country's economy is the ineffective corporate governance practices (Sakarya et al., 2012: 234). In the Asian crisis that started in the Far East in 1997 and spread rapidly all over the world, companies experienced management problems and audit deficiencies, weaknesses in accounting systems and structural problems in shareholder ownership (Karayel, 2006: 37). The Asian crisis became more important with the scandals of Enron in the United States and Parmalat in Europe, leaving all companies to reconsider their existing corporate governance practices (Kula, 2006: 12).

As the main reason for the emergence of the 2008 global financial crisis; aggressive (unconscious or excessive) risk-taking strategies have been shown. Ineffective risk management activities carried out by the managers and boards of directors have also accelerated the collapse of the markets and led to the outbreak of the so-called financial crisis (Tarraf, 2011: 93). Additionally, the regulations and standards for misconduct in accounting by the senior managers of some firms following their interests has also hastened the process of emergence of crises (Gokgoz, 2012: 313).

2.3.3. INSTITUTIONAL INVESTORS

Institutional investors have an important role for the financial institutions that play an important role in fulfilling the functions of financial system, managing the savings of small investors at an acceptable risk level to achieve the objectives of return maximization and maturity matching. Mutual Funds, Private Pension Funds, Investment Partnerships, Life Insurance Companies, Real Estate Investment Trusts and Venture Capital Investment Trusts are described as the institutional investors. As a result of the merger of individual savings under mutual and pension funds managed by corporate investment companies, great financial power has occurred. In the face of the demands of this power, it has become imperative to act more fairly, more transparently, more reliably, and more responsibly within the framework of corporate governance principles. Effective corporate governance enables the company risk and therefore the rate of return demanded by investors to decrease. As a result of this situation and with the increase in the weight of institutional investors in firm investments, institutional investors have the opportunity to follow the

company operations more closely and criticize the company management when necessary, and they can be effective in the formation of company management in general assembly meetings (Mentes, 2009: 59).

The change in the characteristics of shareholders, the increase in the share of institutional investors, and in the number of investments made by pension funds and insurance companies are among the factors that have an effect on the development of corporate governance all over the world. Furthermore, institutional investors' tendency to make profitable overseas investments to diversify their portfolios has also been effective in the emergence of corporate governance (Dogan, 2007: 43).

2.3.4. THE ROLE OF THE PRIVATE SECTOR AND PRIVATIZATION ACTIVITIES

Privatization practices, which have become widespread all over the world since the 1980s, have been indirectly effective in gaining the importance of corporate governance. This situation is mostly due to the public enterprises, which are publicly owned, have moved to financial markets for capital supply and have turned to firm marriages after they have become private (Stone et al., 1998: 2-3). Compliance with corporate governance principles makes the companies within the scope of privatization more efficient and transparent, thereby increasing the demand in both block sales and public offerings. When effective corporate governance is implemented in the companies operating in the public or private sector, especially companies within the scope of privatization; inefficiency and losses arising from bad management and unfair gains disappear and the economy gains dynamism (Ozsoy, 2011: 50-51).

The fact that public trusts private sector firms in terms of evaluating their savings on their behalf and securing their investments is another factor for the residual importance of effective corporate governance. On the other hand, the private sector is seen as the main element of global economic growth and it is stated that the privatization programs implemented in many countries, the developing competition policy, and the liberalization efforts of the capital market are also effective. With increasing confidence in the private sector around the world, the quality of corporate governance becomes more and more important in terms of compliance with the law and establishes public trust. Effective corporate governance affects the private sector and thus the performance of the shareholders, which positively affects economic growth. In this context, both the public sector and the private sector should create and develop more successful corporate governance practices to provide investor confidence (Sehirli, 1999: 13-14).

2.3.5. GLOBALIZATION AND FIERCE COMPETITION ENVIRONMENT

The circulation of capital becomes easier with globalization and this has a positive effect on economic development. Additionally, capital moves abroad faster in times of crisis and causes crises to spread faster as a result of globalization. Therefore, in addition to the fact that corporate governance practices differ from country to country, some similarities have begun to emerge in the operations and management styles of the firms with the globalization of markets. In addition to areas such as price, cost, quality and obtaining financial resources, it is observed that companies compete with each other in terms of corporate governance practices. Due to the aforementioned competitive factors, which reduce investment risk and capital cost, companies try to take the lead in having effective corporate governance practices (Dogan, 2007: 46-47).

As a result of international capital movements accelerating with globalization, institutional investors have started to seek more trust and stability in the countries or companies they invest in. Today, while investors invest in stocks, they are not only limited to the companies in their own country, they are interested in investment tools all over the world. As a result of this situation, investments, income and exports increase, financial markets deepen and international capital movements accelerate. Increasing economic dependency markets make it sensitive to international funding sources, portfolio investments, and market fluctuations. Therefore, companies should adopt reliable and generally accepted corporate governance principles to attract capital (Aktan, 2006: 63).

Corporate governance practices are supported by the capital market regulations, corporate law, accounting and auditing standards, bankruptcy law, legal sanctions, and the seizure of firms by other firms. At this point, both developed and developing countries have taken various measures to prevent undesirable situations that arise as a result of inadequate corporate governance policies and have solved a large part of the problems that have occurred. For example; The Sarbanes-Oxley Act was enacted to prevent financial information manipulation that led to firm scandals in the United States, and various regulations were passed by the SEC and the exchanges. Germany has legislated and enforced corporate governance principles. On the other hand, Russia has made public its corporate governance principles, European Union countries have made corporate governance arrangements, and many developing countries have adopted corporate governance principles as well (Kucuksozen and Kucukkocaoglu, 2005: 84).

2.4. OBJECTIVES OF CORPORATE GOVERNANCE

Corporate governance practices are carried out to protect the investments of the funders. Therefore, in the companies where the corporate governance practices are carried out effectively, investors not only examine the company activities on a periodical basis but also continuously control the managers engaged in dispossessing activities (Kula, 2006: 12). It is possible to list some objectives of corporate governance as follows (Aktan, 2006: 61):

- Protecting and securing the rights of all stakeholders in a direct or indirect relationship with the company,
- Preventing arbitrary use of the powers owned by the senior management of the company,
- Ensuring that shareholders of the company are treated equally,
- Avoiding the danger of large shareholders confiscating minority shares,
- Trying to control the conflict of interest between the risk-taking investors and the decision-making professional managers,
- Establishing an atmosphere of trust for institutional investors who are making long-term investments, reducing the cost of capital and, ensuring easy access to financing opportunities through the issuance of shares of the company.

2.5. CORPORATE GOVERNANCE IN DIFFERENT OWNERSHIP STRUCTURES

The concept of corporate governance was first raised within the scope of problems specific to multinational companies and then started to be discussed in non-public companies and public institutions (Deloitte Corporate Governance Series, 2006: 3). Looking at the companies out of the stock market in many countries; the substantial amount of stock belongs to a family, an industrial enterprise, or the public. In the stock market companies, the share of the shareholders holding the control generally does not exceed 50%. Although there are many similarities regarding problems and solutions in both company groups, companies that are not traded in the stock exchange require a different approach than public companies. Non-public companies; it is possible to group them as family firms, public-owned organizations, group firms, firms owned by private investors, joint venture firms, and heavily privatized firms. However, the companies that are emphasized the most in terms of corporate governance are family companies but not public companies (Ozsoy, 2011: 54).

2.5.1. MANAGERIAL OWNERSHIP

The managerial ownership structure shows that a shareholder holds a large part of the firm's ownership, and the remaining shares are shared among the investors called “minority shareholders” and expresses the ownership density. In companies where ownership is concentrated, the dominant shareholder is more willing and has more opportunity to audit the company management due to the size of the investment. Therefore, with this type of ownership structure, the lack of supervision in companies with scattered ownership is prevented. On the other hand, the managerial ownership structure may cause some corporate governance problems. In companies where ownership is dominant, it may be possible for large shareholders to use the assets of the company against small shareholders in cooperation with the company management. This problem occurs more frequently in countries where minority rights are not sufficiently protected (Deloitte Corporate Governance Series, 2006: 3). The fact that management ownership affects important firm decisions for the firm, the direction and size of this effect has also been the subject of research (Mentes, 2009: 123). Holderness (2003) stated that three important decisions that may affect managers in firms where executive ownership prevails, i.e., those with a high share of shareholders, are top executive pay and incentives, the firm's leverage (indebtedness) ratio and takeover activities. It has been stated that there is not a very large difference between firms with executive ownership and firms with scattered ownership concerning top executive pay and incentives (Holderness, 2003: 56-57).

Regarding the situation between the firm's leverage ratio and the density of ownership, it is not possible to reach a single judgment. In some studies testing the relationship in question; while there is a positive relationship between executive ownership and leverage ratio, some mentioned a negative relationship; some have not found any relationship. It is stated that a situation similar to the relationship between the firm's leverage ratio and executive ownership is valid for the relationship between the takeover of the firm and the executive ownership. In some of the studies, it is stated that there is an inverse relationship between the management of the company and the acquisition of the company, it is stated that firms with managerial ownership are taken over more frequently in some (Stulz, 1988; Holderness et al., 1999; Mikkelsen and Partch, 1989).

2.5.2. FAMILY FIRMS

Family firms refer to firms where two or more people from the same family work in the same firm and one or more of them have a majority stake in the firm (Mentes, 2009: 125). Corporate governance principles that ensure the establishment and maintenance of the trust element within the

firms clarify whether or not there is a proxy problem in family firms, where ownership and management are held in the same hand. Corporate governance in family firms refers to a process of change and differentiation. To be able to determine whether the change in question is at a level that meets the planned and targeted expectations, corporate governance needs to be supported with internal audit and internal control systems. Therefore, it is possible to express that corporate governance in family firms is a collective process, not a process that only the founding family elders and family members can perform (Deloitte Corporate Governance Series, 2007: 13). In Turkey, it is stated that foreign investors are investing largely in family firms. However, in this context, it is important that the family firm in question has a certain background, has a certain consistency in corporate governance and has some credibility arising from past practices (Ararat, 2003: 93).

2.5.3. STATE OWNERSHIP

Although there are many similarities between corporate governance practices in the public and the private sector, and although a principle applicable to one can be easily applied to the other, there are some differences in the basis of corporate governance in the public sector. The concept of shareholders in the public sector and the relationship of the board of directors with the shareholders differ according to the private sector. There is a government in the public sector where the board has to work together and the government has the power to fundamentally and directly influence the issues the board is working on. Even though the boards of directors in the private sector often have to deal with institutional investors who demand a lot, it is stated that working with the government for boards causes more and different problems than institutional investors. Moreover, the fact that the public sector offers a rather complicated legal framework for the boards of directors compared to the private sector reveals the difference between the two sectors within the scope of corporate governance (Sendt, 2002: 5).

Corporate governance principles play an important role in assessing how public-owned companies with a significant share in the economy are managed and improving their management processes. However, it is possible to mention two fundamental problems in the implementation of corporate governance in public-owned companies. First of all, it is not easy to strike the right balance between the responsibility of performing the public ownership function and avoiding improper political interference in the management of the company. Secondly, there may be difficulties in providing an environment in which private sector companies can compete on an equal footing with those public-owned in the markets they operate, and there may be distortions in the competitive environment when governments use their regulatory and supervisory powers. Therefore,

it is stated that corporate governance practices can yield effective results in solving the mentioned problems. Similarly, the separation of the ownership structure of the public and its regulatory functions also provides convenience for public companies in this context (Turkish Industry & Business Association, 2006).

3. CORPORATE GOVERNANCE IN BANKS

Corporate governance practices in the world were first introduced in 1999 by the OECD corporate governance principles and in Turkey for the first time in 2003 by the Capital Markets Board (CMB)'s Corporate Governance Principles (NemliCaliskan and Turan Icke, 2009: 121). In recent years, there have been significant changes in the views of almost all developed and developing countries, as well as OECD and the World Bank, on the extent to which the organization and management structures of large-scale industrial companies should be institutional. Contrary to the general interest in the concept of corporate governance, it was seen that the current corporate governance practices in banks were not given due attention at the beginning and the fact that banks play a very important role in the operation and management of other types of companies was ignored (Macey and O'Hara, 2003: 91). The importance of corporate governance has been understood since the 90s and the Basel Committee on Banking Supervision has emphasized that corporate governance practices in financial institutions are extremely important and emphasized that the management structure in banks should be composed of the board of directors and senior management. Thanks to effective corporate governance practices, it becomes possible to positively affect both the soundness of the financial system and the level of economic development throughout the country (Andres and Vallelado, 2008: 2570).

3.1. OVERVIEW OF BANK CORPORATE GOVERNANCE

The structure of corporate governance plays an active role in realizing the corporate goals of banks, maintaining their daily operational activities, protecting the interests of shareholders and protecting corporate activities and the rights of depositors. Therefore, it is possible to express the corporate governance of the bank as a structure where the business and activities of the institutions are managed by the board of directors and senior managers (Tuna, 2005: 9-10). Banks' proprietary structure, frequent fluctuations in financial markets, intense competition and increasing investment alternatives expose banks to a variety of risks and require measures to be taken to address this situation. Moreover, the fact that the banking sector is subject to very strict regulations and under constant control in almost every economy also reveals the fact that banks should apply the corporate governance practices in line with their structure (Ungureanu, 2008: 1).

Corporate governance practices in banks are different from the corporate governance practices adopted in non-financial firms. The first reason for this is that banks are accountable to many stakeholders. Banks with more than 90% client accounts (this ratio is around 40% in non-financial firms) have more stakeholders (shareholders, depositors, holders of secondary debt) than non-financial firms. Additionally, the expectations of shareholders differ according to the expectations of other stakeholders. Shareholders focus on the risk-oriented and short-term objectives, while depositors and other stakeholders avoid risk and concentrate on long-term objectives. The other reason for this differentiation is that banks have an opaque structure than other types of firms. Having a non-transparent (opaque) and complex structure plays an important role in the interaction between the bank's management and the board of directors, as well as between the bank and the banks' regulatory bodies. The extent to which the board effectively represents shareholders depends on the extent to which it knows the internal functioning of the bank. On the other hand, independent board members play a more active role in conducting the Foreign Relations of the banks, as they are more familiar with the financial markets. Therefore, the corporate governance practices in banks differ from those of other types due to the non-transparent and complex nature of banking activities and the risk composition of banks' assets changes at any time compared to non-financial firms (Mehran et al., 2011: 3-5).

In addition to the existence of some differences in the banking sector compared to the real sector, banks are of great importance for the development of the real sector, corporate governance practices and efficient resource allocation. Efficient resource allocation of banks provides benefits in lowering capital costs, strengthening capital formation and increasing their productivity. If bank executives have a strong corporate governance mechanism, this plays an important role in the efficient allocation of resources and effective corporate governance on the funded companies. Therefore, corporate governance practices in banks directly affect the activities of companies and the national economy (Levine, 2004: 2).

3.2. IMPORTANCE OF CORPORATE GOVERNANCE IN BANKS

Effective corporate governance practices are of great importance in creating and maintaining a sound trust environment between the public and the banking sector (Basel Committee on Banking Supervision, 2006: 3). Since the banking sector has a very important place in almost every economy in the context of financial intermediation, the corporate governance practices of banks have become a subject of more attention than other sectors. The lack of corporate governance practices in the banks causes the banks to lose the ability to manage their assets and liabilities

properly and to create a liquidity crisis. As an inevitable consequence of this situation, an economic crisis occurs throughout the country. Therefore, corporate governance practices applied in banks are one of the issues that all stakeholders should focus on (Htay et al., 2012: 3).

Corporate governance practices in the banking sector are also of great importance in developing countries' economies for many reasons. One of the reasons for this situation is that banks have a very dominant share in the financial systems of developing countries and are an important trigger for economic growth. Second, since financial markets are often not able to reach adequate levels of economic development, banks are an important source of financing for most firms in developing countries. Third place; banks are seen as a means of payment adopted by all parties, and therefore they are a highly trusted depository institution for the savings of stakeholders. Fourth, the economies of many developing countries are looking to privatize, unload portfolios or reduce the role of economic regulation, making banking systems freer. Therefore, the bank managers in these economies have the opportunity to take more initiative in the management of the banks (Arun and Tumer, 2004: 372).

It is stated that if effective corporate governance cannot be implemented, banking surveillance and control mechanisms will not function at the expected level (Dogan, 2007: 110). Therefore, effective corporate governance in banks is also critical for banking surveillance and supervisory authorities. Effective corporate governance that is clearly defined and implemented both facilitates the ability of auditors to perform their duties and increases the cooperation between the bank's management and the supervision authorities (Basel Banking Audit Committee, 1999: 3). Considering corporate governance practices, some conflicts may arise between shareholders and managers regarding their risk-taking preferences, and the attitudes of shareholders towards taking risks may not be welcomed by managers. In this context, the effectiveness of corporate governance practices in banks is of primary importance in resolving the conflict between the bank's shareholders and managers (Anginer et al., 2018: 330).

Another reason why corporate governance is so important in the banking sector is the possibility of ineffective corporate governance practices in the sector leading to the bankruptcy of banks. The bankruptcy of banks significantly increases public expenses due to the negative impact it creates on valid deposit insurance systems, fee payment systems, and various macroeconomic indicators (Basel Committee on Banking Supervision, 2006: 3).

Finally, the lack of free entry into the banking sector, the need to obtain a license to carry out banking operations, the fact that deposits in

the banking sector have a greater share than equity, the rapid and intense interaction of the banking sector with macroeconomic factors and the fact that the sector is open to systematic risks are among the factors increasing the importance of corporate governance in banks (Tanrioven et al., 2006: 91).

3.3. THE BASIC DIFFERENCES OF CORPORATE GOVERNANCE PRACTICES BETWEEN BANKING AND NON-FINANCIAL FIRMS

Corporate governance practices in banks have some differences compared to non-financial companies. The reasons for this situation generally include the number of shareholders, the level of competition in the administrative labour market and the product market, the executive compensation, strict regulations, and high leverage level (Adams and Mehran, 2003: 124-126). For instance, banks are subject to strict regulations since they are obliged to protect the rights of depositors and to reduce systemic risk (Sanchez et al., 2020: 53). Additionally, banks are strictly regulated because of their critical position in financial intermediation and payment systems, which lead to many negative macroeconomic externalities. These may create adverse effects on the functioning of the general economy (Haan and Vlahu, 2005: 229).

The fact that the majority of the capital in banks is provided by the depositors and bondholders significantly increases the leverage ratio. While the leverage ratio in banks generally varies between 87% and 95%, in non-financial companies this ratio is around 20-30%. A high leverage ratio increases both the bankruptcy possibilities of banks and the conflicts of interest between shareholders and depositors. If the interests of the top management in banks and the interests of the depositors are in harmony, top management may be encouraged to invest even in the projects whose net present value is not positive. This strong equity governance increase conflicts between shareholders and creditors. Increasing agency costs lead to a decline in firm value (John et al., 2016: 305). Although the majority of the capital in banks is provided by depositors and bondholders, decisions are mostly taken by managers, shareholders and boards of directors. Therefore, bank managers do not have to get permission from depositors while making decisions about risk profiles (Becht et al., 2011: 438). On the other hand, banks occupy an important position in the real economy, because they are the main creditors. Therefore, in the case of ineffective corporate governance practices in banks, the capital allocated to non-financial companies cannot be used in the efficient areas (Leaven, 2013: 67). For executive compensation, there may be also some differences in corporate governance practices. In the case of a remuneration to increase shareholder value, managers are willing to make decisions to increase firm

value, which also increases their willingness to take risks. But it is not appropriate to choose a share-based pricing path to protect the rights of depositors who are not shareholders of the firm, such as banks (Díaz et al., 2018: 40).

CONCLUSION

Corporate governance emerges as a concept that regulates the relations between the board of directors of companies and the stakeholders and enables companies to be managed and controlled effectively. Especially in developing countries, effective corporate governance policies play a major role in the success of company management, and they attract the attention of foreign investors by allowing companies with weak corporate governance practices to strengthen their capital structures. Although corporate governance practices vary among companies or countries according to many factors such as ownership structure, accounting standards, protection levels of minority shareholders, control power of board members, the main purpose in the implementation of these policies is to ensure the separation of ownership and control.

Undoubtedly, corporate governance is a concept that is considered to be extremely necessary for both financial and non-financial companies. Agency costs and opportunistic behaviours of managers are defined as two main factors that negatively affect the effectiveness of corporate governance practices. The main reason for the emergence of agency costs is the inability of the company owners to control and the conflicts of interest between managers and company owners. Financial scandals such as Enron, WorldCom and Parmalat, which resulted from the reasons such as lack of control and fraudulent activities of executives, emphasized the necessity of corporate governance at this point. Although it is stated that minority shareholders have to bear more agency costs than controlling shareholders, it is possible to state that corporate governance is a concept that aims to protect all shareholders.

Since the banking sector plays an important role in the national economy, keeping the corporate governance level in the sector at high levels is of great importance for lenders, company owners, managers, potential investors and supervisory institutions. Due to the capital structure they have and the high risk they bear, banks are subject to very strict audits and some compelling regulations and these differences are also reflected in the corporate governance practices of banks. Also, banks provide significant resource transfer to companies operating in the real sector and play an important role in the development of national economies. At this point, the restructuring process initiated within the framework of corporate governance, especially as a result of the 2001 banking crisis, encouraged banks to make radical changes in their financial, administrative and capital

structures, and these innovations had a positive impact on the sector. Therefore, effective corporate governance practices are considered as one of the factors that should not be ignored in the banking sector, as in many other sectors.

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