Corporate Governance and Enterprise Risk Management

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Agenda

- Corporate Governance in Turkey
- ERM as a Part of Corporate Governance
- ERM and Corporate Governance at Sabanci Holding

Corporate Sector and Capital Markets

- Economic Stability: growth in four consecutive years since 2001,
  - 2003: US$ 239 billion; 2004: US$ 300 billion; 2005: US$ 360 billion;
- No. of Joint Stock Companies: 120.000 (99%SME's)
- No. of Public Companies: 637 (ISE Listed + Unlisted)
- No. of ISE Listed Companies: 282
- Market Cap:
  - 2003: US$ 69 billion (29% of GNP),
  - 2004: US$ 98 billion (33% of GNP),
  - 2005: US$ 156 billion (50% of GNP),

Ownership and Control Structure in Turkey

- Turkish firms are generally:
  - Family-controlled
  - Complex financial-industrial conglomerates
  - Structured as pyramids
  - Members of large groups (cross-ownership)

- Controlling shareholders often hold shares with nomination privileges and/or multiple voting rights.

- Many publicly traded companies have a small free float.
  - Foreign Share in The Free Float: 59%

Ownership and Control Structure in Turkey (2)

- In practice, the statutory board of directors plays a limited role in corporate governance.
- Executives do not play a strategic role in company affairs.
- Board members of subsidiaries consider their primary loyalty to be to the controlling shareholder of the parent company.

Corporate Governance Framework of The CMB

- The principal sources of compulsory corporate governance standards are the Turkish Commercial Code and the capital markets laws.
- The Capital Markets Board (CMB) has introduced comprehensive, non-binding corporate governance principles. The CMB has a pre-eminent role in developing, administering and enforcing corporate governance standards.
- Publicly held companies must comply or explain their reasons for non-compliance.
- The CMB has published draft amendments to the Capital Markets Law for comment.

Corporate Governance Framework of The CMB (2)

- Capital Markets Board has established the corporate governance Principles in July 2003
  - “OECD Corporate Governance Principles” of 1999 constitutes the base
  - Main focus is publicly held companies
  - The implementation of the Principles is optional however disclosure regarding the firm’s approach is required
  - “comply or explain” approach is valid

- The Principles consist of four main sections, namely:
  - shareholders,
  - disclosure and transparency,
  - Stakeholders,
  - board of directors.

- February 2005 revision: Publicly open companies should disclose their compliance situation regarding the Principles starting from the financial year 2004.

- ISE Corporate Governance Index

Existing Corporate Governance Practices

- Comprehensive corporate governance standards exist, but incentives to implement the standards and disciplinary forces are weak
  - the CMB is promoting implementation of a comprehensive corporate governance code,
  - private sector awareness of and interest in international best practices is rising,
  - transparency is improving in some areas,
  - but high standards without strong incentives or effective discipline are insufficient.
- Limited incentives and weak disciplinary forces have not curtailed controlling shareholders' tendency to pursue personal interests without regard to potential adverse effects on minority shareholders.

Existing Corporate Governance Practices (2)

- Staff of the independent regulators are well-educated, professional and motivated, but most lack practical, private sector experience

- Certain developments have potential to enhance market discipline, but the corporate governance framework does not encourage domestic institutional investors to pro-actively exercise their rights as shareholders

- Threats to the principal regulators’ operational independence exist

Future of Corporate Governance in Turkey

- An era of macro-economic instability distorted incentives and may have adversely affected corporate governance.
- Improving economic conditions could lead to better corporate governance.
- A crisis in the banking sector has led to significant structural and regulatory reforms.
- Parliament is considering sweeping changes to the Turkish Commercial Code.
  - Proposed reforms to the TCC could strengthen the board's monitoring function
  - and strengthen protections for minority shareholders

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What is ERM?

"… a process, effected by an entity's board of directors, management and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risks to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives."

Source: COSO Enterprise Risk Management – Integrated Framework. 2004. COSO.

ERM and Good Governance

Are we taking the right risks?

- How are the risks we take related to our strategies and objectives?
- Do we know the significant risks we are taking?
- Do the risks we take give us a competitive advantage?
- How are the risks we take related to activities that create value?
- Do we recognize that business is about taking risks and do we make conscious choices concerning these risks?

Are we taking the right amount of risk?

- Are we getting a return that is consistent with our overall level of risk?
- Does our organizational culture promote or discourage the right level of risk taking activities?
- Do we have a well defined organizational risk appetite?
- Has our risk appetite been quantified in aggregate and per occurrence?
- Is our actual risk level consistent with our risk appetite?

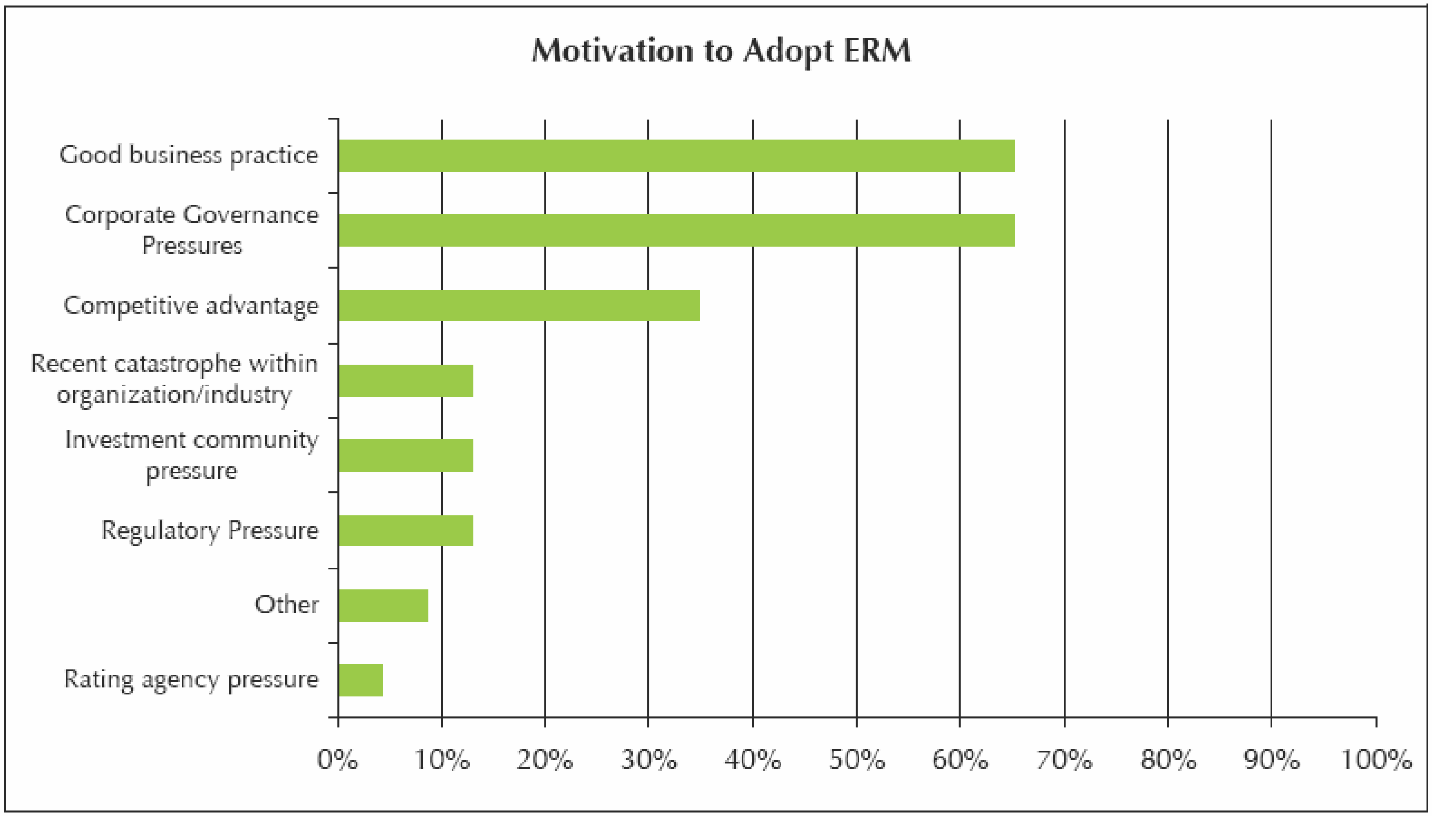
Do we have the right processes to manage risk?

- Are our risk management processes aligned with our strategic decision-making process and existing performance measures?
- Are our risk management processes coordinated and consistent across the entire enterprise?
- Does everyone use the same definition of risk?
- Do we have gaps and/or overlaps in our risk coverage?
- Is our risk management process cost effective?

ERM and Corporate Governance

- **Improved Corporate Governance**
  - Assists Senior Management, Audit Committee and Board of Directors in discharging their governance responsibilities through concise, relevant and timely communications from decentralized operations
- **Focus on Shareholder Value and Achievement of Strategic Objectives**
  - Creates focus on risks having the largest potential impact on shareholder value and strategic objectives
  - Better anticipates risks before they occur thereby reducing earnings volatility and operational challenges
- **Cost Savings**
  - Efficiently deploys capital and risk management resources to high risk activities and adopts best practices consistently across business units and value chain processes
- **Better Business Decisions**
  - Enables better business decisions and risk optimization based on more sophisticated risk analysis, quantification and modeling supporting a better understanding of the organizations risk tolerances
- **Consistent Management of Similar Risks**
  - Puts in place consistent and documented processes for the management, measurement and reporting of key risks across all business units
- **Linkage Established Between Risks**
  - Identifies linkages between separate risks so that more meaningful enterprise-wide exposure and scenario analyses can be performed

ERM and Corporate Governance (2)



Source: <u>Enterprise Risk Management Benchmarking Survey 2004</u>. 2004. PriceWaterhouseCoopers.

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Corporate Governance Practices at Sabanci

Detailed disclosures regarding the four components of the Principles are made on the web site

- Shareholders:
  - A separate department for shareholder relations
  - Road-shows, investor conferences, meetings
  - Required disclosures regarding shareholders' interests
- Disclosure and transparency:
  - Audited 6-month and annual financial reports (as well as quarterly reports) are announced regularly
  - Significant event and developments are disclosed to the public on a timely manner
- Stakeholders:
  - Stakeholders are kept updated via meetings, seminars, trainings and Internet.
  - Stakeholders' participation in the company management is ensured through 360 feedback mechanisms
  - There is not any complaints about discrimination within the company
  - Social Responsibility projects are held through Vaksa (the foundation)
- Board of directors:
  - Risk Management Internal Audit mechanisms improves governance applications
  - Disclosures are made in terms of number, structure and independence of the committees established by the BoD.

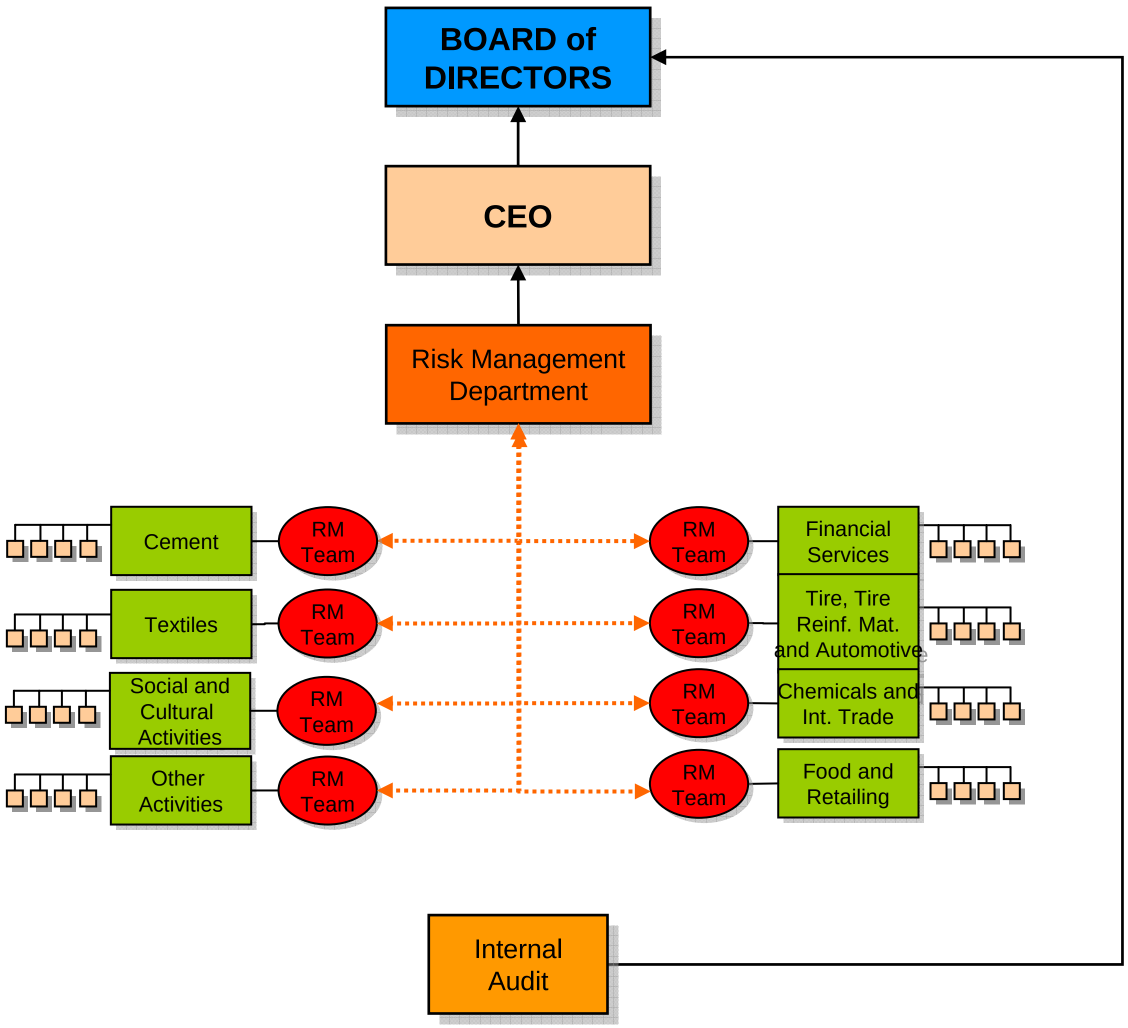
Sabanci Holding
Risk Management Vision

"Effectively apply sound risk management methods across the spectrum of the Holding's companies, thus preserving the investments of its shareholders and partners."

Sabanci Holding
Risk Management Objectives

- To develop a widespread, systematic “Risk Management” concept throughout the organization and improve Corporate Governance
- To manage risks within defined risk tolerance levels
- To design and implement an effective risk management reporting and information management system
- To integrate ERM, as a proactive process, within the corporate culture so it becomes an important part of the strategic business planning and operational management processes

Sabanci Holding
Risk Management Organization



ERM’s Realized Benefits

- Significant improvements in insurance program’s cost and structure
- Ease to switch to risk based audit approach
- Support for Corporate Governance application improvements
- Support to establish risk/return relationship as an important approach embedded in decision making mechanisms
- Help to improve our risk profile for investors and other stakeholders.
  - European Risk Management Award – “ENTERPRISE-WIDE RISK MANAGEMENT PROGRAMME OF THE YEAR”

Thank you…

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