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## Comparison of public and non-public SMEs' corporate governance strategies in Turkey

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### Abstract

Small and medium sized enterprises (SMEs) are very important for economic development. If proper corporate governance strategies are implemented by SMEs, their growth opportunities are expected to increase. In order to understand the impact of proper corporate governance strategies of SMEs, public and non-public companies are compared. In this study, corporate governance scores for nine public and nine non-public SMEs are calculated. It is found that only three of the public SMEs and none of the non-public SMEs had adequate corporate governance score which is based on Capital Market Board of Turkey's corporate governance principles about stakeholders.

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*Keywords:* SMEs, Corporate governance, Public firms, Non-public firms

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### 1. Introduction

Small and medium sized enterprises (SMEs) are extremely important for all economies in the world. There are different reasons for this importance. First of all, SMEs contribute to economic growth by producing goods and services. Second, strong economies also need SMEs besides large ones. Third, social peace and political stability can also be maintained by the help of strong SME structure. Fourth, SMEs are main factors for social stability and competitive market economy. SMEs contribute to innovation, employment, production, economic development and dispersed ownership in society. Due to these contributions, SMEs have a central role in public policies. All countries, especially developed ones, pass laws in order to create a suitable economic environment for the establishment, growth, development and protection of SMEs (Cansız, 2008).

With their flexible structures, SMEs can meet different demands in different markets and create innovative economic activities. Besides, SMEs have begun to supply goods and services not only for local markets but also for the global markets. Accountability, social responsibility, transparency and fairness are basic requirements in order to

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operate in global markets. These requirements are all related with good corporate governance structure. In order to have a good corporate governance structure, SMEs are required to make adjustments in areas such as information and transparency, innovation, performance and risk evaluation and auditing.

Recently, corporate values such as long term shareholder value, business ethics, corporate social responsibility and corporate citizenship have begun to attract too much attention (Thomsen, 2004). Especially, institutionalization in firm structures is one of the most important topics nowadays.

According to Gregory (2000), having the ability to find funds from financial markets, being able to operate efficiently parallel to corporate establishment objectives, meeting stakeholder expectations, complying with the laws of the countries are defined as corporate governance. A more brief definition of corporate governance is “good corporate management”. In this regard, it is very important to determine the responsibilities of top management and board, rights of internal and external stakeholders but it is not enough. Besides, application of management principles and techniques such as change management, strategic management, total quality management, human resources management etc. are also required for good management (Aktan, 2006).

In conventional management perspective, SMEs have short organizational life, do not have sustainable growth, and face many management problems. A good corporate governance structure is expected to help SMEs to be successful and to achieve sustainability. Besides, a good corporate governance structure gives importance not only to stockholder benefits but also to other stakeholders. SMEs need primarily an institutionalized organizational structure to establish a good corporate system in their organizations.

Literature review about SMEs and corporate governance is given in the second section of our study. The methodology and empirical findings are given in the third section. The fourth and final section is devoted to the interpretation of the empirical findings and conclusions.

## 2. Literature Review

### 2.1. SMEs

Although SMEs are very crucial for all countries, there is no consensus about the definition of SMEs in the related literature. There are different definitions about SMEs due to different economic growth and social conditions in these countries (Kuwayama, 2001). SMEs are defined as firms that have inadequate capital, low managerial costs, high hand labor, fast decision making ability and low cost production (Çelik and Akgemci, 2007).

Some scholars define SMEs as firms with less than 100 employees (Jordan, Lowe and Taylor, 1998) but some define it with employees less than 200 employees (Michaelas, Chittenden and Poutziouris, 1999). Some scholars made definitions based on sales and total asset figures. Ayyagari, Beck and Demirgüç-Kunt (2007) examined definitions of SMEs in 76 countries and defined it as firms with less than 250 employees.

SMEs have an important role in the Turkish economy as in the world economy in terms of employment and value creation. As can be seen in Table 1, approximately 99% of the firms in Turkey are SMEs. 95% of these SMEs are very small (micro size) ones, 3% are small ones and %1 are firms with medium size.

Table 1 Number of Employees and Frequency of SMEs in Turkey

Firm Size	Number of Employees	Frequency (%)
SMEs	1-250	99,35
Micro	1-9	95,36
Small	10-49	3,01
Medium	50-99	0,97
Large	More than 251	0,65

Source: Turkish Statistical Institute (Çemberci, 2013).

Most of the SMEs in Turkey operate as suppliers, vendors, subcontractors, etc. for large size firms (Çemberci, 2013). SMEs prevent unemployment and help economic development. It is found in a research conducted in USA that half of the job opportunities are created by SMEs (Cohen and Noll, 1991). Besides, SMEs have an impact on economic and social development of rural areas by forming relationships with their customers and prevent migration to metropolitans. These reasons increase the importance of SMEs that can keep up with changes in the world, be open to innovations and carry out their operations with a dynamic, professional management understanding (Gümüšoğlu and Doğan, 1997).

SMEs in Turkey, as well as the ones in all over the world, encounter problems related with their internal structure and environment. Especially, instabilities, recessions in the Turkish economy and the implementation of changing economic measures lead to failure and poor performance in SMEs (Atay, 2013). Besides, SMEs have to deal with management problems related with their internal structures. Financial, marketing and personnel issues related with business functions are the main management problems of SMEs. The main source of these issues is incompetence of management (Alkibay, Songür and Ertürk, 1999; Özgen and Doğan, 1997) and, especially, the strong position of owners who assume all the managerial authorization and make irrational-subjective decisions in the SMEs (Özgen and Doğan, 1998).

## 2.2. Corporate Governance

According to the definition made by Organization for Economic Co-operation and Development (OECD) Corporate Governance Committee, corporate governance is a system that corporations are directed and controlled. Besides, corporate governance is defined as relationships among top management, board of directors, shareholders and other stakeholders. In this regard, corporate governance is a structure that objectives of corporations and performance evaluation methods to reach these objectives are determined (Tunal, 2009).

A firm (management) is expected to ensure the rights of all stakeholders and satisfy their needs equally (O'Higgins, 2001). A firm is also expected to recognize not only its direct stakeholders (e.g. stockholders, customers, employees) but also indirect ones (e.g. society in general, environment, NGOs) that are affected by a firm's activities because it is a sustainable way for companies to proceed (Vinten, 2001). Basically, corporate governance is a system based on principles, processes and business results (Günay, 2008). It is important to care about interests of all stakeholders in order to establish this system. In other words, as it is posited by the stakeholder theory, the benefits of all stakeholders but not only investors should be considered (Freeman, 1984; Gibson, 2000).

Corporate governance is a concept that made firms change their management styles and is affected by cultures, laws and financial structures of different countries. Differences among countries about corporate governance made stakeholders use different dimensions of this concept (Lane, Astrachan, Keyt, and McMillan, 2006).

There are two main corporate governance models in the world. These models are stockholder governance and stakeholder governance (Friedman and Miles, 2002; Gamble and Kelly, 2001; Letza, Sun, and Kirkbride 2004; Prabhaker, 1998; Sternberg, 1997; Turnbull, 1997, 2002; Vinten, 2001; Wheeler and Sillanpää, 1998). The stockholder governance model emphasizes the importance of shareholders in the governance of corporations. On the other hand, all stakeholders (e.g. shareholders, employees, customers, suppliers, society in general, government, financial institutions, etc.) are equally important in the stakeholder governance model (Günay, 2008). In today's business world, the stakeholder governance model is more rational than the stockholder governance model because of complex network of relationships among corporate stakeholders.

In international level, principles of corporate governance are first published by OECD in 1999. These principles turn out to be international reference in all over the world. Corporate governance has become more important for businesses in Turkey due to regulations about corporate governance, Turkish Trade Act, and European Union adjustment laws (Çemberci, 2013). Capital Markets Board of Turkey (CMB) first published corporate governance principles in 2003. These principles were transparency, accountability, responsibility and fairness (CMB, Corporate Governance Principles, 2003) but these principles are revised and principle of public disclosure is added among the previous ones in 2005 (Kavut, 2010).

CMB adopted a voluntary approach for the application of corporate governance principles. But CMB used the “comply or explain” principle for the companies quoted in stock market in order to develop corporate governance in Turkey. This principle increased the importance of corporate governance (Sönmez and Toksoy, 2011). CMB made it obligatory in 2005 that public companies publish corporate governance compliance reports and show these reports in their websites. CMB tried to make these public companies inform their stakeholders about these companies’ operations and legal obligations by the help of corporate governance compliance reports (Kavut, 2010).

Corporate governance principles in Turkey are revised between December 2011 and February 2012 by CMB and there are four main headings: 1. Shareholders, 2. Public Disclosure and Transparency, 3. Stakeholders and 4. Board of Directors. These principles are expected to provide better conditions for obtaining funds, higher performance, higher earnings, better competitiveness and lower risk (Ramaswamy, Ueng and Carl, 2008).

### *2.3. SMEs and Corporate Governance*

Growth is a very normal process for successful and healthy corporations. Large scale firms all start their operations as SMEs but they become large by completing many difficult cycles (Özgener, 2003). An entrepreneur (SME) encounters many difficulties, especially in the growth cycle, in each cycle (Akin, 2002). SMEs are expected to monitor changing conditions in the market, adapt themselves to the process, and develop growth strategies in order to enter international markets (Aslanoğlu, 2007). In this regard, it becomes an obligation for SMEs to form new strategies and give importance to corporate governance practices that start with institutionalization.

Traditionally, it is thought that corporate governance is related with large-sized companies and agency problems. Agency problem arises as result of the relationships between shareholders and managers. It may be thought that there is no need for corporate governance in SMEs because the owner and manager is the same person and agency problem is irrelevant in these firms. Besides, it may be thought that there is no need for accountability for the firms that do not use external funds. However, a firm needs its stakeholders for its existence and growth. In other words, it does not mean that there is no need for corporate governance if the owner and manager is the same person and a firm does not use any external funds (Abor and Adjasi, 2007). In this regard, it is important that SMEs form good relationships with their customers, suppliers, employees and society in general.

Researches about SMEs focus on issues such as the impact of management quality on the success of these firms and importance of professional management in SMEs related with their organization types, sizes and structures (Watson, 1995). Institutionalization, known as professional management, creates strong and stable firms, especially, in competitive environments. Thus, institutionalization in SMEs creates trust for the business world and society in general (Çakıcı and Özer, 2007). Kendirli and Çağlar (2010) made a research about the financial institutionalization of SMEs in Çorum, Turkey and emphasized the importance of Basel II and international accounting standards. They argue that transparency and accountability are important not only for public companies but also for all companies because these principles are expected to create trust and help them access to low cost and new financial sources. Corporate governance in SMEs, which starts with institutionalization, aims at responsibility not only to shareholders but also to all stakeholders (Liang and Meng, 2010). Therefore, SMEs are expected to achieve wealth and financial sustainability with their stakeholders.

Pluralistic management rather than singular management becomes important in SMEs by the help of corporate governance. In other words, decisions in SMEs are made not by less talented and less informed one person, who is the owner and manager, but by more talented and informed top management team. In this regard, each member of management team will feel himself or herself more safe and secure while coming up with alternative strategic ideas and this is expected to create strategic change in SMEs (Brunnering, Nordqvist and Wiklund, 2007).

Abor and Adjasi (2007) examined the impact of corporate governance in SMEs in Gana and argued that having independent board members bring forth a new strategic aspect and increase firms’ competitiveness. Independent board members help firms have creativity and innovation and achieve fast growth. In this regard, it is reported in a study conducted in Japan that SMEs with high growth rates have more independent board members compared to large-sized

firms (Liang and Meng, 2010). Having a board without independent board members in SMEs makes it ineffective in terms of monitoring daily operations of management (Brunninge and Nordqvist, 2004; Huse, 2000). On the other hand, the existence of independent board members allows boards to be used as strategy development instruments (Fiegener, 2005). Therefore, independent board members play an important role in the strategic growth of SMEs.

There are pros and cons for implementing corporate governance principles in SMEs. Advantages of implementing corporate governance principles are mentioned above. Although corporate governance has many advantages for the SMEs, there are also costs. For example, having an external audit and independent board members are costly, especially for the SMEs. Advantages of corporate governance are received in the middle-term but costs are assumed in the short-term. This fact about cost makes the implementation of corporate governance principles difficult in SMEs. Calculating dollar cost of corporate governance is difficult for firms of all sizes (Chittenden, Kausar, and Poutziouris 2002). Clarke and Klettner (2009) examined corporate governance applications of 19 SMEs quoted in Australian stock market. They argue in their study that implementation of corporate governance principles have a significant dollar cost for firms of all sizes. Besides, they argue that there is 25% more time cost for the large-sized firms. Time cost is even more than 25% for the SMEs. Yet more, time cost of corporate governance is more emphasized than dollar cost in SMEs in their study. As a result, utility-cost analysis must be made by SMEs to implement corporate governance principles in their firms.

### 3. Methodology

#### 3.1. Research Goal

The most important obstacle for having a high growth opportunity in SMEs is especially related with accessing financial sources. SMEs, like large-sized firms, are obligated to comply with the rules and principles of government institutions that regulate capital markets. In addition to compulsory rules, there are voluntary corporate governance principles that help firms go public. Corporate governance can be defined as a process to provide trust for the stakeholders. In this regard, implementation of corporate governance principles is expected to help firms to go public, increase their reputation in the market, maximize their long-term firm value and provide sustainability. Therefore, the purpose of this study is to make a comparison between public and non-public SMEs in Turkey in terms of their corporate governance applications related with their stakeholders, to determine the differences between these two groups of firms and to emphasize the importance of good corporate governance applications in SMEs' growth strategies.

#### 3.2. Research Methodology

In order to reach the research goal explained above, nine public SMEs that operate in manufacturing sector are determined. Besides, nine non-public SMEs (rival firms to public SMEs) with similar foundation years, scales and field of activities are determined randomly. In order to determine nine non-public SMEs, foundation years, scales and field of activities of public SMEs are used as key words in Google search engine. The websites of firms that are received from search engine are examined one by one and firms with closest features to public SMEs are determined as "rival firms". The documents that are received from the websites of 18 SMEs (public and non-public) are examined elaborately in terms of application of CMB's corporate governance principles related with stakeholders. In order to prevent advertising and/or criticism, public SMEs are denoted as SME-1, SME-2, ...SME-9 and non-public SMEs are denoted as RIVAL-1, RIVAL-2, ...RIVAL9. The names of these 18 SMEs are given in alphabetical order: Akgün Radyatör, Alternatif EVA Kauçuk sanayii, Bakanlar Medya, Baysan Inc, DanetInc, Delta Kağıtçılık, Ersan Endüstriyel Sünger Ürünleri, ESG Yapı, Mega Polietilen, Penta Reklam, Polifilm Ambalaj Sanayi, Rodrigo, Temapollnc., Sanifoam, Say Reklamcılık, SekuroInc, VanetInc., Yards Tekstil.

Field of activities, number of employees, foundation year and places, and number of independent board members of public and non-public SMEs are given in Table 2 and Table 3 below. As can be seen in Table 2, although three public SMEs (SME-5, SME-7 and SME-8) are in the same field of activity, they are not rivals because they do not produce same products. There are important differences between public and non-public SME groups in terms of institutionalization. For example, none of the non-public firms except one (RIVAL-3) has declared the number of employees on their websites. Besides, only three of the non-public SMEs have declared their foundation place on their



3.a. Equal opportunity	X						X		X	%33
3.b. Written rules in recruitment	X					X			X	%33
3.c. Fair behavior and education	X	X		X	X	X	X		X	%67
3.d. Active communication	X	X				X	X		X	%56
3.e. Performance evaluation criteria	X						X		X	%33
3.f. Discrimination and mobbing measures	X								X	%22
3.g. Supporting the establishment of NGOs (unions)										%0
3.h. Safety of workplace and working conditions	X	X				X	X		X	%56
<b>4. Relations with Customers and Suppliers</b>										
4.a. Customer satisfaction	X	X	X	X	X	X	X	X	X	%100
4.b. Active communication	X					X	X		X	%44
4.c. Quality standards	X	X		X	X	X	X	X	X	%89
4.d. Preserving trade secrets	X		X				X			%33
<b>5. Ethical Rules and Social Responsibility</b>										
5.a. Ethical rules						X	X		X	%33
5.b. Social responsibility	X	X	X	X	X	X	X		X	%89
Frequency (Public SMEs) (Average Frequency = %45)	%83	%39	%28	%17	%22	%50	%72	%11	%83	

Implementation of corporate governance principles of CMB under the heading “stakeholders” are shown for nine non-public SMEs in Table 5. “Customer satisfaction” variable has also the highest frequency (100%) for the non-public SMEs. This variable is followed by the “social responsibility” and the quality standards” variables (67%). As can be seen in Table 5, the rest of the 15 corporate governance variables related with stakeholders have frequencies less than 50%. Nine of these variables have zero frequency.

Table 5 Implementation of Corporate Governance Principles of CMB under the Heading “Stakeholders” by Non-Public SMEs

	Rival 1	Rival 2	Rival 3	Rival 4	Rival 5	Rival 6	Rival 7	Rival 8	Rival 9	Frequency
<b>1. Company Policy Regarding Stakeholders</b>										
1.a. Protecting the rights of stakeholders										%0
1.b. Informing stakeholders										%0
1.c. Resolution of conflict of interest among stakeholders										%0
<b>2. Stakeholder Participation</b>										%0
<b>3. Human Resource Policy</b>										
3.a. Equal opportunity							X			%11
3.b. Written rules in recruitment										%0
3.c. Fair behavior and education		X				X	X		X	%44
3.d. Active communication		X	X				X			%33
3.e. Performance evaluation criteria							X			%11
3.f. Discrimination and mobbing measures										%0
3.g. Supporting the establishment of NGOs (unions)										%0
3.h. Safety of workplace and working conditions	x						X			%22
<b>4. Relations with Customers and Suppliers</b>										
4.a. Customer satisfaction	x	X	X	X	X	X	X	X	X	%100
4.b. Active communication										%0
4.c. Quality standards		X	X		X	X		X	X	%67
4.d. Preserving trade secrets										%0
<b>5. Ethical Rules and Social Responsibility</b>										
5.a. Ethical rules		x	X	x						%33
5.b. Social responsibility	x		x		x	x	x		x	%67
Frequency (Non-Public SMEs) (Average Frequency = %22)	%17	%28	%28	%11	%17	%22	%39	%11	%22	

As can be seen in Table 4 and Table 5, both public and non-public SMEs emphasize the importance of “customer satisfaction” variable with a frequency of 100%. Besides, least important corporate governance variable is “supporting the establishment of NGOs (unions)”. This is only variable with zero frequency for public SMEs. On the other hand, there are nine variables that have zero frequency by the non-public SMEs. It can be easily seen that there is a big difference between these two groups of firms (public and non-public).

The rows at the bottom of Table 4 and Table 5 show corporate governance index scores in terms of stakeholder governance. In terms of these index points, none of the non-public SMEs have scores more 50%. On the other hand, three public SMEs (SME-1, SME-7 and SME-9) out of nine have high and adequate corporate governance index scores. Besides, when public SMEs’ corporate governance scores are compared with non-public SMEs’ scores, it can be seen that there is a big gap among these two groups of firms.

#### 4. Conclusion

The purpose of this study is to see whether going public by some of the SMEs in Turkey created a difference in terms of corporate governance principles based on stakeholders or not when compared with the non-public firms. The results show that public SMEs performed better than non-public SMEs in terms of their corporate governance scores. But it is found that only 33% of the public SMEs have corporate governance scores above 50%. Besides, frequencies for only eight variables out of eighteen are more than 50%. These results show that most of the firms (public and non-public) do not comply with the corporate governance principles related to stakeholders.

Only one heading out of four headings of CMB’s corporate governance principles are examined in this study. These results should not be interpreted as public SMEs do not comply with other principles under other three headings. But as it is shown in the literature review, good corporate governance refers to the heading “stakeholder” among corporate governance principles of CMB. As a result, as can be seen in Table 4, findings related with variables show that even public SMEs have deficiencies about corporate governance principles. It is important to note that these deficiencies do not exist for all of the public SMEs. For example, SME-1 and SME-9 have implemented 83% of the corporate governance principles. SME-7 follows these firms with a 72% frequency.

As can be seen in Table 5, average frequency of corporate governance variables for the non-public SMEs is 22%. Besides, none of these firms have corporate governance scores higher than 50%. This result is parallel to the theory that is mentioned in the literature review. Since these firms do not offer any shares for the public, it very normal that they have poor corporate governance scores when compared with the public SMEs. It is because most of the SMEs have problems about financial sources. Short-term costs are deterrent for the non-public SMEs when compared with the advantages of corporate governance in the mid to long term. It can be argued that if Turkish government subsidizes non-public SMEs for the implementation of corporate governance principles, these firms can be institutionalized voluntarily. There are only 19 firms that are quoted in the stock market of Turkey (BIST). A subsidy for the implementation of corporate governance principles by SMEs is expected to increase the number of SMEs in the stock market. This move by the Turkish government is also expected to develop capital markets in Turkey.

It is also found in our research that all of the public SMEs have external audit and submit their annual reports. It is also seen that public SMEs give very detailed information to public (i.e. accountability and transparency) regarding other three headings of CMB’s corporate governance principles. These findings show that these public SMEs transformed themselves in terms of their institutionalization. For example, four of the public SMEs have independent board members and it shows that these four public SMEs emphasize the importance of institutionalization and corporate governance. In this regard, it is not a coincidence that three (SME-1, SME-7 and SME-9) out of these four public SMEs had the highest corporate governance scores in the study. Besides, public SMEs access to financial sources by offering their shares to the public. Moreover, especially these public SMEs have a good reputation in the eye of their stakeholders by having a good corporate governance application and accessing new financial sources. As it is known, a good reputation maximizes long-term firm value and eases sustainability. As a result, the growth strategies of these three public SMEs in terms of their corporate governance applications are a good example for all other SMEs in Turkey. These three firms are good examples that show how strategic change can be achieved in SMEs.



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