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THE IMPACT OF BASEL II ON THE CORPORATE GOVERNANCE PRACTICES OF TURKISH BANKS

The main cause of the 2001 financial crises which has severely struck the Turkish banking sector was not only the uncovered interest arbitrage of domestic banks but also their defects in corporate governance. Until that date domestic Turkish banks were established within a business group mainly as a provider of internal capital to group firms which were tied to each other with pyramidal ownership structures. There was a high degree of information asymmetry between investors and managers of the banks. Right after the crises the necessity to ensure banks to conduct good corporate governance practices through increasing transparency, disclosure and accountability so as to improve market efficiency and decrease the capital market imperfections, became more obvious to the regulatory and supervisory agencies of the country. Moreover the report of OECD on Turkey in 2004 stresses the importance of corporate governance for domestic banking sector as an essential component for a sustainable economic growth in Turkey. The significance of the quality of corporate governance in banking sector has not only grown in Turkey in that period but also in other developed and developing countries in the world. Therefore, Basel II criteria account for the risks for not conducting good corporate governance practices through promoting market discipline. As a result of the insufficiency of Basel I standards, prepared in 1988, Basel II contains principles for risk management of banks and planned to be launched in 2008. While Basel I obliged banks to have adequate capital to back up credit and market risks, Basel II also requires banks to have sufficient capital for the operational risks which include agency costs and managerial entrenchment in banks. Therefore Basel II criteria is a potential external force on banks to mitigate the conflict of interests between banks and their stakeholders through escalating a monitoring mechanism on banks led by increased transparency. The favorable results of Basel II, in terms of corporate governance, can be seen even before its application is commenced in Turkey, through foreign banks which merge with or acquire domestic banks in Turkey.

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