Türkiye Kurumsal Yönetim Derneği
Corporate Governance Association of Turkey

Corporate Governance Association of Türkiye

Corporate Governance for Family Businesses in Türkiye:

Why and How to Implement?

Deloitte. TSKB ANADOLU EFES

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Corporate Governance for Family Businesses in Türkiye: Why and How to Implement?

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Foreword

The world is undergoing a period of rapid transformation. We are living in a period with more risks than in the past as well as an increasing number of variables. While traditional ways of doing business are becoming obsolete for all companies, regardless of industry, we are quickly entering a period where we will conduct business in increasingly complex structures.

In this environment, companies need a new vision to survive, create value, and position themselves appropriately in such a new order. Considering that family businesses, which make up 95% of companies in our country, have an average lifespan of only 25 years and that the handover rate decreases with each generation, it is crucial for companies to review their strategies promptly.

On the other hand, the problems of family businesses are not limited to generational transitions. All stakeholders, from senior management to suppliers and customers, have varying expectations, especially during challenging times like the current Covid-19 pandemic. Companies that cannot manage this process well or achieve sustainability face significant issues with some having to cease their operations.

Creating long-term value, aligning company activities with economic, environmental, social factors and decision-making mechanisms, and ensuring sustainability in the face of challenges ranging from global pandemics to the climate crisis are all possible through the implementation of corporate governance principles. This is because corporate governance extends the life of a company and adds value by protecting the interests of all stakeholders in a fair manner.

As the Corporate Governance Association of Türkiye, we strive to ensure the development of corporate governance in our country, to support the implementation of the best practices in this field, and to increase the number of good examples. In this sense, we believe that this publication by distinguished authors will serve as a guide. I would like to take this opportunity to thank the contributing authors, our former Chair Feyyaz Ünal, the Board of Directors of TKYD, and working groups for producing this publication for us.

Dr. Tamer Saka
Chairman of the Board of Directors, TKYD

Introduction

Corporate governance was formalized with the OECD Principles in 1999, and the Capital Markets Board published the Corporate Governance Principles for Türkiye in 2003. The amendments to the Turkish Commercial Code in 2012 and the developments in the Capital Markets Legislation since 2003 have led to greater importance being placed on this topic by companies in our country.

As the Corporate Governance Association of Türkiye (TKYD), we have been trying to uphold, develop and promote the concept of corporate governance in Türkiye since 2003. Today, with more than 600 individual and 60 corporate members, our association has established a significant communication network between the private sector, the media, regulatory institutions and organizations, NGOs, and the academic world.

Companies can only survive in the long term if they have a management system that is based on certain rules and principles and is constantly updated according to current conditions. That is why it is very important that we internalize corporate governance and quickly transform the companies into appropriate structures.

According to various studies, the lifespan of a company in Türkiye is limited to 25-30 years. Family businesses are not only a pillar of the national economy and a source of employment, but also a source of dynamism and renewal. Approximately 95% of the companies in Türkiye are family-owned. Studies show that only less than 10% of businesses make it to the third generation. Adopting and implementing corporate governance principles creates more value and economic growth from a national interest perspective. An examination of the developments concerning companies in developing countries shows that many have been able to create significant value by embracing corporate governance, understanding capital markets properly, and taking the right steps to access capital and financing. Therefore, corporate governance is important to make our companies sustainable, more valuable and competitive in the international arena.

Our association launched the Anatolian Seminars Project as a result of its efforts to bring corporate governance principles closer to family businesses as the linchpins, the Turkish economy. To date, we have met with very valuable key shareholders and professional managers in 40 Anatolian cities. Based on the experience from the seminars, we prepared handbooks, published city-specific "Corporate Governance Perception Survey" reports based on one-on-one interviews with major shareholders in six different Turkish cities, and discussed the results in panels held in cooperation with the Chambers of Commerce and Industry in Anatolia. We translated the International Finance Corporation's (IFC) Family Business Governance Handbook into Turkish. We put family business issues on the agenda in several issues of our periodical Corporate Governance Review, offering different perspectives through topical articles and interviews. Our goal has been to offer a new perspective to the key shareholders and professional managers of the influential family businesses in our country through our projects and publications focused on family businesses.

We offer this publication for the benefit of all interested parties and hope that this publication, which is the result of the dedicated efforts of the Working Group on Corporate Governance in Family Businesses, will guide the corporate development practices of family businesses in Türkiye.

Corporate Governance Association of Türkiye

TABLE OF CONTENTS

I. Institutionalization and Corporate Governance in Family Businesses

Corporate Governance Principles

It is a fact that organizations working to achieve success must consider the rights of all stakeholders, not only of their own generation but also of future generations. In this sense, corporate governance practices create the most conducive environment for this approach.

It is clear that private sector companies must be structured according to the principles of fairness, responsibility, transparency, and accountability to create competitive conditions not only in the country but also in the global markets.

Corporate governance is the regulation of the management of any organization that people form in modern life for the achievement of a purpose. If we narrow this general definition down to a company, we can say that it is the establishment of all kinds of laws, regulations, codes, and practices that enable the company to attract human and financial capital, to operate effectively and efficiently, to create long-term economic value for its shareholders, while respecting the values of the society of which it is a part.

Fairness, accountability, transparency, and responsibility are universally accepted and valid principles of corporate governance. They also overlap with many areas such as ethics, compliance, and environmental protection.

The responsibility that comes with the success of corporate governance principles ensures that an organization contributes to future generations with the same values and satisfies all shareholders and stakeholders. Considering all these relationships, the company management should strive to satisfy the expectations of shareholders and all stakeholders in a balanced manner and to achieve a sustainable performance level of the company in the long term.

Corporate governance practices should aim to ensure that the company can attract necessary resources by focusing on four key principles: fairness, transparency, accountability, and responsibility. These four key principles of corporate governance are interrelated on the basis of measuring and improving performance so that companies are expected to create value for their shareholders while working in harmony with social values. We can state these four key principles as follows. Although this examination is primarily necessary for companies with a wide share distribution or especially for those whose shares are traded on the stock exchange, it has now become important for any company that wants to take its business into the future.

Fairness

Safeguarding shareholder rights, including minority and foreign ones, and ensuring the enforceability of agreements with all stakeholders is an indication of the company management's equal treatment of all stakeholders. This principle refers to the protection of shareholder rights, including minority and foreign ones, and the enforcement of contracts. The corporate governance framework should protect shareholder rights and facilitate the exercise of those rights. It recognizes shareholders as owners of the property. Shareholders, as the owners of legally recognized and divisible shares in the company, have the right to maintain or dispose of their interests in the company. Effective corporate governance is based on laws, procedures, and practices that protect this property right and include secure methods of ownership, registration, and transfer.

Responsibility

Ensuring that the company's activities and conduct comply with the relevant legislation and social and ethical values.

Corporate governance aims to recognize the rights of all stakeholders as set out in laws and bilateral agreements, to create effective cooperation between companies and stakeholders in creating earnings and new business opportunities, and to maximize the number of financially strong businesses. However, it requires companies to comply with laws and regulations that reflect societal values while creating value for shareholders.

Corporate governance principles recommend the development of mechanisms that encourage employee participation in management. They emphasize providing the necessary environment for all stakeholders to communicate their contributions and views to the board.

Transparency

Adequate, accurate, clear, and comparable information on the company's financial performance, corporate governance, and shareholding structure should be disclosed to the public in a timely manner. Corporate governance ensures accurate and timely disclosure of all material matters relating to the company, including its financial position, performance, ownership, and management. Information is expected not only after the activity but also before and during it.

These disclosures should announce the company's past performance, future targets, and significant risks to shareholders, and, if the company's shares are traded on the stock exchange, to existing and potential investors.

One of the most serious practical problems with transparency is the lack of comparability of financial information due to differences in accounting standards applied in various countries. Since 2005, the European Union has required all listed companies to prepare their consolidated financial statements in accordance with International Financial Reporting Standards (IFRS), issued by the International Accounting Standards Committee, to ensure the comparability of financial information. The Turkish Accounting Standards Board (TASB) also translated IFRS into Turkish in 2006. Not only listed companies, but also those who want to do business with international companies and the financial sector should integrate their accounting systems with IFRS.

Accountability

Clearly defining the rules and responsibilities of corporate governance requires the board to respect the rights of management, shareholders, and stakeholders. Corporate governance establishes the company's strategic guidance, responsibility for its future presence, effective oversight of management, and the board's accountability to the company and its shareholders.

Accountability covers the aftermath of the activity, unlike transparency, which involves providing feedback before, during, and after the activity. This principle recommends that the board independently monitor the performance of senior management and ensure the board's accountability to shareholders. The division of responsibilities between the board and top management should be clear for this to work well. Otherwise, it will remain unclear who has the authority to make decisions and therefore who is accountable for those decisions. In other words, an effective division of labor between the board and top management is an indispensable condition for the principle of accountability in corporate governance. For this reason, rules on the structure and functioning of boards of directors occupy a prominent place in corporate governance reports and codes.

The Importance of Corporate Governance in Family Businesses

For companies whose shares are not traded on a stock exchange, corporate governance principles have become increasingly important over time because of their direct impact on the ability of companies to continue to operate in a stable manner. Family businesses show a rapid increase in performance due to their unique advantages during their establishment years. However, the need to develop certain systems to ensure the continuity of performance in terms of relationships becomes more complex as companies grow. In other words, the entrepreneur needs to "manage growth" in order to sustain success. As the company grows with the development of new business, it invests in different areas and the shareholders need to work with professional management. This creates the role of the risk-taking capitalist and the paid professional manager. In short, ownership and management are separated from each other. When such a distinction takes place, it highlights the need for corporate governance principles to establish effectively functioning systems. It is important to recognize that a successful entrepreneur may not have all of the critical resources and personal qualities that are needed to manage growth.

Another important factor for family businesses is the growth of the family, a process that is independent of the growth of the company. Even if the family business performs satisfactorily by meeting the financial expectations of the entrepreneur, it may not be able to meet the financial expectations of the expanding family in the second and third generations. Therefore, family members' financial expectations of the business should be clarified and the appropriate level of performance defined.

Another situation arising with the expansion of the family is that, in addition to the family being a stakeholder on its own, stakeholder groups with different interests emerge within the family, such as "both shareholders and employees, non-shareholders and employees, employees and non-shareholders, neither shareholders nor employees." If the divergent interests of these stakeholder groups are not managed well, the continuity of the company is threatened by disagreements among family members about the operation and future of the company. Corporate governance in family businesses aims to prevent the future of the company from becoming gridlocked for internal reasons by establishing mechanisms to discuss and balance the different expectations of family members regarding the business.

Capital is another issue that brings corporate governance practices for family businesses into focus. If undercapitalized, the family has to communicate with a widening spectrum of partnerships, institutional investors, financial institutions, and individual investors. As a result of the establishment of partnerships in this way, the responsibilities of the parties towards each other necessitate corporate governance. In fact, one of the main objectives of corporate governance is to protect and enhance the rights of the owner arising from the capital partnership.

Corporate governance is also important in terms of regulating the relationship between the family and the company, which is a key condition for the sustainability of family businesses. Corporate governance regulations to be developed in family businesses can attract talented managers to the company by responding the following expectations:

- Performance transparency of professional managers,
- Remuneration based on performance and in line with fair market conditions,
- Career development paths are not blocked by family members,
- Professionals and family members are subject to the same performance system,
- Determining areas of authority and responsibility in decision-making.

These practices aim to accurately assess the people who will benefit the company and prevent the loss of professionals who are valuable to the company. It will ensure that shareholders of family origin, who are the most important stakeholder group in the company but do not participate in its management, have a say in important company policies and strategies, such as questioning company performance, profit distribution, succession-related issues, transfer of power and authority, decisions on common expenses, and borrowing. In addition, meeting expectations such as transparency and setting rules for employing family members, can help prevent potential conflicts of interest that could harm the company.

Representation and Responsibilities of the Family in the Company

It would be appropriate to consider the views of the Family Council in determining objectively and realistically the knowledge and skills that family members should have to assume positions in the family business. Family members may also become employees of the company and hold management positions if their knowledge, etiquette, education, experience, and performance levels are appropriate. The Family Council may be responsible for assessing and monitoring whether a family member has managerial qualifications.

It is not enough for a person working in a family business to be a family member to be directly appointed to certain management positions. In particular, family members who will serve at the management level of the company should have a vision, adequate education, and advanced management skills. This need can never be different compared to professionals employed from outside the family. Measures should be taken to ensure that family members with inadequate performance and managerial qualifications acquire the necessary knowledge and skills. A family member should be asked to step down if, despite these measures, they are deemed incapable of management. It will benefit them and the company. It is the obligation of the family to provide guidance and take the necessary measures for the personal and professional development of family members who will work in the company in the future and who are expected to take part in its management. In principle, family members should start at the lowest level and work their way up through as many levels as possible to gain a thorough understanding of the business. The company's board determines in which department and at what level new family members will start their new jobs. It would be appropriate to establish a communication mechanism between the board and the family council, and for the board to regularly inform the family council about activities and decisions.

Relationships Between Family Members and Professional Managers

Family members and professional managers may approach issues in a similar way and have the same foresight about the problems they face. Therefore, it is very important to represent independent views. It is suggested that those with executive responsibilities be determined according to competence, regardless of whether they are family members or not, and that non-executive and non-family members be appointed as independent board members.

Instead of leading professional managers to think like family members, it would be in the best interest of the company to encourage them to express their opinions from different perspectives and develop alternatives. Taking into account the approaches of professional managers will help create a democratic working environment and participatory management style. The responsibility for this lies with the family member who is in the top management of the company.

Family Assembly

It is the highest decision-making and sharing body of the family. Only family members are eligible to participate. These family members do not have to be related to work. It would be appropriate for the eldest living family member to chair the family assembly.

Family Council

The Turkish Commercial Code and related legislation recommend establishing bodies such as a board of directors and an audit committee in companies and require forming some management and audit bodies. Moreover, creating a Family Council to increase the effectiveness of the family with the companies in which it is a shareholder will be beneficial so that it can facilitate communication and organize business relationships in a healthy manner.

A family council is an environment where family members meet regularly to discuss issues affecting the company and the family and to determine and make decisions about family and business values, company policies, future strategies, and goals. It is also appropriate for the family council to include competent non-family members who are believed to be able to add value to the family and its business. It should be taken into account that these people will be aware of the family's internal issues. In a sense, such a person is the family's confidant, who may be appointed to the Family Council for a period of time or indefinitely, depending on the family's decision.

The family council is expected to encourage discussions and democratic approaches leading to greater participation of family members in decision-making, increased information exchange, and openness towards other family members. In a sense, the transparency principle of corporate governance is also established within the family.

The family determines the requirements for family members and/or outsiders to participate in the family council. It is up to the family to decide how, when, and under what conditions blood relatives and in-laws of a family member may become members of the council.

In large families with more than two generations, it would be appropriate for the Family Council to be led by an Executive Board, with the chair of the Executive Board also serving as the President of the Family Council. The conditions under which the Chair and members of the Family Council and the Executive Board will be elected and for how long, and their responsibilities, should be determined according to the family's decision and the family constitution.

The fact that an experienced consultant explains all this to the family, informs them in terms of all legislative details, and ensures that the arrangements are in line with family values and traditional structure is of great importance for the sustainability, health, and smooth transfer of the Family Council to future generations.

Family Office

Families with family businesses need family offices that provide multiple services to family members and shareholders. These services may include tax, legal and financial assistance related to assets, managing the family's investment portfolio, providing necessary information to shareholders, and making family/shareholder opportunities available to owners equitably in accordance with agreed rules. A simple request from a family member can be difficult and time-consuming for a non-family of company employee or manager. In these cases, family offices function as a demarcation line between family and work.

Instead of the company doing what a family member wants, the family office does it. The family office helps organize the relationship between family, business, and non-business investments. Family offices should report to family councils.

Family Constitution

The greatest danger and weakness in a family business is the confusion between the concepts of family and company. There is a need for a "Family Constitution" on the family side to pass on family businesses to future generations, to ensure their continuity and institutionalization. In family businesses that cannot survive, we see that the balance between family and business relationships cannot be established, and that family and business priorities are mixed when meeting personal needs. Creating a family constitution plays an important role in managing healthy relationships between shareholders, family members, and top managers in family businesses.

Family constitutions, designed to facilitate the operation of family businesses now and in the future, set out the principles to be followed by shareholders in their relationships with each other, family members, and company managers. A constitution based on good faith, if its legal nature is regulated in accordance with the legislation, contributes to family unity and the long-term preservation of capital in the family and the family business.

A proper constitution that is agreed upon by the family members helps to address existing and potential problems within the family according to the rules, comfort family members in and out of management, and attract appropriate professional managers.

The functionality, sustainability, and value of a family constitution depend on the family's future planning, discussion, and creation with the participation of more than one person. The process of creating and developing a constitution is even more important than the constitution itself. In this process, the family should act wisely and seek advice from the proper and experienced people. This consultant should treat each family member equally, take their views, understand their personal and family-related expectations, recognize potential future conflicts in the light of their experience, and recommend appropriate measures to be considered in the relevant sections of the constitution. This process, which also requires a psychological approach, is critical in the constitution-making stage. It is important to remember: Every family is special. Family constitutions are and should be unique to each family. There is no template for this, and there cannot be. They may have general headings, but they should be examined for each family, and family-specific content should be created with sensitivity.

The successful creation of a Family Constitution requires a wide range of experiences and perspectives and a broad vision, including the transfer of company management to future generations, tax planning, personal wealth management of family members, company valuation, and goal setting. This requires working with an experienced advisor/board of advisors.

The articles of the family constitution can be added to the articles of incorporation, shareholding policies and agreements, and purchase and sale agreements to be harmonized with the legislation. This is where the competence and experience of the advisor to work with matter.

Creating a Family Constitution

Preparing a family constitution is the most important step in the institutionalization of the family. It is best done during the institutionalization process of the family business. But this may not always be the case. The contribution of the family constitution to the functioning of the family business is undeniable. Linking the management of the company to certain rules contributes positively to the relationship between management and subordinates, extends the life of the company, and ensures the sustainability of change and dynamism.

Key Components of a Family Constitution

- It should regulate the communication and relationships between family members,
- It should determine conditions for employing professional managers,
- It should determine what competencies family members should have if they become managers,

- It should establish rules for family members to establish new companies individually or collectively,
- It should fully separate family and company relationships,
- It should define precise criteria for decision-making in the family assembly and council,
- It should determine how the meetings and agendas of the family assembly and council should be formed,
- It should define the powers and responsibilities of the family assembly and council,
- It should contain rules rules on how to protect assets,
- It should determine share transfer conditions and limits for family members,
- It should establish rules for family members to work at the company,
- It should ensure unity in all matters as a responsibility to set rule-based examples for future generations.

What Does a Family Constitution Ofer Families and Companies?

- It can separate shareholding and company management issues.
- It implements a healthy management style by separating family and company communication.
- It ensures the evaluation of decisions and results.
- It creates a corporate, permanent, and forward-looking company structure.
- It defines the vision and values of the family and sets goals for the future.
- It preserves family traditions and passes them on to the next generation.
- It promotes mutual respect, love, support, and cooperation among family members.
- It ensures the continued trust of family members in the company and its management.
- It sets rules for family members working at the company.
- It can guide family members' education planning.
- It allows the personal development of family members.
- It can create a method within the family to make decisions about the current situation and future of the company.
- It determines the conditions for relationships with persons/institutions/organizations with whom the family collaborates.
- It establishes conditions for delegation, authority, and succession planning.
- It arranges work sharing.

- It determines policies on how to protect and develop assets.
- It creates the conditions for the company to survive and continue to develop for generations to come.
- It guides the next generations to specific disciplines.

Considerations When Drafting a Family Constitution

- Selecting the person/organization to receive support from on the Family Constitution sensitively.
- Considering that the selected person will be a lifelong confidant of the family, and establishing and signing the terms of a confidentiality agreement.
- Establishing a Family Assembly and Family Council according to the size, structure, and traditions of the family, following one-to-one interviews with family members.
- Beginning to work on the Family Constitution when the family meetings reach a certain maturity.
- The rest is planned according to the person/organization to receive support for the Family Constitution. One should remember that a Family Constitution is viable and applicable to generations if:
- it is created according to the expectations of all parties, not those of a few members,
- treats all family members equally.
- the person/institution consulted has a conciliatory role,
- it is not created according to the wishes of the top generation of the family, but takes into account the views and demands of the next generation,
- a participatory management philosophy is established,
- it does not contain unlawful principles because it sets out the current and future management of the company,
- it is supported by a shareholding policy and shareholders' agreement and is regulated in accordance with the legislation

Shareholders' Agreement

Shareholders' Agreement on the Way to Corporate Governance in Family Businesses

Today, family businesses play a major role in the Turkish economy, and their presence helps to increase and strengthen economic resilience. It is important to construct the institutionalization processes of family businesses in terms of family, company, and third parties.

The family constitution, which is one of the methods used by family businesses in the process of institutionalization, can be considered the first step towards the creation of a shareholders' agreement. A family constitution is a set of rules signed by the members of the family, reflecting the will to respect certain principles, without legal sanctions, but rather with a social and psychological impact. The principles accepted within the family through the family constitution are transformed into an arrangement that affects family members through the shareholders' agreement, and shareholders and managers who join the company as non-family individuals. The main objective here is to isolate the company from shareholder relationships in line with the common denominator of shareholders as a separate entity from the personalities of shareholders.

Shareholders' Agreement Concept

The Shareholders' Agreement is concluded between the shareholders of the company to regulate the relationships of the shareholders with each other regarding the company, their relationships with the company, and the rules to be implemented in the company. The Shareholders' Agreement is an atypical agreement, as it is not defined or regulated by any law. As mentioned above, the shareholders' agreement covers most of the matters regulated in the family constitution in the event that the main shareholder family has a family constitution. However, even in the absence of a family constitution, it still allows for detailed and binding regulation of relationships between the shareholders of the company.

The shareholders' agreement may be drafted in such a way that all the company shareholders may become parties to it, or at least two of the shareholders may become parties to it. In practice, it is healthier for all shareholders to sign the shareholders' agreement together to ensure inclusiveness and minimize potential conflicts.

The shareholders' agreement may address, in general, limitations on the transfer of shares held by the shareholders, pre-emption and repurchase rights and purchase options, management rights and decision-making mechanisms, competition restrictions, and other rights and obligations related to the company, as well as issues and matters the regulation of which is deemed inappropriate or limited by law or which cannot be regulated by the articles of association.

Binding Nature of the Shareholders' Agreement

The Shareholders' Agreement is binding only between the parties to the agreement; therefore, it can only be enforced against the parties to the agreement. Transactions violating the Shareholders' Agreement may not be asserted against the company but may be considered within the scope of liability arising from breach of obligation by the parties. Namely, any damage caused by transactions contrary to the shareholders' agreement may be claimed from the shareholder of the company that is a party to the agreement. Any damages caused by the actions of the shareholder who breaches the shareholders' agreement as a party and an officer or shareholder of the company may be demanded from them based on this agreement. For this purpose, it is recommended to introduce various rules on penal clauses and indemnification of damages to increase the sanctions and deterrence for the transactions of the shareholders who violate the Shareholders' Agreement as a party to it. In other words, a shareholders' agreement is a legal instrument that has indirect, rather than direct, effects on the company, since the company is not a party to it, and it is essentially designed to protect the company from potential shareholder disputes.

Relationship of the Shareholders' Agreement with the Company's Articles of Association

Under Article 339 and Article 340 of the Turkish Commercial Code (TCC) No. 6102, the matters that may be regulated in the articles of association of a joint-stock company are defined in a limited manner. As mentioned above, the Shareholders' Agreement may include matters and issues that cannot be regulated in the Articles of Association of the company, or those the regulation of which this way is deemed inappropriate or limited by law. However, regulations limited by the TCC or related legislation, or those exceeding the limits of mandatory legal rules may be included in the shareholders' agreement, but they cannot be subject to the articles of association.

To give an example, Article 489 et seq. of the TCC includes the cases where the transfer of shares may be restricted, and transfer restrictions other than Article 489 et seq. may not be subject to the Articles of Association pursuant to Article 340 of the TCC, but may be regulated in the Shareholders' Agreement upon the agreement of the parties. In this respect, to achieve the targeted result of the shareholders' agreement taking into account the limitations in the TCC, it would be appropriate and enforceable to incorporate provisions in a way to achieve the purpose of the Shareholders' Agreement, even if they are not identical to the articles of association. In addition, adding a provision stating that in the event of a conflict or disparity between the shareholders' agreement and the articles of association, the provisions of the shareholders' agreement shall take precedence for the parties will increase the effect of the former for the parties.

Main Issues Regulated in the Shareholders' Agreement

Management-related Regulations

General Assembly/Board of Shareholders Provisions: Pursuant to the TCC, shareholders are required to convene within 3 (three) months after the end of the Company's operating period and hold an ordinary general assembly for joint-stock companies or a board of shareholders meeting for limited liability companies. In addition, an extraordinary general assembly or shareholders' meeting may be held in cases provided for in the shareholders' agreement or the TCC, such as capital increases.

The quorums for holding meetings and passing regulations at the above-mentioned Company Meetings will be regulated in detail in the shareholders' agreement and higher quorums may be determined, provided that they do not fall below the mandatory ones specified in the TCC. For example, qualified meeting and/or resolution quorums may be granted to the General Assembly for capital increase resolutions, and changes to the company's business line or title.

Board of Directors/Board of Managers Arrangements: The Shareholders' Agreement may limit the arrangements for the representation and administration of the company according to the regulations of the Board of Directors. If the company is a limited liability company, such a board is called the Board of Managers.

These regulations may determine the number of members of the board of directors, the number of shareholders from each group that should be on the board if the company's shareholders are grouped, whether management privileges are granted to shareholder groups, the term of office of the board members and the limits of representation power.

If the representation power is regulated in detail in the shareholders' agreement, in line with the organizational structure, the company's internal directive and signature circular must comply with the provisions outlined in the Shareholders' Agreement in addition to the articles of association and the provisions of the TCC.

As a general rule, the quorum for the meetings of the Board of Directors is determined according to the provisions of the TTC. As in the case of general assemblies, the Shareholders' Agreement may contain detailed provisions on qualified meeting and resolution quorums for the company's board of directors on certain matters. This instrument allows certain shareholder groups to exercise veto power over management rights; accordingly, such resolutions may be subject to the requirement that the entire board of directors participates and vote in favor of such decisions. The qualified meeting and resolution quorums set forth herein are frequently applied in material matters such as contracts or acquisitions or sales over a certain amount, credit relations, waiving or replacing any lawsuit to which the company is a party, and the company's providing guarantees or becoming a guarantor.

Share Transfer Restrictions and Practices

Share Transfer Restrictions

Shareholders may ensure that the shareholding structure of the company is secured by stipulating in the shareholders' agreement that their shares in the company may be transferred only within the framework of the provisions of the shareholders' agreement and the articles of association and that all other transfers shall be null and void for the company.

At this point, the question is whether the limits in the TCC's mandatory rules have been exceeded. In other words, it is very crucial to ensure that the limitation imposed by the shareholders' agreement is not null and void in practice to prevent invalid transactions. Although the shareholders' agreement may address matters that cannot be regulated under the articles of association, the validity of the broad restricted transfer provisions may be questionable in the event of a dispute.

Share transfer restrictions may make it difficult to transfer shares to third parties by ensuring that shares are primarily transferred among the company's shareholders. However, it may also be possible to exempt from the share transfer restrictions shares passed on by inheritance to a son or daughter-in-law and surviving spouse. In such cases, it will be necessary to take advantage of the legal provisions of the TCC, which aim to ensure that the harmonized shareholding and corporate structure of the company is maintained.

The principle of right of share transfer, which applies in principle to joint-stock companies, can be regulated according to the needs of the company and its shareholders by adding provisions on share transfer restrictions to the shareholders' agreement and articles of association. In practice, share transfer restrictions may be used to prevent the transfer of shares to third parties whose participation in the company is undesirable, or to meet the specific needs of family businesses to maintain the balance of power within the company. In this context, shareholders' agreements serve to prevent the undesirable transfer of control, alienation, or loss of quality of family-owned joint-stock companies by providing a basis for regulations on share transfer restrictions. The relevant agreement includes provisions such as Pre-emption, Repurchase, Call Option, and the Put Option to make it more difficult to transfer the company's shares to third parties.

Pre-emption Right

Regardless of whether the shareholders of the company are grouped or not, a shareholder who wishes to transfer their shares may be obliged to first make an offer to the shareholders in their own group and, if there is no grouping, to the other shareholders of the company. After the introduction of such a regulation, it would be appropriate to include a reasonable Takeover Value arrangement that provides a certain framework for the valuation method of company shares. This is because, at this point, an equitable way can be followed by ensuring that the shareholder who wants to transfer their share in the company offers the same value to the bidders.

Call Option:

A sanction or right called a call option sanction may be imposed upon the occurrence of certain adverse circumstances or conditions set forth in the shareholders' agreement. To put it more precisely, if the relevant shareholder has committed certain violations stipulated in the shareholders' agreement or has carried out transactions on their shares prohibited by the articles of association or shareholders' agreement, they may be obliged to compulsorily transfer all of their shares to other shareholders by selling them in proportion to their existing shares.

Deadlock and Put Option:

If the shareholders, despite their good faith efforts to reach an agreement, are unable to do so within a period of time to be determined in the agreement and on issues that will be referred to as deadlocks in the agreement, and in the reasonable opinion of any of the shareholders, such disagreement prevents the continuation of the conduct of the company's business according to the principles of the agreement, a resolution procedure, referred to as a deadlock procedure, may be organized and the Put Option may be detailed. In order to prevent the abuse of this right, it is appropriate to include additional safeguards and contexts in the shareholders' agreement. If this right is correctly designed, the share transfer will take place and the deadlock will be overcome.

Non-Competition

In family businesses, the business of the company is often the distinctive sign of the family. The need to include non-competition provisions in the shareholders' agreement is related to the ownership of the company by the entire family and shareholders, the importance of the company activities, and the possibility of unfair competition through the use of information or trade secrets that the shareholders possess by virtue of their position and duties within the company for the benefit of another company with which they have a relationship.

If the shareholder of a joint-stock company is also a member of the board of directors of the company, they would be legally subject to the non-competition clause. Article 396 of the TCC stipulates that a member of the board of directors may not, without obtaining the authorization of the general assembly, engage in a commercial business that falls within the scope of the company's field of activity, either on his own account or on behalf of another person, nor may they join a company engaged in the same type of commercial activity as a partner with unlimited liability. The company has the freedom to claim compensation from the shareholders serving on the board of directors who act in violation of this provision, or instead of compensation, deem the transaction to have been made on behalf of the company and claim that the benefits arising from the contracts made on behalf of third parties belong to the company. Pursuant to Article 613/1 of the TCC, shareholders of limited liability companies are obliged to protect company secrets. This obligation may not be removed by a shareholders' agreement or a resolution of the general assembly. According to this provision, the confidentiality of limited liability company partners is regulated in a mandatory manner. In limited liability companies, shareholders may not engage in transactions that provide them with a special benefit and that harm the purpose of the company.

Unless expressly provided for in the shareholders' agreement, there can be no non-compete provisions for shareholders, except to the extent permitted by legislation. For this reason, although supported by the legislation, it is of great importance for the future, sustainability, and strength of the company in the relevant market to include provisions in the shareholders' agreement that compel shareholders to refrain from transactions and behaviors that compete with the company.

Sanctions, Penal Clauses and Validity

The sanctions to be imposed as a result of the breach of the shareholders' agreement will be the sanctions under the law of obligations, except for the penal clause and other provisions agreed upon in the agreement. Such sanctions can be listed as payment in kind, compensation, rescission of the contract, and termination of the contract for just cause. Which of these situations applies may vary depending on the nature of the violation. In any case, a prudent approach to the validity of the sanction in question would be to ensure that the sanction to be envisaged is proportionate to the act in question and that it is applied in a way that does not cause economic ruin to the shareholder in his capacity as the breacher.

Applicable Law and Dispute Resolution Mechanism

The parties may agree to determine the law applicable to the contract and dispute resolution procedures. However, it is recommended that the parties have recourse to alternative remedies to be arranged for in the contract to shorten the dispute resolution period and to control costs. These remedies may generally include arbitration, mediation or conciliation.

Conclusion

Shareholders' agreements, which have emerged as a manifestation of the principle of freedom of contract, are becoming increasingly important in practice for family businesses in terms of providing flexibility in regulating the relationships among shareholders and their relationships with the company and protecting confidentiality among shareholders. The conclusion of a shareholders' agreement among the shareholders of a family business is important to protect the structure of the company and the rights of the shareholders by regulating the rights of family members as shareholders and the operation of the company. By organizing a shareholders' agreement, family businesses will have established an important basis for institutionalization and sustainability by regulating the principles agreed upon in the family constitution in a more binding manner. This will allow the company to move forward independently of shareholder relationships. It should be remembered that in a family business, such agreements should emerge as a result of the will of the parties and stakeholders to comply with the framework arrangement in this direction and to see the system as superior, and should be formed with the reflection of the common will of all stakeholders. This is because even these agreements alone would not be sufficient to remove the parties from a possible dispute but only serve as a guide to the parties in a possible dispute.

Succession Planning and Processes

It is important to ensure that transfer plans to new generations are created and implemented in a timely manner to protect family wealth and businesses and assure continuity across generations. If this structure is not implemented, conflicts of interest will inevitably arise and affect the management of the company. Any individual with inheritance rights who does not wish to participate in family businesses brings the risk that the company will be split up, that shares will be sold to non-family members, or that the company will be split internally, to the extent of their future shareholding. Current and future rights are always at risk if they are not protected by the Family Constitution and Shareholders' Agreement.

Succession plans are successful to the extent that the founder intends to hand over the company and the next generations are capable and willing to take responsibility for its management.

Succession Planning

The succession plan is not a process in itself, but the key to the continuity of the company for generations to come with the vision of the shareholders. Delays in implementing this plan can lead to family disagreements and wrong decisions in selecting the next generation to participate in the company.

A succession plan must have specific, measurable, achievable and consistent goals in order to be meaningful and feasible. A process should be in place to ensure the identification of such goals, the initiation of activities to achieve them, and the approval and support of the whole family.

A successor or successors can be successful if they have experience and skills in everything from family business to tax planning, from valuation to goal setting.

II. Components of Corporate Governance

More than 90% of the companies operating in Türkiye appear in the form of family partnerships. The family members who own the business need to trust the system and know that information flows to them accurately and reliably so that they can put work aside, spend more time with their families and loved ones, spend time on their hobbies, and transfer authority and responsibilities to future generations and/or professionals. It is of utmost importance that these transfers take place in a healthy way that contributes to the sustainability of the organization as both the company and the family members become professional for sustainable growth with the establishment of good and effective management mechanisms, and improved effectiveness of the existing internal control system.

An effective internal control system can be likened to a construction built on solid foundations. If we match the building blocks of a building with those of a company, the foundation of the building is the information systems infrastructure in the company. Today, the financial statements that enable bosses, managers, and stakeholders to have information about a company that is not dependent on technology are a reflection of the records created in the accounting systems of such a company. Depending on the extent to which a company runs its processes through the system,
business processes such as finance, purchasing, sales, and production are carried out by building on the existing information systems infrastructure. The roof of the building can be considered in terms of organizational level controls and management oversight responsibilities. The exterior of the building is the financial statements, which are seen by all stakeholders and persons/organizations that need or want information about the company.

Creating an auditable environment is undoubtedly one of the most prominent actions a company can take to ensure that the building is robust, that it can stand upright for many years with its inhabitants (employees, family members if we think in company terms), and that it can manage crises.

An auditable environment depends on retaining long-serving employees who are loyal to the company and the family in line with their competencies, as well as writing standardized processes that are independent of individuals and approved by the board of directors, trusting the system rather than individuals, conducting business according to the principle of separation of duties, and incorporating the knowledge and experience of individuals about the company into the corporate memory. Only in this way will a corporate culture be created that will pave the way for good governance and corporate governance principles (fairness, transparency, accountability, responsibility). Throughout this journey, the support and ownership of family members in management and decision-making bodies, along with other professional management, is a critical success factor for the healthy completion of the journey and the survival of the company.

This section discusses how to create the mechanisms that would be useful to help manage the family business in an effective way. The rules, processes, and approaches by which organizations are managed and controlled should be analyzed under the heading of corporate governance.

Corporate governance is not only about an organization's compliance with certain internal and external regulations, but also reflects its approach, culture, personality and preferences while balancing the different expectations of its stakeholders. Effective governance is only possible through functions that performs different roles within the company. At the same time, the changing nature of business over time, global crises, and ever-evolving markets are shaping organizations' approaches accordingly. In order to minimize or even benefit from the risks they face, organizations need to establish and operationalize certain mechanisms. They include:

- Risk Management,
- Internal Audit,
- Effective Internal Control System,
- Financial Affairs,
- Financial Reporting and Independent Audit Mechanisms.

Including the aforementioned mechanisms

within the corporate structure and benefiting from their activities, reporting and outputs will have a positive impact on the sustainable growth and profitability of organizations.

Risk Management

In general terms, risk can be defined as the uncertainty of losses and gains that may result from choices and decisions made throughout the organization. Risk management is therefore a mechanism that aims to ensure the stability of organizations by enabling them to determine the impact of their decisions and to prioritize, mitigate and measure the risks they face.

Organizations are constantly exposed to risks of various sizes and types due to the environment in which they operate and the actions they take as part of their activities. Every decision made to achieve identified objectives involves a certain level of risk. Every decision-making process involves risk, whether it is at the operational level or at the strategic/organizational level, which affects the entire organization. When we evaluate risk in this sense, the process of determining and managing how the organization will make decisions about the risks it faces is called risk management, or as it is more commonly called in some circles, enterprise risk management.

Another definition of risk management places it at the center of an organization's strategic management, describing it as a process by which organizations methodologically address and monitor the risks they face in order to achieve the results they seek for each activity.[1]

Fundamentally, the purpose of risk management is to manage risk, not to eliminate it.[2] From this perspective, risk management is a process that supports the decision to take risks that are acceptable, economically viable and legally permissible. The risks that can be taken should be consistent with the organization's risk appetite, and no risk should be undertaken that the senior management would not accept.

It is important for organizations to establish risk management functions and to benefit from their output by effectively feeding them to protect themselves from internal and external negative impacts and to identify risks. The most prominent benefits of this are that it provides company stakeholders

1. Executive's Guide to COSO Internal Controls, Robert E. Moeller, Wiley, 2014
2. Business Risk Management in International Corporations, Sebastian Kot & Prezmsylaw Dragon, 22nd International Economic Conference, 2015

that risks to which the organization may be exposed are being monitored and managed. These oversight and management activities guide the management of the organization on issues such as financial, operational, strategic, compliance, and fraud issues, including all kinds of risks that organizations may face. Such structures, which systematically manage risk, also provide reasonable assurance that institutions comply with internal and external regulations and are managed in accordance with corporate governance principles.

The risk management functions established by organizations should not be expected to have the same structure and characteristics in every application. The functional structure should be shaped depending on factors such as the size of an organization, the breadth and complexity of its operations, the industry and geography in which it operates, and the structure of its human resources. This function, preferably reporting to the Board of Directors, may include persons with management and business experience as well as those with technical knowledge in line with the organization's field of activity.

Risk management can be conceptually assessed within the frameworks underpinned by approaches such as ISO 31000 Risk Management or COSO Enterprise Risk Management (ERM) within international norms; these resources can be utilized during the establishment of structures. The activities should help to classify the risks to which the organization is exposed and then to manage them by making additional distinctions in terms of type and nature for the effective assignment of monitoring and responsibilities.

COSO CRM is based on event identification, followed by risk response.[3] The main objective here is to understand the magnitude of the risk faced (both individually and in combination with other risks) and to determine what opportunities or threats it presents to the company and to determine a response. This approach also includes scenario analysis to evaluate the positive or negative situations that the organization may face as a result of its responses to risks, and to decide on what the most effective solution may be. Activities such as classifying and prioritizing risks, creating risk maps, and discovering relationships between risks can be useful in such assessments, and it is very important to be in constant communication with the units inside the organization

3. Risk Assessment in Practice, Deloitte & Touche LLP, Dr. Patchin Curtis & Mark Carey, 2012

to raise awareness and provide first-hand information about risks through workshops and interviews.

According to ISO 31000, enterprise risk management offers a different approach and defines how the mechanism will be shaped and operated based on the "7R & 4T" method for risk classification (Recognition, Ranking, Responding, Resourcing, Reaction, Reporting, and Reviewing/Tolerate, Treat, Transfer, Terminate - Terminate).[4]

Risk Management and Internal Control System

The organization's senior management is primarily responsible for establishing a risk management and internal control system that is compatible with the organization's culture and is implemented to support the achievement of the organization's strategic objectives. While these systems cannot completely eliminate risk (nor be responsible to do so), senior management should ensure that they are effective, operational, and robust to the risks to which the organization is exposed.

The systems to be established should be embedded in the day-to-day operations of the organizations and should be updated in parallel with emerging developments. Systems should not be viewed as functions that periodically review activities, but as integral parts of daily operations.[5]

Risk Management and Internal Control Systems are components of the Three Lines Model, the details of which are explained in the following sections. Both components need to feed off each other while acting in synchrony. The main challenge lies in assigning specific tasks and ensuring effective and efficient coordination between these groups to avoid "gaps" in controls and unnecessary duplication in scope. The responsibilities of groups of risk and control specialists should be clearly defined so that they understand the limits of their responsibilities and where and how their positions fit into the overall risk and control structure of the organization.[6]

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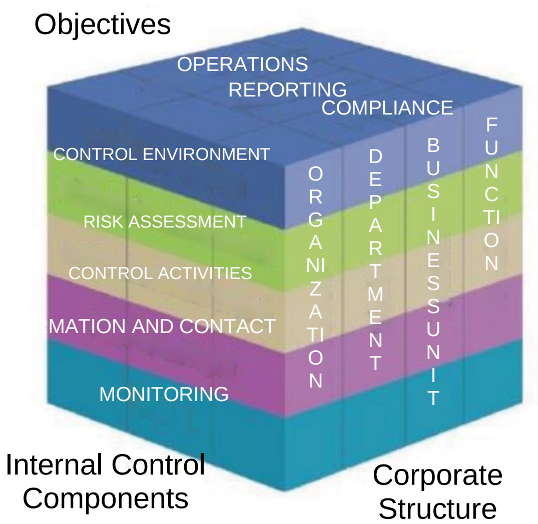
4. A Structural Perspective on Enterprise Risk Management (ERM) and ISO 31000 Obligations, Institute of Risk Management (IRM & AIRMIC), 2009
5. Guidance on Risk Management, Internal Control and Related Financial and Business Reporting, The Financial Reporting Council, 2014
6. IIA's Three Lines Model, Update on the Three Lines of Defense, 2020

As the paragraph above indicates, coordination is the critical word and the concept needs to be filled in. Neither process will work properly with an internal control system that ignores the organization's significant risks, or with a risk management that does not benefit from internal control system findings. The organization should strive to use both processes in a way that can provide the highest benefit to its activities, follow the continuous development opportunities that arise, update them whenever possible, and make them support the corporate strategy.

Internal Control System

COSO (The Committee of Sponsoring Organizations of the Treadway Commission), which serves as a guide to organizations on internal controls, defines internal control as a process performed by an entity's board of directors, managers, and other personnel that is designed to provide reasonable assurance regarding the effectiveness and efficiency of business operations, the reliability of financial reporting, and compliance with applicable laws and regulations. A number of key components must interact to ensure that the internal control system, which consists of all these internal controls, functions as intended and result in the successful completion of business objectives.



The Internal Controls-Integrated Framework established by COSO was first published in 1992 and updated in 2013.

The internal control system has three main objectives and five components.

The objectives of the system can be listed as follows:

Operational targets

Developing business processes that ensure the effective and efficient use of assets and protect them against possible loss and damage.

Reporting objectives

Establishing a reliable, timely and transparent financial reporting process.

Compliance targets

Ensuring compliance with legal regulations.

The internal control system consists of the following five integrated components:

Control environment

It is a set of standards, processes, and structures that form the basis for the successful implementation of internal control throughout the organization. The Board and senior management set the "tone" at the top regarding the importance of internal control, including the standards of conduct expected of the organization's employees. Management should communicate expectations from various levels of the business.

Risk assessment

Organizations face both internal and external risks. Risk assessments play a role in identifying the negative consequences that may arise if these risks materialize and determining how to manage them; they provide a basis for identifying, analyzing, and managing the risks that may pose obstacles to achieving the organization's objectives.

Control activities

They are policies and procedures that help manage risks that may prevent the organization from achieving its objectives. They include various activities such as approvals, authorizations, validations, reconciliations, business performance reviews, security of assets, and separation of duties.

Information and communication

An organization needs in-depth knowledge of its activities to support the achievement of its objectives and fulfill its internal control responsibilities. Management obtains or generates and uses relevant and qualified information from both internal and external sources to support the operation of the other components of internal control. One of the important points here is that employees can clearly receive the messages of from top management. The proper execution of communication and information flow with external parties should be considered from two perspectives - in terms of receiving timely and accurate information from external parties and ensuring that the information provided to them reflects the truth.

Monitoring activities

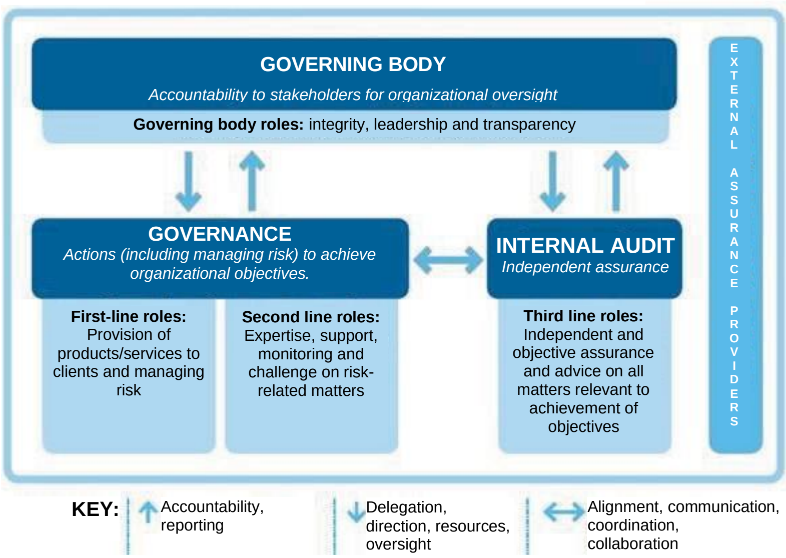
It is the process of evaluating the design and operation of controls during specified periods and taking action when necessary as a result of such evaluation. This includes ensuring that the above steps are performed properly. Continuous monitoring activities are also critical to provide timely information to senior management and management.

One of the fundamental steps in understanding the effectiveness of the internal control system, and therefore the effectiveness of risk management, is to understand the Three Lines Model.

The Three Lines Model helps organizations identify the structures and processes that are best suited to achieve their goals and build a strong governance and risk management system. The model considers management controls and internal control measures as first-line roles, while including risk control and compliance units, which are placed by management, as second-line roles. Internal audit, which acts as an independent assurance, is included in the third-line roles.

The model, which has been updated and renamed the Three Lines Model (formerly known as the Three Lines of Defense), is based on certain principles. The model recommends that practitioners ensure accountability within the organization, take management actions for risk-based decision-making, and establish an internal audit mechanism to promote continuous development and improvement. As part of this function, the governing body should ensure that the organization's

The IIA's Three Lines Model



**Taken from the IIA publication Three Lines Model - Update on the Three Lines of Defense, July 2020.*

objectives are aligned with the expectations of its stakeholders, while ensuring that an appropriate structure is in place.

Especially in lines 1 and 2 of the model, the departments that perform their activities in line with the organization's objectives take on tasks to undertake and manage risks within the internal control system. Internal audit has the responsibility to review the tasks carried out by these lines as a party independent of the executive and to contribute to the organization by suggesting improvements for those parts that are not as expected.

Taken together, the ultimate goal is for all roles to add value to the organization. Responsibilities must be assigned and monitored according to the nature of existing roles and expectations to protect and sustain the value created.

In today's business world, designing and operating an effective internal control system that supports an organization's sustainable growth strategies is considered one of the most important elements in increasing shareholder value. However, it is important to ensure that the internal control system

In addition to operating the risk management system, the objective should be to take one step further and ensure that risk is managed effectively by communicating with the board and relevant stakeholders.

What Risks Will I Face If I Do Not Establish an Effective Control System?

It is necessary to view the internal control system as an integral part of the company's day-to-day operations, rather than as a system designed and operated in addition to business operations. The negative consequences of not designing and implementing an effective internal control system can be summarized under five main headings:

1. Facing Unexpected Risks

Failure to establish a comprehensive and structured internal control system throughout the organization may cause it to suffer losses and/or irreversible situations due to its inability to take timely action resulting from unprepared, unexpected errors and misconduct. It is impossible for an organization that is not prepared for these risks, and in a sense is not even aware of them, to design how and by what means it can eliminate the negative effects of the event.

2. Establishing Controls That Do Not Function Properly

The attitudes, behaviors, and understanding of the company's shareholders, board of directors and executives are not clearly and strongly communicated throughout the organization. There is insufficient focus on ethics and integrity, the most important concepts in establishing a control environment.

The controls in place are not written and formalized. Errors and misconduct are detected after they occur, and procedures to investigate non-routine transactions by company owners and managers are not implemented.

Many errors and misconduct cannot be prevented due to the establishment of improperly functioning controls or their inadequate implementation. Below is a list of issues that are commonly encountered by organizations in this situation.

- Adopting approaches that are not in line with ethical rules and corporate culture,
- Failure to report on time,

- Failure to properly complete the reports and declarations required by the legislation,
- Failure to identify the source of errors and attribute responsibility for them to the relevant person due to an ineffective tracking mechanism,
- Misuse of company cash (e.g. unnecessary expenditures, using advances in excess of the required amount),
- Selling goods/services more expensive or cheaper than they should be due to ineffective monitoring of costs,
- Errors and abuses in bank, personnel, vendor, and customer accounts due to lack of reconciliations,
- Obtaining goods and services at high cost (inadequate bidding, inadequate negotiation, or abuses involving third parties),
- Maintaining unnecessary excess inventory and purchasing unnecessary fixed assets,
- Theft and embezzlement,
- Recording income and expenses in the books that do not comply with the legislation, transactions that have not passed through the appropriate approval mechanisms, and transactions that do not comply with authorization limits.

3. Violation of Legal Regulations

The risk of non-compliance with applicable laws and regulations increases if a healthy control environment does not exist within the organization and if the procedures and policies to be followed are not applied by the company's owners and employees, including the members of the Board of Directors.

Organizations that do not review compliance with legal regulations immediately and/or periodically are likely to face criminal sanctions in these areas, and the sustainability of their operations may be adversely affected.

4. Inadequate Security Measures

Failure to adequately protect the organization's assets (such as money in cash and banks, goods in warehouses, and fixed assets in the enterprise) increases the risk of errors and fraud against those assets. The organization's assets related to all types of information technology (hardware and software) and its intellectual property rights should also be considered within this scope.

5. Inadequate Information Flow

Documentation is inadequate and institutional memory is weak. If the staff turnover rate is high, the problem can reach serious dimensions. The accountability culture is weak.

The flow of information to the owner, board of directors, and senior management is not healthy due to inadequate management reporting. Therefore, management-related decisions are made without the proper evaluation and filtering of financial information. A sound assessment of pricing, costs, and profitability is often not made when entering into a commercial activity.

Why Internal Controls are Important for Family Businesses?

As is well known, organizations face threats that originate from within or outside. In some cases, these threats become reality, causing significant damage to companies and the economy. Such organizations can be affected by such situations, regardless of their internal structure, whether they are family-owned or not. In this respect, family businesses are not exempt from the aforesaid phenomenon and must take the necessary measures to be prepared and agile.

Another important issue that is different in family businesses compared to other businesses is the approach of family members who find a place in the organization. These approaches may arise from differences in management attitudes and competencies, or in the context of communication problems. Establishing an effective internal control system will pave the way for activities to be carried out independently of individuals in the organization and ensure that communications can be conducted in a healthier and more corporate tone. In this sense, through activities such as the creation of committees to support internal control within the organization and the creation of legislation and monitoring channels to foster an ethical environment, family members within the organization can become more institutionalized, which in turn can create an environment of trust and contribute to transparency.

A family business with an effective internal control system will have a structure in which corporate governance and corporate culture are effective, strategies and goals are clear, performance can be closely monitored, reviews can be made in a timely manner,and information flow is healthy. Family members who will work in this environment will have to assume the responsibilities expected of them by the system thanks to the corporate culture effect to be created.

Current State of Internal Controls and Risks in Family Businesses

The assessments identified significant weaknesses in the existing internal controls in family businesses, and such weaknesses expose organizations to serious risks. The following section discusses some of the more common negative aspects of family businesses.

- It is observed that the system is mainly based on trust (due to the influence of culture and senior management) and that "control" practices are inadequate as a basis for institutionalization.
- Because the internal control framework has not been formally established, existing controls are not known throughout the organization and therefore do not function as designed.
- Failure to create internal control awareness among all employees of the organization, and not giving importance to training in this direction, causes employees not to take ownership of the controls to which they should pay the utmost attention, and ineffective control activities are performed.
- In the absence of continuous monitoring to ensure that internal controls are operating effectively and efficiently, management may assume that controls are operating perfectly when they are not currently being implemented as designed.
- The principle of separation of duties is an unfamiliar concept to most private and family businesses; in some cases, it is not applied because human resources are considered a constraint. Ignoring this principle often increases the risk of misconduct in organizations.
- While a properly designed and operated control (with the support of integrated systems and processes) is expected to detect error or fraud "before it occurs", in Turkish practice, person-dependent controls are often designed to detect error or fraud after it has occurred. In other words, the focus is on detection rather than prevention controls, which play a more effective role in risk management.
- Controls over financial reporting are often implemented through manual methods that lack formality and discipline. Manual controls can lead to errors and misuse.
- Employees often do not understand or question how the work they are responsible for interacts with other processes. It is observed that a significant portion of the errors arises from the lack of communication between operational units and financial and administrative units.

- The controls in place are predominantly person-dependent, and employees have inadequate documentation of their activities. Inadequate documentation, coupled with high staff turnover, leads to a lack of institutional memory and serious process problems.
- While the use of software without a systematic infrastructure for reporting and analysis is growing rapidly, controls over it remain inadequate.
- Unlawful and unethical activities and actions of bosses and family members in management, often unknowingly, create a "role model" for employees that is destructive to the effective implementation of internal controls.
- Family members in management and bosses may perform significant "non-routine" operational activities in the context of rapidly growing operations. However, it is often observed that these transactions are not reviewed from a financial reporting and regulatory compliance perspective, leaving an organization exposed to significant risks after the transaction is completed.
- Management reporting that includes the elements needed to manage the business, such as financial position and performance, cash flow statements, financial analysis, and key performance criteria, is often lacking, or the inadequate reporting methods applied feature very basic elements.
- The "culture of accountability and transparency" may not have developed among employees, including company owners, as a result of a weak control environment.
- The risk of errors and misconduct increases due to the lack of a "culture of reconciliation" within internal departments and with third parties.
- There are significant security gaps in assets, processes, and information technologies. Awareness of information security risks is not sufficiently developed.

Benefits of Effective Internal Controls for Companies

The design and implementation of an effective internal control system goes far beyond minimizing errors and misconduct within the organization; it is important for the "continuity" and "growth" of the company.

The benefits of a well-designed and implemented internal control system can be summarized as follows.

- Creating a basis for effective and efficient operations, it also helps to identify events that may have a negative impact on the company's ability to achieve its goals in a timely manner and to take measures to ensure that their impact is minimized.
- It identifies negative situations that may have a significant impact on the achievement of the organization's objectives, allowing one to understand which activities are carried out properly and the effectiveness of management, and to take necessary measures in a timely manner.
- It contributes positively to ensuring compliance with the reporting deadlines set for the organization and the inclusion of accurate information in these reports.
- It supports compliance with internal and external legislation and rules.

While the establishment and proper functioning of an effective internal control system may pave the way for management to make better decisions, it cannot guarantee "perfect" results and error-free management. It is possible to evaluate the main points that may limit the system as follows.

- Relevance of the targets set,
- The possibility of making the wrong decision,
- Errors resulting from human nature, errors of interpretation,
- Management's ability to override controls that have been put in place,
- Circumvention ("by-passing") of controls through fraud committed by management, employees or third parties,
- External events that the organization cannot influence.

As noted above, senior management and management will not be able to have full assurance regarding the controls due to these and similar circumstances. Instead, they will only be able to obtain reasonable assurance. Nevertheless, decisions should be made as to what controls should be designed and operated considering these circumstances, and efforts should be made to minimize the adverse consequences as much as possible if risks materialize.

Internal Audit

According to the definition of the Institute of Internal Auditors (IIA), the internal audit is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

The mission of Internal Audit is defined by the IIA as enhancing and protecting organizational value by providing risk-based and objective assurance, advice, and insight. The mission of Internal Audit refers to it aspires to accomplish within the organization. The mission in the new IPPF (International Professional Practice Framework) is specifically positioned as to show how practitioners should use the whole framework to achieve this mission.

In setting the framework for internal audit, The IIA expects compliance with the Definition of Internal Auditing, the International Standards on Internal Auditing (Standards), the Code of Ethics, and the Main Principles (collectively referred to as the Mandatory Guidance). In addition to compliance with this legislation, supporting legislation and publications, such as Recommended Guidance and Position Papers, are also published to improve and enhance internal audit functions.[7]

Conducting internal audit activities using the Standards ensures uniformity in the approach of internal auditors and the fulfillment of certain responsibilities, despite the fact that they are performed in a wide variety of legal and cultural environments, for organizations with very different purposes, sizes, complexities, and structures, and by internal and external persons.

General objectives of standards

- Guiding compliance with the mandatory elements of the International Professional Practice Framework.
- Providing a framework for promoting and implementing a wide range of value-added internal audit services.
- Creating a suitable basis for the evaluation of internal audit performance.
- Promoting improved organizational processes and activities.

Standards are divided into two main categories: Qualification and Performance Standards. Qualification Standards address the qualities of the organizations and individuals

7. https://www.tide.org.tr website, Standards and Resources Section
8. International Standards on Internal Auditing within the Scope of the Professional Practice Framework, International Institute of Internal Auditors, 2016

who perform internal audit activities, while Performance Standards describe the nature of internal audit and provide quality criteria used to evaluate the performance of these services.[8]

A closer look at the Qualification Standards reveals that they address issues such as:

- Identification of the purpose, authority, and responsibilities of internal audit and defining them in a directive and stating compliance with the Mandatory Guidance defined by the IIA,
- Ensuring the independence and objectivity of internal audit's function and describing it clearly,
- Explanation of the function's communication with other units,
- Determining the competencies of unit employees and ensuring that they exercise the utmost professional care and attention while carrying out their activities while ensuring continuous professional development,
- Establishing a quality assurance and improvement program that covers all aspects of internal audit activities within the unit.

On the other hand, the Performance Standards offers guidance over the following:

- Management of internal audit activities,
- Scope of the evaluations to be made about other units, evaluation methods,
- Planning activities,
- Determining the objectives, scope, work programs and resources of the tasks to be performed,
- Detection, identification, analysis, evaluation, and recording of information,
- Supervision and control of the tasks performed,
- The reporting method to be applied.

An evaluation of the results of the above research shows that it is important for organizations to take steps to establish internal audit structures, while those with established internal audit structures also need continuous improvement to go further and derive maximum benefit from this activity.

Information technology auditing is an important part of internal audit, in addition to process auditing. Process audits evaluate an organization's processes against internal and external rules and management expectations, while information technology audits evaluate the technology infrastructure on which the processes in question run. The main purpose of audits is to understand whether the established system is functioning as expected and whether it provides the desired benefit to the organization.

In information technology audits, standards such as COBIT, ITIL, ISO 27001, etc. established by different organizations are used to access the best practices in the world and to compare the technology infrastructure of the organization. Among these assessment frameworks, the ISACA-updated framework and currently implemented as COBIT 5, provides assessments in the following impact areas within the COBIT skill categories.

- Evaluate, Direct, Monitor
- Align, Plan, Organize
- Build, Acquire and Implement
- Provide, Serve, Support
- Monitor, Evaluate, Evaluate

COBIT assessments aim to review an organization's approach to information technology by attempting to answer questions such as "Are stakeholder needs met?", "Are enabler goals achieved?", "Is the lifecycle managed?", "Are good practices applied?". It defines the roles and responsibilities of each level within the organization for these processes while performing these activities.

It is critical that cybersecurity risks, which arise in parallel with information technology risks and the proliferation of Internet-connected devices, are addressed and included in organizations' internal audit programs. Organizations' private data, intellectual property, and cyber infrastructure can be compromised by deliberate attacks or inadvertent security failures and the vulnerabilities of an unregulated global internet. In this respect, the top management of an organization should be aware of the cyber risks it may face and ensure that the internal audit takes the necessary actions (internally or through external resources) to address them.

Although organizations aim to ensure that their activities continue uninterrupted, internal and/or external adversities may prevent this. The internal audit function should also reasonably ensure that business continuity plans are in place, that they are kept up to date, that employees are aware of them, and that senior management is informed accordingly.

Another issue on the internal audit agenda that organizations have recently focused on is the use of analytical methods in auditing, which replaces traditional methods and brings a new value-added perspective to internal audits. As it is known, the business processes of organizations are becoming more complex every day, they are being digitalized, and different departments are working with different systems.

The use of data analytics during audits lead to:

- The possibility to conduct higher value-added audits,
- Adding an innovative perspective to audits,
- Faster audit implementation,
- Possible reductions in audit costs.

The effectiveness of internal audit can be increased by incorporating data analytics techniques in all stages from planning to reporting, while data management, modeling, and visualization can enhance the effectiveness of such activities and provide a value-added perspective.

What is an Internal Audit? Why is it Important?

The internal audit activity, which constitutes the third line of the Three Lines Model and an important pillar of an effective corporate governance approach, protects and enhances corporate value by providing risk-based, objective assurance. As the model suggests, an internal audit is not only a department accountable to the governing body, but also has a great responsibility to be its "eyes and ears".

Internal audit plays a key role in measuring and reporting on companies' internal control, risk management, and management information systems, ensuring the improvement of business processes and the effective and efficient use of resources, helping to prevent errors, fraud, and misconduct, reducing losses that may be caused by risks, and contributing to the achievement of organizations' objectives by protecting their reputation.

In today's business world, internal audit is seen as the insurance of sustainable growth, corporate governance, and reputation in the face of changes such as globalization; free movement of capital; increased international investments; growing, diversifying, and complex transactions; developments in communications and technology; effectiveness and efficiency in operations; fraudulent financial reporting scandals, bankruptcies, and major company losses; and increasing commercial regulations around the world.

How Does the Need for Internal Audit Arise in Family Businesses?

Family businesses have an important place in the national economy, given their position, value, contribution, and volume. These companies represent the vast majority of businesses in our country and around the world. However, an examination of the life cycle of these companies shows that their lifespans are not very long, with a significant number of them disappearing under the management of the first and second generations. Research has shown that the main reason family businesses disappear is the lack of institutionalization and the inability to establish an accurate and accountable control system. The goal of making long-term, sustainable decisions about an organization's vision, processes, and structure lies at the heart of efforts to establish corporate governance practices and structures.

Family businesses that aim for continuous growth and development in global competition need internal audit activities to ensure corporate governance structure. As the organizational structure of companies grows, so does the need for control to effectively manage the organization through complex transactions and market relations. Management's responsibilities for establishing an internal control system and ensuring its operability take priority.

In addition, establishing an independent and impartial Internal Audit function that provides assurance to management creates a perception that enhances the company's credibility with investors and lenders.

Internal Audit provides management with accurate information on the effectiveness and adequacy of the internal control system, the suitability of business processes, and the quality of the organization's performance in achieving its objectives by advising management on identifying risks that the organization may face in the future and taking the necessary measures. Internal audit is an important step in establishing the corporate governance structure of family businesses striving to survive in today's rapidly changing business world. The internal control system designed by the organization's management to provide reasonable assurance on the effectiveness and efficiency of business processes, the reliability of the financial reporting system, and compliance with laws and regulations are evaluated by internal audit. The effectiveness of the internal control system and internal audit activities play an important role in preventing errors, fraud and abuse, and loss of revenue and assets. In short, openness to audit is a guarantee of profitability and efficiency.

As a requirement of institutionalization, family businesses should formulate plans to carry out their activities in line with the targets and measure the success of the process of achieving the plans through the internal audit function and ensure that deviations from the plan are corrected. Internal audit provides family businesses with the stability and reasonable assurance in their operations.

Initiating Internal Audit Activities in Family Businesses

One of the following three methods is preferred for initiating internal audit activities in family businesses:

1. Internal Sourcing

Establishing an internal audit unit within the business and performing activities by assigning internal auditors through this unit.

2. Outsourcing

Conducting audit activities with internal audit services to be provided by a professional organization from outside the business.

3. Co-Sourcing

Joint use of internal and outsourcing methods (internal audit professionals within the organization are supported by the outsourcing company to perform the activity and transfer knowledge and methods).

The management of the organization determines the most appropriate method for it, by taking into account factors such as its size, organizational structure, the maturity of its risk management activities, the effectiveness of its internal control system, principles stipulated by the legal regulations regarding the industry in which it operates, and the level of funding required to provide the knowledge, skills, and equipment necessary for the internal audit activity.

If the internal audit activity is to be performed with internal resources, senior management should first commit to initiating an activity for which it will ensure its independence and objectivity in accordance with international standards, as well as its full support. The internal audit activity should be positioned within the business organization to ensure its independence and objectivity. Therefore, it should not be tied to executive positions.

If the internal audit activity is to be partially or fully outsourced, outsourcers should have appropriate skills, equipment, reputation, experience, and references, and they should be free of any financial, corporate or personal relationships that could compromise their independence and objectivity.

In all three cases, the competencies of the persons to be assigned internally or hired externally for internal audit activities should be appropriate for the task, and they should be selected among those who hold professional certificates or are candidates for certification.

After determining the method to be used to initiate the internal audit activity, the activities are generally designed and performed as indicated in the process flow below:

Establishing the Internal Audit Directive: A standard operating procedure that defines the purpose, authority, and responsibilities of the internal audit function within the organization is prepared and submitted to the Board of Directors for approval.

Determining the position of the internal audit unit within the organization: The internal audit unit's position within the business organization is determined by its independence.

- Establishing job descriptions for professionals working in the internal audit unit: Job descriptions, including the powers and responsibilities of the managers and employees working in the internal audit unit, are put in writing.
- Evaluation of internal controls: Detailed interviews are conducted with the process and sub-process owners identified within the business operations and the relevant existing internal/external legislation is examined. The risk/control structure is evaluated according to best practices. Improvement recommendations are made for existing and potential risks and control points.
- Conducting a risk assessment: Risk factors and audit areas within the organization are identified and audit areas are prioritized as a result of the risk assessment.
- Preparation of the annual internal audit plan: As a result of the risk assessment, an annual internal audit plan is prepared, including staffing and budget requirements.

The use of internal or external resources, or a combination of both, will shape the internal audit activity in the process flow summarized above for structuring of the internal audit activity in accordance with the knowledge, skills, equipment, business size, legal regulations of the industry in which it operates, business policies, the attitude and understanding of the management required by the internal audit activity and the area of business activity.

Conducting Internal Audit Activities in Family Businesses

Conducting an effective internal audit activity within the organization requires that the internal audit manager reports to a level of management that enables the internal audit activity to fulfill its responsibilities. While conducting internal audit activities, unit employees should not face any restrictions or interventions related to their areas of duty and should be authorized to access all types of documents, information, records, assets, and areas. These capabilities should be clearly defined in an internal audit regulation approved by the audit committee and the board of directors.

In general, the internal audit activity is performed in the following stages:

1. Assessment of risks and creation of an internal audit plan

Professional care and attention should be given to ensuring that internal audit activities are conducted and managed effectively. Professional care and diligence require considering the scope of work required to achieve the objective of the engagement; the complexity of the matters within the scope of work; the effectiveness and adequacy of risk management, control, and corporate governance processes; the likelihood of material errors, irregularities or anomalies; and the cost of the potential benefits of the duty.

Effective management of value-added internal audit activities depends on risk-based planning of internal audit activities, communication with senior management, and a reporting and monitoring system.

The management evaluates the field of activity, industry risks, and market conditions in light of the organization's objectives. The risk-based internal audit plan prepared as a result of the assessment of the organization's activities, processes, and related risks, as well as the human resources and budget required for the realization of the plan, are submitted to the evaluation and approval of the audit committee and the board of directors of the organization.

During the development of the internal audit plan, steps should be taken to include information technologies and cyber risks, as well as the business processes performed by the organization, and to review approaches to business continuity.

2. Planning the audit work

The activities, processes, and systems to be audited and the related control objectives are identified in the annual audit plan approved by management. A "Risk & Control Matrix" is created as a result of identifying the identified risks and control objectives. The scope of this document should be broadened by taking into account the misconduct risks. As a result of the document, a detailed "Audit Plan" and "Audit Programs" are created regarding the activities, processes, and systems to be audited by assigning an auditor with professional knowledge and care to perform the internal audit activity.

3. Implementation of the audit activity

The auditor conducts preliminary research on the activities, processes, and systems to be audited, determines the methods to be applied during the audit in line with the information obtained, and plans the work. The audit activity is performed by checking the compliance of the activities within the work plan to assess whether the activities, transactions, or processes are performed in accordance with the procedures and rules of the organization.

4. Reporting of audit results

At the end of the audit activity, the auditor identifies findings and prepares an audit report that includes the significance and impact of the findings, areas for improvement, and proposed solutions. Audit evidence that is deemed important during reporting may also be attached to the report and presented to senior management.

5. Follow-up of findings

Establishing a reporting follow-up system that ensures that the audit activity does not end with the reporting process and that implementation plans and results are monitored to follow up on the findings and implement the proposed solutions will increase the effectiveness of the internal audit activity.

Finally, it should be noted that the primary factors that determine the effectiveness of internal audit in an organization include the position of the internal audit activity within the organization, its fields of activity, its authority to access all types of information, documents, and records at the corporate level, its independence as well as the objectivity, competencies, management, supervision, reporting, and quality assurance of internal audit professionals in accordance with the definitions and approaches stipulated in the standards. In this regard, it would be useful to develop a quality, assurance, and development program to ensure continuous monitoring of the effectiveness of the internal audit activity and its compliance with the code of ethics and international standards.

Relationship between Internal Audit and Internal Control

As noted in the previous sections, internal control is a system that is embedded in an organization's processes and operations, is influenced by individuals, and provides reasonable assurance as a means of achieving the organization's objectives. On the other hand, internal audit is a function that periodically reviews the effectiveness and efficiency of an organization's internal control system by prioritizing risks and optimizing resources.

Internal control is the responsibility of the organization's management. Internal audit is needed to assess its effectiveness and relevance. Therefore, internal control and internal audit should be regarded as two different but complementary concepts.

Internal control is a set of systems designed to protect business assets, increase the effectiveness and efficiency of operations, ensure the reliability of the information system, and guarantee compliance with legal regulations. The internal audit activity's assessments of the internal control system in accordance with its methodology are of great importance in terms of making this system stronger and more effective.

The Three Lines Model is established in organizations that have reached a certain level of maturity. The internal control system in the first line involves evaluations and monitoring of concepts such as separation of duties, cross-control, authorization limits, and approval mechanisms. An effective internal control system that covers the entire organization also reduces risks. The second line includes the activities of units such as financial control, risk management, and compliance. The activities of these units also complement the internal control system. The third line is internal audit. Internal audit activity provides reasonable assurance to senior management on the effectiveness and suitability of the activities in the first and second lines, while contributing to the identification and remediation of shortcomings in the internal control system.

While the existence of an internal control system constitutes one of the basic stages of the institutionalization of organizations, the suitability and quality of internal controls find their value through internal audit activities. In recent years, internal audit has shifted from a transaction- and error-focused approach to a process-oriented approach that recommends doing the right job as well as doing a job right, taking on a role as a strategic intelligence partner for the organization, developing and adding value, and identifying measures that need to be taken in advance.

At this point, it is worth mentioning the benefits to organizations of establishing structures for continuous audit and control. An evaluation of the reporting and information to the senior management in the continuation of the control and audit activities with a "delay" in a sense clearly shows that continuous control and audit activities

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9. Sürekli Denetim Modelleri ve Yaklaşımları, Dr. Ass. Prof. Osman Nuri Şahin, Prof. Dr. Süleyman Uyar, Uluslararası Akademik Forum 2018: Gerçek Zamanlı Güvence Modeli Olarak Sürekli Denetim ve Sürekli İzleme, 2018

will reduce this "delay" factor and bring benefits such as faster decision-making and the flexibility to take precautions before the risk materializes by establishing preventive controls.

The main reasons for the emergence of continuous audit are considered to be as follows.

External Causes

The digitalization of trade, the need for more frequent presentations, prompter detection of anomalies, and financial crises.

Technological Developments

Cloud systems, storage, electronic transactions, and ERP environment.

Focus on Internal Control

Laws and Regulations such as "SOX, Elliott Report, AICPA Redbook, IIA GTAG No.3, ISACA IT Audit and Assurance Guidelines No.42".

From this perspective, continuous auditing and monitoring, which replaces traditional auditing and monitoring, enables organizations to respond proactively to risks, act with effective timing, and report continuously and more frequently.

Benefits of Internal Auditing Mechanisms

The economic contribution of the internal audit activity to the organization is to assist management in identifying potential risks, ensure efficiency in business processes by evaluating the effectiveness and suitability of internal controls, and reduce losses that may be caused by risks.

The main purpose of an internal audit is to increase the effectiveness and efficiency of business operations and to create added value for them. In this context, an effective internal audit activity provides the following important benefits to organizations.

- Identifying internal and external threats preventing the organization from achieving its objectives and ensuring effective management of such threats,
- Optimizing the costs and ensuring efficiency in operations,
- Preventing losses due to errors, fraud or abuse,
- Early detection and prevention of unforeseen events that may have a devastating impact on the organization. Minimizing the damage

that may be caused by such events,

- Ensuring that the organization seizes opportunities in the internal and external environment,
- Improving corporate governance practices and enhancing corporate reputation,
- Supporting the institution to increase its resilience to economic, financial, and real sector crises,
- Protection and recording of corporate assets,
- Ensuring the organization's compliance with the governing laws and regulations,
- Safeguarding the reliability and accuracy of the financial reports publicly disclosed by the organization and the operational and financial data used by company managers in decision-making.

Financial Affairs Function

Only with strong companies can a strong economy exist.

And strong companies can only be built with strong Financial Affairs Functions...

Every day, countless decisions with financial implications are made in an office in one of 81 different cities across our nation of 81 million people. Some of these decisions are highly strategic, such as mergers, acquisitions, IPOs, bond issues, joint ventures, expansion into new markets, entry into new lines of business, product/service launches, or investment in a new factory; some are tactical, such as the decision to outsource a job or do it in-house, or the choice of the financing model to support a project; some are operational, such as whether to increase a customer limit, close a gap in a foreign exchange position, or approve a transfer between budgets... Regardless of their nature or impact, all these decisions have in common the added value that a competent finance function can bring to the process. It is at this point that a leader, a strong CFO, is needed to build such a team of experts and guide them in the right direction in their interactions with numerous internal and external stakeholders. Having an expert and well-equipped team is essential for a CFO to build a strong finance function because the risks and opportunities are too large and complex for one person to handle alone while they impose an important role on leadership. Today, the competencies expected of finance teams are evolving rapidly. Business literacy, readiness for technology and digitalization, the transition from a silo approach to a partnership approach, relationship, change and communication management, advanced analytical skills, agility/flexibility, solution orientation, stakeholder management, analytical and synthesis skills and project management are just some of the competency requirements that will come to the fore among the technical qualifications required for the job.

It is time to add the adjectives "Digital" and "Analytical" to finance's traditional roles of "Guardian" and "Operator" and the relatively newer roles of "Catalyst" and "Strategist". The finance function is now much more active in the areas of digitalization and analytics, and CFOs have started to take on important roles in supporting the transformation of their companies. First, robotics and, a little later, artificial intelligence are entering the world of finance. Analytical solutions will form the backbone of decision-making mechanisms. Therefore, the era of "next-generation" digital CFOs is not far off. With all these changes and transformations taking place, it is also necessary to consider developments in the human resources world that also affect the financial affairs/finance function. Employee experience is becoming increasingly important, leadership traits are changing, Generation Z is now joining the workforce alongside Generation Y, and finding and retaining the right talent sources is becoming more challenging. In such an environment, CFOs continue to be the right hand of CEOs, but a challenging test awaits CFOs in terms of building, developing, and sustaining teams.

Financial Reporting and Independent External Audit

The integration of financial markets and the ability of capital to move across international markets is staggering in today's world, where information is shared at an incredible speed. In an increasingly competitive environment, making the right decisions in a timely manner and implementing them quickly is critical to a firm's survival. Fast access to the cheapest financing sources has become one of the most important parameters to survive in the competition, especially for companies with a borrowing-based growth model. Since the growth model of the vast majority of family businesses is based on borrowing, access to more advantageous (readily accessible and relatively cheaper) sources of financing has become crucial for their survival.

According to Deloitte's M&A report, the Turkish M&A market performed better than in the previous two years despite the negative economic developments in 2018. In 2018, 256 transactions totaling $12 billion took place thanks to a small number of large transactions and strong trading volume in the first half of the year. Although the number of transactions declined by 13% compared to the record number in 2017, the total trading volume increased by 17%. The ten largest transactions accounted for 63% of the total annual volume in 2018, with strategic investors and a small number of large transactions coming to the fore. In 2018, the total number of transactions by foreign investors remained at a modest level of 74 transactions, similar to the previous year. However, with the dominant role of foreign strategic investors in large transactions, they accounted for 63% of the total transaction volume.

This data again highlights two points in bold. The first of these two points is that Turkish companies will try to maintain their borrowing-based growth strategies in the coming period. The second point is that in the absence of a transparent and stable political and economic environment, capital tends to seek safe havens and continue to go where it can find more profitable and secure conditions.

It is imperative that Turkish companies become transparent in their financial reporting and produce understandable and comparable data by sharing their financial statements in an internationally accepted financial reporting language to access cheap sources of financing in the international financial markets and attract foreign investors. When the owner of the money does not have access to financial data in the language they understand and in the quality they are used to, they cannot analyze the firm, do not feel safe, and turn elsewhere or lend at higher interest rates, perceiving the risk as high. A private fund manager sitting on the high floors of a skyscraper in New York will be more likely to direct investments to Türkiye to the extent that they can compare the financial performance of a firm operating in Türkiye with the financial data of a firm operating in a similar field in another country in a timely manner and feel secure. If they cannot measure and analyze financial data, they will prioritize other countries where they can get reliable data.

Just as individuals can travel comfortably when they speak a foreign language that is widely used in the world, companies can travel comfortably with financial statements prepared in a language that is accepted in international markets. This internationally recognized accounting language is called International Financial Reporting Standards (IFRS). In other words, IFRS is to companies what English is to individuals.

IFRS is accepted as a common financial reporting and financial data production language used in 120 countries around the world. Even the United States is working to harmonize its accounting standard, US GAAP, with IFRS. In fact, European companies listed in the U.S. can optionally file their IFRS-compliant financial statements with their investors on the U.S. stock exchanges.

As it is known, Turkish Financial Reporting Standards (TFRS), which are compatible with IFRS, can be applied by companies in Türkiye. In addition, large and medium-sized enterprises must apply BOBİ standards, which are very close to IFRS. Although it is a matter of debate how accurately the relevant companies apply TFRS and how well they are audited, the widespread application of TFRS in Türkiye is very valuable for the integration of Turkish companies into international markets.

Recently, we have observed that political and economic fluctuations, especially currency fluctuations, have hurt our country's economy and company balance sheets. Figures show that the profits and equity of many companies have shrunk and even turned negative under the financing burden. As the increasingly competitive conditions make it more difficult for companies to survive, it is vital to be able to access the most advantageous sources of financing in the fastest possible way and to integrate with international financial markets. Providing transparent, comparable, and reliable financial data required by global financial markets to attract foreign capital to Türkiye is possible with quality and transparent financial reporting in more companies, among other political and economic factors.

So, what steps should a family business take and where should it invest to achieve the above-mentioned competence of transparent, reliable, and timely financial reporting in compliance with international financial reporting standards?

System infrastructure in financial reporting

The transaction volumes of companies, types of transactions, complexity levels, size, and occurrence frequency of occurrence make it impossible to manage company accounting with manual or primitive accounting programs. The market determines the price of the product, and consumers all over the world can access the most advantageous products for them on their smartphones at affordable prices. Because the market determines the price of the product, firms can control and manage their costs and processes. Companies that can monitor and control their costs and continuously improve their processes become more competitive. This information also needs to be produced in a fast and reliable manner, without any delays. Under these conditions, it becomes imperative for companies to invest in ERP systems that collect and report financial data on the system, removing manual intervention and processes as much as possible. In today's business world, it is a necessity to invest in the right model and option for itself to reach the ability to produce IFRS-compliant financial statements from the system quickly and reliably.

Human resource capability

An analogy can be drawn between companies achieving the competency to report in an internationally recognized financial statement language and a person learning a foreign language. Just as it would be unrealistic to expect individuals to learn a foreign language overnight, it would be unrealistic for a company's entire accounting and finance function to learn and internalize an internationally recognized accounting language in a very short period. It is possible for an organization to gain this reporting competence through long training and, if necessary, external talent transfer. An area to invest in as a value-added competency is to ensure that the company's reporting and analysis, including management reports, budgets, and financial statements, are fully compliant with international financial reporting standards, and that the performance system is based on IFRS-compliant data from a single source.

Independent audit

Firms express themselves in the global capital markets through their financial statements. The reliability of these financial statements in the eyes of investors and financiers directly affects a firm's credit and risk premiums. An independent audit gives investors the confidence they need in a company's financial statements. A report from a globally recognized and reputable independent auditing firm describes the company in the financial markets on its behalf. Audited financial statements accelerate the processes required for the firm to convince the parties of the reliability of its financial statements.

It is also an important opportunity and development process for the entire company, especially the accounting and finance departments, to learn the documentation discipline and the independent audit perspective, to train the accounting staff, and to enable the management to recognize the areas for improvement. For these reasons, working with a reputable independent audit firm adds value to family businesses.

Internal control environment and internal audit

The events that occur in the firm flow into the accounting system in the form of figures and they are transformed into accounting vouchers to describe certain events. In order for these transactions to be described accurately and realistically, they must be described by the system through a properly designed process. While the control points in these processes ensure the proper functioning of the system, the internal audit provides reasonable assurance on the reliability of the firm's processes, control environment, and IT environment. It provides assurance to the company's board of directors, audit committee, and stakeholders and enhances the quality of independent audits. An effective internal control system and internal audit function are essential for companies to meet international good governance criteria. (*For detailed information on internal control environment and internal audit, see "II. Components of Corporate Governance/Internal Control System and Internal Audit*".)

They include various activities such as reconciliations, business performance reviews, security of assets, and separation of duties.

Information and communication

An organization needs in-depth knowledge of its activities to support the achievement of its objectives and fulfill its internal control responsibilities. Management obtains or generates and uses relevant and qualified information from both internal and external sources to support the operation of the other components of internal control. One of the most important points here is that employees can clearly receive messages from top management. The proper execution of communication and information flow with external parties should be considered from two perspectives - in terms of receiving timely and accurate information from external parties and ensuring that the information provided to them reflects the truth.

Monitoring activities

It is the process of evaluating the design and operation of controls during specified periods and taking action when necessary, as a result of such evaluation. It ensures that the above-mentioned steps are operated properly.

III. Ways to Access Funding Sources

Introduction

In the 21st century, globalization has led to the differentiation of business models and more technological developments in industry, production, and marketing.

In parallel, mergers and acquisitions, strategic and joint ventures, franchising, licensing, and national and international incentive funds have been used to diversify and expand opportunities in addition to traditional sources of cash, which are primarily provided by the banking system.

In this chapter, we will discuss "easy access to resources and effective financial management," which are critical business priorities for family businesses, as they are for all firms in today's complex and risky commercial markets.

What is Financial Management? What is its Purpose?

Functionally, financial management encompasses all company activities related to investment, financing, dividend distribution, and related strategic planning.

Investment involves a company's decision to invest in fixed or non-current assets such as machinery and equipment for reasons such as product development, preparation for new markets, renovation, capacity expansion, or transition to a new business model.

While financing deals with where and how to obtain the necessary funds for investments and working capital, dividend distribution deals with the decision of whether to keep the profits within the company - self-financing - or to share them between the company and its shareholders.

In family businesses that aim for good financial management, the following should be performed effectively:

- Financial Analysis,
- Financial Planning,
- Cash Flow Management,
- Fixed Asset Management and,
- Financial Risk Management

And financing decisions should be made in line with these efforts. Of course, these efforts should also be integrated and interpreted in the context of economic and political developments. Although companies have different perspectives and priorities depending on their business activities, the financial management activities generally aims for:

- Creating efficiency from activities - profit maximization,
- Revenue maximization that generates cash flow,
- Cost control,
- Development of market share,
- Ensuring healthy and sustainable growth.

The transition to financial management is an important step for many family businesses that, due to the lack of effective financial management, are unable to see the situation, conditions, capacities, and available opportunities, and therefore unable to find the right solutions.

Current Attitudinal Differences on Financial Issues in Family Businesses

There are many differences in the attitudes of family and non-family businesses towards financing.

Family businesses are generally observed to lack detailed knowledge of various financial techniques and therefore the use of such techniques remains at a low level.

Family members in family businesses tend to be able to move more easily between their own financial resources and those of the business, to direct their own resources more easily to business activities, and to transfer company funds or profits to their own use freely and at their discretion without seeking a specific predetermined management decision.

However, unlike non-family businesses, family businesses consider "commercial banks" to be a regular source of family financing.

Another situation observed in family businesses is that they are generally more reluctant than non-family businesses to accept equity financing and join forces with strategic and financial partnerships by receiving equity investments.

It is observed that a significant number of family businesses are content with accounting activities, do not employ a finance manager, and prefer this task to be performed primarily by the shareholders. However, it is noted that family businesses in European Union countries are more likely to work with employees specialized in financial matters and are in a much better position to delegate responsibility than businesses in Türkiye.

Family Businesses from the Perspective of Financial Providers

Financial providers in both domestic and international markets have certain expectations of family businesses and principles that they consider essential. Understanding these expectations is important for companies to manage their relationships with their funders as important stakeholders. In this context,

Reliability, reputation, and ethical issues expected in the management and company activities: no negative records (bankruptcy postponement, legal proceedings, etc.) during the intelligence work to be carried out for the company and shareholders, aligning the company request with the need, professional-institutionalized senior management that envisages healthy growth and sustainability and cares about a healthy financial structure while the transparency and accuracy of the financial and other data shared by the company and the answers to the questions to be addressed during the process can be counted among indispensable elements, Expert financial management, command of needs, accurate expression and presentation of needs, and the existence of a healthy database and reporting infrastructure are also among the basic expectations.

Finance providers expect the source of debt repayment to be well understood and planned by company management prior to the transfer of funds and/or capital investment. They seek answers to the following questions: Who are we financing? For what purpose and for what need? Do we agree on the value this need will bring to the company?

Do commercial activities create value? Does the management see short- and medium-term sustainability risks? Is the shared financial data and other information healthy and reliable? What are the risks and supporting collateral conditions?

Financial providers also seek to partner with companies that can generate positive cash flows and profitability under various scenarios.

However, they want to work with companies that can do their calculations well, look out for their interests, and also have a win-win approach and efficient relationships with their financiers.

In other words, this perspective refers to the diversity of product use, the level of resource utilization, the balanced product orientation, and the ability to manage the relationship in an efficient and mutually value-creating arrangement.

There is a widespread belief in Türkiye that the past family and commercial performance of family members in management is expected to be regarded as a positive and effective reference for financial providers in today's evaluations, regardless of the current conditions. However, management must recognize that while this is an important value, in today's complex business and economic environment, it is only meaningful to financial providers in terms of current and forward-looking variables. In short, past performance is important for funders but it does not guarantee future performance.

Accessing the Right Source of Funding-Financial Strategies

The foundation for accessing the right source of funding and developing effective financial strategies is primarily possible through good financial management. It is not realistic to expect to achieve successful results with only accounting knowledge or the perspective of an accountable manager.

For this reason, in family businesses that continue to operate in line with their objectives, it is necessary to establish a professional finance department and staff within the organization parallel to the structure of the company.

Because the accurate collection, processing, and reporting of a firm's financial data are critical to financial decision-making, it is important to establish the necessary infrastructure for a healthy and timely accounting and reporting system.

The ability to take action against risks or to plan for normal financial flows depends on the establishment of such a system. It is also only through such an infrastructure that family businesses can be built on a solid foundation to grow, sustain, and pass on to the next generation.

Establishing sound, accurate, and up-to-date cash flow projections that can be questioned and corrected will make it easier to anticipate financial needs in advance/on time and take the necessary actions.

The basic functions of specialized finance managers are as follows:

To find the resources needed by the company for various reasons, at different times, with favorable conditions and at the required time, to use the surplus funds generated by the business operations in appropriate and profitable areas, to maintain the company's equity/debt balance and to benefit from leverage, to protect the firm against the risks (interest rate risk, exchange rate risk, liquidity risk, etc.) it may encounter in the financial markets in relation to its structure or conjunctural fluctuations, or to manage such risks, to establish healthy, long-term, and clear relationships with financial institutions and to manage them on a daily basis,

and to guide the top management of the company with its recommendations in parallel with these activities.

This infrastructure and alignment enable the company to develop sound financial strategies and planning. As a result, companies that can accurately identify the reasons for their financial needs, perceive the risks they face and how to manage them and establish healthy relationships with financial providers will be better able to design and manage their financial strategies.

Although financial strategies may vary depending on the company's field of activity, the industry and market in which it operates, and the general context, one of the most important elements that we should consider as basic financial compatibility is the need to pay as much attention as possible to the rule that short-term needs should be financed with short-term funds and medium and long-term needs should be financed with equity or medium and long-term resources.

As mentioned in the previous chapters, a clear identification of the need in the first place is the key element in finding and accessing resources that are compatible with it (including maturity, currency, collateral, etc.) and producing effective financial results.

What should the Action Plan Include in terms of Facilitating Access to Funding Sources?

According to their priorities in this regard, family businesses should start the process of institutionalization within a professional management approach as soon as possible and employ expert, experienced, and successful finance managers in their businesses. These managers should also be empowered by the shareholder family members.

Before accessing funding sources, firms should determine where the need for funding comes from and why it is needed, both in terms of finding the right source and determining the product, maturity, and price.

Such identification will make it easier to communicate accurately and easily with financial institutions at the time of need or well in advance, and to seek out and access compatible financial opportunities.

Short-term funding needs generally arise from working capital requirements. At this point, the company must first make sure that it has sufficiently questioned and organized its internal dynamics. It should ensure that working capital is properly managed by shortening the inventory carrying period, if any, as much as possible, managing the receivable collection and debt payment period as balanced as possible, and minimizing idle funds.

Research generally shows that the majority of businesses face cash shortages and face difficulties when collecting receivables and managing their cash.

Therefore, businesses should analyze their customers thoroughly and regularly for credit sales, follow effective collection policies, and prepare regular cash budgets.

Medium- and long-term financing is required for new product development, fixed asset investments, entry into new markets, capacity expansion, purchase of new equipment, the establishment of new production facilities, large-scale modernization, renovation, or capacity expansion investments.

When such funding needs are identified, negotiations with financial institutions should also focus on medium- and long-term funding sources.

Tactically, family businesses should consider whether, after optimizing working capital, they can raise more capital for investment in line with the good governance phenomenon. This is because finance providers will not pay enough attention to a firm with working capital problems.

In an environment where internal dynamics are optimized as much as possible, outsourcing is important for leverage. The type, maturity, and pricing terms of the external resource to be used are influenced by variables such as current market prices, expectations, the company's financial performance, and general creditworthiness.

Another action plan should include targeted communication plans to ensure that company management maintains close and good relationships with financial institutions during their daily activities, rather than on an emergency basis.

Developing healthy relationships with multiple organizations while they are still in the process of institutionalization will bring bargaining advantages and different funding opportunities when the need arises.

Properly identified financial needs will need to be articulated and defended to financial providers. This can only be achieved by companies that understand their position and are able to build healthy relationships.

In addition to borrowing, options for long-term financing should be monitored and, if necessary, managed, such as public offerings of shares on the stock exchange and financial and strategic cooperations with equity investors.

Company management should be open to opportunities such as mentoring, business coaching, consulting, training, etc. that will introduce them to alternative sources of funding and financing instruments and fill their knowledge gaps. In addition to obtaining financing, they should investigate and be close to mentoring, consulting, and business coaching grants, especially those provided as grants by universities, TÜBİTAK, and other national and international private and public projects.

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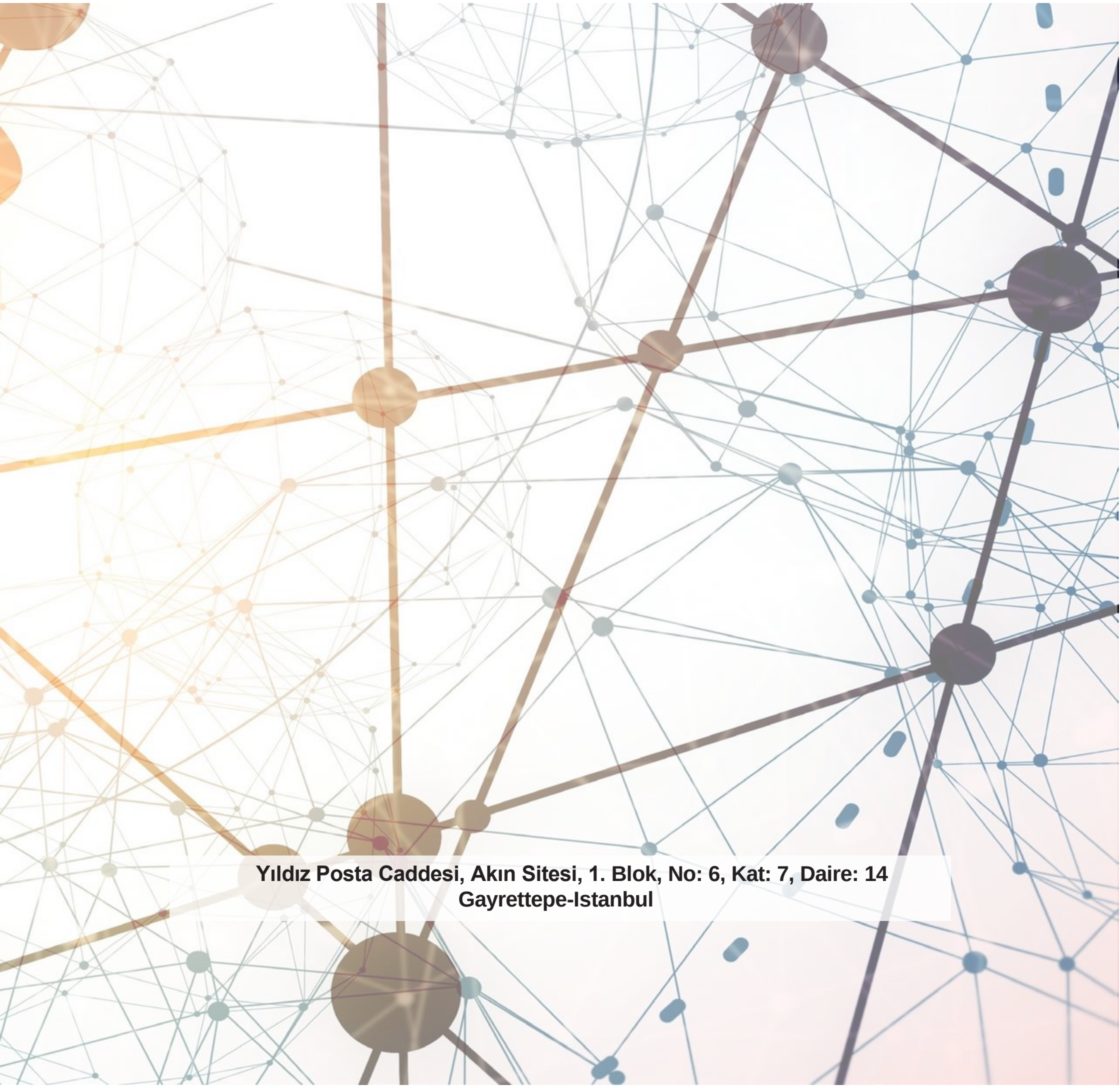

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