

Accounting, Finance, Sustainability, Governance & Fraud:
Theory and Application

Kıymet Tunca Çalüyurt *Editor*

History of Accounting, Management, Business and Economics, Volume I

Accounting, Finance, Sustainability, Governance & Fraud: Theory and Application

Series Editor

Kıymet Tunca Çalıyurt, İktisadi ve İdari Bilimler Fakültesi, Trakya University
Balkan Yerleşkesi, Edirne, Türkiye

This Scopus indexed series acts as a forum for book publications on current research arising from debates about key topics that have emerged from global economic crises during the past several years. The importance of governance and the will to deal with corruption, fraud, and bad practice, are themes featured in volumes published in the series. These topics are not only of concern to businesses and their investors, but also to governments and supranational organizations, such as the United Nations and the European Union. Accounting, Finance, Sustainability, Governance & Fraud: Theory and Application takes on a distinctive perspective to explore crucial issues that currently have little or no coverage. Thus the series integrates both theoretical developments and practical experiences to feature themes that are topical, or are deemed to become topical within a short time. The series welcomes interdisciplinary research covering the topics of accounting, auditing, governance, and fraud.

Kıymet Tunca Çalıyurt
Editor

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<https://4thtrakyaaccfinaud.trakya.edu.tr/>

Our congress was started with the support of Prof. Dr. Oktay Güvemli, whom we lost right after the congress. We remember him with respect. He has told me that we should go on to organize this congress series and especially publish on the first years of the Turkish Republic. I would like to share conference scientific programme to disclosure each presenter’s title, name and contribution.

1.BALKAN MUHASEBE VE YÖNETİM TARİHİ KONGRESİ
1ST BALKAN ACCOUNTING AND MANAGEMENT HISTORY
CONGRESS

Balkan Kongre Merkezi Trakya Üniversitesi

Balkan Congress Hall, Trakya University

20 KASIM 2019 – NOVEMBER 20th, 2019

10.00 – 11.00

AÇILIŞ PROGRAMI – OPENING CEREMONY

Prof.Dr.Kıymet Çaliyurt, CPA, CFE, TÜRMOB Eğitimcisi – İşletme Bölüm Başkanı (Head of Business Administration Department)

Haluk Kaba – Edirne Serbest Muhasebeci Mali Müşavirler Odası Bşk.Yrd. (Vice President – Edirne Chamber of Certified Public Accountants)

Özay Öztürk – Edirne Ticaret Borsası Başkanı (Head of Edirne Commodity Exchange)

Recep Zıpkıncı – Ticaret ve Sanayi Odası Yönetim Kurulu Başkanı (Head of Edirne Chamber of Commerce and Industry)

Prof.Dr. Ayhan Gençler – İktisadi ve İdari Bilimler Fakültesi Dekanı (Dean of Faculty of Business Sciences and Economics)

Prof.Dr.Erhan Tabakoğlu – Rektör Trakya Üniversitesi (Rector of Trakya University)

11.00 - 11.30 KONGRESAN FOTOĞRAFI (CONFERENCE PHOTO)

COFFEE BREAK (IKRAM ARASI)

11.30 – 12.15 KONGRESAN KONUŞMASI (KEYNOTE SPEECH)

Prof.Dr.Oktay Güvemli

Muhasebe ve Finansmans Tarih Araştırmaları Vakfı Başkanı

President of the History Research Foundation for Accounting and Finance

“19.Yüzyılın İlk Yarısında Muhasebe Düşüncesindeki Gelişmeler”

“Developments in Accounting Thought in the First Half of the 19th Century”

12.15 – 13.00 KONFERANS KONUŞMASI (KEYNOTE SPEECH)**Prof.Dr. Ahmet Vecdi Can****Dekan, İşletme Fakültesi, Sakarya Üniversitesi, Türkiye**

Dean, Business School, Sakarya University, Turkey

“Türkiye’de ve Dünya’da İşletme Programlarının AACSB Akreditasyon Tarihi ve Durum Değerlendirmesi”

“AACSB Accreditation History and Status Assessment of Business Administration Program in the World and Turkey”

13.00 - 13.45 ÖĞLEN YEMEĞİ (LUNCH)**13.45- 15.00****PANEL (20 KASIM 2019 - NOV 20, 2019)****"Maliye Okulu" nun Tarihi**

"The History of School of Fiscal Studies"

*Başkan - Chair***Mali Müşavir Oral Levender, CPA****(Em. Edirne Defterdarı, ret. Head Treasury in Edirne City)****PANELISTS:**

Bağımsız Denetçi SMMM Ahmet Kaya, Av. Mehmet Kaya, Prof Dr Ziyaettin Bildirici, Prof Dr Ahmet Ak , Dr Ahmet Kavak , Dr Yusuf Akça

<p>15.30 - 17.00 PANEL (20 KASIM 2019 - NOV 20, 2019)</p> <p>"Muhasebe ve Yönetim Tarihi" "History on Accounting and Management"</p> <p>Başkan – Chair Prof.Dr.Batuhan Güvemli, KGK Eğitimci, Trakya University</p> <p><i>Dr.Öğr.Üyesi Kemal Demir, Yönetim ve Organizasyon Ana Bilim Dalı, İşletme Bölümü, İktisadi ve İdari Bilimler Fakültesi, Yalova Üniversitesi</i></p> <p><i>Assist.Prof.Dr. Kemal Demir, Management and Organization Division, Department of Business Administration, Faculty of Business Sciences and Economics, Yalova University</i></p> <p>"Erken Cumhuriyet Dönemi İşletmecilik Uygulamaları: Türk Hava Yolları Örneği"</p> <p>"Managerial Applications in the Early Period of Turkish Republic: Turkish Airlines Case"</p> <p>←→</p> <p><i>Dr.Öğr.Üyesi Baki Çakır, İktisat Tarihi Ana Bilim Dalı, İktisat Bölümü, Kırklareli Üniversitesi, Turkey</i></p> <p><i>Assist.Prof.Dr. Baki Çakır, Division of Economy History, Economy Department, Kırklareli University Turkey</i></p> <p>"Mukaataların¹ Mültezimlerinin² Muhasebe Süreci"</p> <p>"Accounting process of rent income collection in Ottoman"</p> <p>←→</p> <p><i>Prof.Dr.Tzvetelina Andreeva, University of National World and Economy, Sofia, Bulgaria</i></p> <p>"Development of the life insurance sector in the Bulgarian economy"</p> <p>"Bulgaristan' da hayat sigortası sektörünün gelişimi"</p> <p><i>Snejana Basheva, Maria Markova, Kalina Kavaldzieva – University of National World and Economy</i></p> <p>"History of accounting in Bulgaria"</p> <p>Bulgaristan'da muhasebenin tarihi"</p> <p>←→</p> <p><i>Snejana Basheva, Atanaska Filipova-Slancheva, Liliyana Kamburova, UNWE, Sofia</i></p> <p>"Origin and Evolution of Audit Profession in Bulgaria"</p> <p>←→</p> <p>"Lavdosha Ahmetaj, Kamila Karaj, Alexander University Durrës, ALBANIA</p> <p>Economic crisis and state elasticityBulgaristan'da Muhasebe Tarihi" "History of accounting in Bulgaria"</p>

I also would like to thank Editorial Director William Achauer and Editor Anushangi Weerakoon for their support and help all the time. As congress and book series editorial board, we would like to meet with our readers at Volume 2.



Prof. Dr. Kıymet Tunca Çalıyurt
Book Series Editor

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Editor and Contributors

About the Editor

Prof. Dr. Kıymet Tunca Çalıyurt, CPA, CFE, graduated from the Faculty of Business Administration at Marmara University, Istanbul, Turkey. Her Master and Ph.D. degrees are from Accounting and Finance Programme from the Social Graduate School, Marmara University. She has worked as an auditor in Horwath Auditing Company, a manager in McDonalds and a finance staff in Singapore Airlines. After vast experience in the private sector, she has started to work in academia. She is holding CFE and CPE titles. Her research interests are in accounting, auditing, fraud, social responsibility, corporate governance, finance and business ethics, environmental sustainability with a particular interest in aviation management, NGOs, women rights in business. She was a visiting researcher in John Molson School of Business in 2001 summer (International Centre for Aviation Management), Massachusetts University Amherst Business School in 2014 summer, 2018 summer (Accounting and Information System) and University of National World and Economy in 2019 summer (Faculty of Accounting). She is the founder of the International Group on Governance, Fraud, Ethics and Social Responsibility (IGonGFE&SR) and International Women and Business Group (IWBG) in 2009; both groups organize international annual conferences and published international book series. She is the book series editor in Springer which is indexed in Scopus, with the title *Accounting, Finance, Sustainability, Governance and Fraud: Theory and Application* and the book series editor in Routledge with the title *Women and Sustainable Business*. She is the founding chief-in-editor for the *Accounting Finance Auditing: An International Journal*. She is a regular speaker in Cambridge Economic Crime Symposium and a workshop organizer on the role of external auditor in fraud prevention. Some published books by Prof Çalıyurt are *Emerging Fraud* (with Sam Idowu), *Corporate Governance: An International Perspective* (with Sam Idowu), *Women and Sustainability in Business: A Global Perspective, Sustainability and Management: An International Perspective* (with Ulku Yuksel), *Regulations and Applications of Ethics in Business Practice* (with Dr. Jiang Bian), *Ethics and*

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Part I

Introduction

Chapter 1

Introduction: In Memory of Prof. Dr. Oktay Guvemli



Kıymet Tunca Çalıyurt

Abstract What is the importance of knowing the history of economics, accounting, management, audit, tax, and finance? What good is it for us to spend time on the past instead of studying the future and predicting the future? If you work as an academic or a practitioner in the fields I mentioned above, you have asked yourself these questions. The answer to this is many, but most importantly, if you want to analyze the decisions taken in different countries in the business world in these areas, it is useful to have historical knowledge on this subject. In the decisions taken by countries in different situations, genetic codes will come into play and will carry traces of the past. New generations will want to take new steps in their business decisions taken in the past. They will brag about the decisions their ancestors made, or they will discuss the problems they experienced because of their ancestors' decisions. They will try to correct the wrong decisions made in the past. Some countries, on the other hand, as they examine their history, realize that their ancestors made much more advanced discoveries long before the practices in the world. This is the best benefit of knowing history. My professor Prof. Oktay Guvemli at Business School in Marmara University has taught us accounting history and later we had found an opportunity to organize the 12th World Congress of Accounting History in Istanbul under his presidency. Many years later, he asked me to organize Accounting and Management History Conferences. I am very lucky that I had an opportunity to organize the *1st Balkan Accounting and Management History Congress* under his supervision: Other organizers were Mount Allison University (Canada), University of National World and Economy (UNWE), International Hellenic University (Greece), Public Oversight Accounting and Auditing Standards Authority at Turkey, and Chamber of Sworn-in Certified Public Accountants of Istanbul on November 20–22, 2019, at Balkan Congress Center in Trakya University Edirne Türkiye. In this chapter, as a starting of the history sub-series, I would introduce Prof. Oktay Guvemli, President of the 12th World Congress of Accounting Historians in Istanbul, 2008 and Founder of the Association of Accounting and Finance Academicians of Turkey (MUFAD).

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Keywords Business history · Accounting history · Economic history · Financial history · Taxation · History · Auditing history · Management history

1.1 Brief Biography of Prof. Dr. Oktay Güvemli (Tax Sworn-In Accountant)

Oktay Güvemli was born in a town (Fatsa—the district of Ordu, Turkey) on the coast of the Eastern Black Sea. He completed his undergraduate education at the Academy of Economics and Commercial Sciences, in Ankara, in 1960. He finished his master's degree at Istanbul University, in 1961. Between 1963 and 1973, he worked as Analyst Financier at the Industrial Investment and Credit Bank (Sınai Yatırım ve Kredi Bankası). He began his academic life at Marmara University in 1973. He became Associate Professor in 1974 and Professor in 1980. Prof. Güvemli has been continuing his academic life along with a CPA career in the private sector (Fig. 1.1).

He received education in Belgium and France in 1967 during the development stage of the European Economic Community. He worked as an intern at the European Investment Bank. His first international accounting activity was the World Accountants Congress of Paris in 1967. He established the Association of Accounting and Finance Academicians of Turkey (MUFAD) in the 1990s and acted as its Chairman for years. This association organized the 12th World Congress of Accounting Historians in Istanbul in 2008.

Fig. 1.1 Prof. Dr. Oktay Güvemli



This association also organized conference series titled *Balkans and Middle Eastern Countries Accounting and Accounting History Conferences* in 2007, 2010, and 2013, in Edirne and Istanbul.

During his academic life between 1973 and 1990, he gave lectures and wrote books about financial statements analysis, preparation, and evaluation of investment projects and corporate planning.

He pursued an interest in accounting history around the 1990s. In 1994, he translated and published Pacioli's *Summa* in Turkish. Afterward, he completed his four-series work titled *Accounting History of Turkish States* within six years. He participated at the 8th World Congress of Accounting Historians (WCAH) in Madrid in 2000. He organized a Turkish delegation to attend the 2004 (St. Louis) and 2006 (Nantes) Congresses papers. He was Convener of the 2008 Istanbul Congress, where 55 different countries participated and 240 papers were submitted. Once again, he organized a Turkish delegation to participate at the 13th WCAH in Newcastle, 2012, with 19 papers.

Oktay Güvemli aimed to establish relations with the academicians of the Balkans and Middle Eastern countries between the years 2000 and 2013 to increase accounting history activities. He visited Egypt, Iran, Greece, Macedonia, Romania, and Albania many times to exhibit the five thousand years of recording culture of the Middle East. He wrote books about this subject along with fellow academicians and participated in international conferences. He also published the Conference Proceedings of the mentioned activities in 2007, 2008, 2010, and 2013.

He focused his research on the Islamic Era (622–1850) and the westernization era (1850–2011) of Middle Eastern recording culture. Recently, he published a book regarding this subject along with Prof. Cengiz Toraman and Prof. Batuhan Güvemli, titled *State Accounting in the Ottoman Empire—Anatolian Accounting Culture* in 2015. In 2019, he contributed to the publication of a three-volume encyclopedia titled *History of Middle East Accounting (3000 BC–2000 AD)* along with fifteen academicians.

Prof. Güvemli was Editor of the *Accounting and Financial History Research Journal*, which is published semi-annually in Turkey. He assisted in the preparation of a monthly program about accounting history on a local TV channel. He was also Chairman of the board of trustees at the Oktay Güvemli WAQF of Accounting and Financial History (MUFTAV). This WAQF serves the accounting history community with one of the biggest accounting libraries in the Balkans and Middle East. The library is located in Istanbul with its fifteen thousand (in ten languages) accounting, finance, and accounting-financial history books. Prof. Güvemli was married and had three children and six grandchildren.

1.2 Establishment Purposes of the Oktay Güvemli Accounting and Finance History Foundation

The foundation aims to develop and expand the science of accounting and financial history in Turkey, the Balkans, and Middle East countries. In line with this purpose, the foundation will organize educational programs and encourage and support undergraduate and graduate academic studies on the subject (Fig. 1.2).

The foundation has established a specialized library in İstanbul-Şişli. As of 2020, there are over seventeen thousand books in the library. The library is a platform for Middle Eastern accounting history research, which was born in 1994 during the celebration of the 500th anniversary of Pacioli's Summa.

Since 2011, the foundation publishes Accounting and Financial History Research. The journal aims to introduce Turkish accounting, finance, and business culture to the world.

The foundation also organizes international accounting history congresses and conferences. These studies are an adventure of Middle Eastern recording culture and Middle Eastern accounting history research.

Prof. Carnegie (2020) gave details about the journal founded by Prof. Güvemli as “The Turkish journal, Muhasebe ve Finans Tarihi Araştırmaları Dergisi, or the Journal of Accounting and Finance History Research, published in the Turkish and English languages, has been published since 2011, with 19 issues produced to the time of writing. This journal was not specifically identified by its name by Matthews (2019). Toraman (2020) advised that of the articles published in these issues, 74% are published in the Turkish language and 26% in English. Accounting history articles dominate the focus of this journal, with 86% of articles published in this field, with the remainder on financial history (5%) and business history (9%) 0.8. In China, the journal Research in Accounting History (RIAH) was first published in 2017 and features articles in the Chinese and English languages 0.9. This newly launched journal is sponsored by the International Center for Accounting History Research, China Accounting Museum, Shanghai Lixin University of Accounting and Finance. Three of the four articles in the inaugural issue are in English, including Previts et al. (2017)”.

Fig. 1.2 Logo of MUFTAV



1.3 Why Accounting History?

Accounting history measures accounting's success in the past; the investigation of how successfully accounting has done its job in the past as a service sector is the subject of accounting history. From this point of view, the emergence of changing recording needs makes the stories important.

Past 180 years (1839–2019), Turkey has experienced changes in accounting thought twice. The first change occurred during the post-Tanzimat Westernization movements. During this change, the Ottoman Empire's staircase (merdiban) method had to leave its place for the double-entry accounting method. The second change took place after the Proclamation of the Republic. In this process of change, the double-entry accounting method has preserved its existence by complying with the conditions of the time. Still, the accounting idea separated from the Commercial Law, which it developed until then, and entered taxation control. The Turkish Commercial Code, published in 2011 within the framework of the change brought about by the globalization phenomenon of the economy, is a search for innovation in this regard.

Accounting history is a new science. Ancient recording cultures around the world await investigation by accounting historians. What makes this important is that the future of accounting has to be explored in the past (MUVTAF 2022).

As an International Group on Governance Fraud and ESG, we plan to organize *2nd International Balkan Accounting and Management Congress* in November 2023 in Istanbul.

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Part II

History of Accounting

Chapter 2

The Development of Agriculture Zakat Accounting



Mohd Hairul Azrin Besar and Khairul Hidayatullah Basir

Abstract Zakat (almsgiving) is one of the pillars in Islam and also payable on agricultural produce and livestock. Agriculture zakat is imposed on individuals and agribusinesses in which both agricultural produce and livestock have reached the minimum assessable quantity (*nisab*) and without the need to fulfill the required period (*hawl*), respectively. As there is an increasing trend in agribusiness, thus, the importance of zakat accounting should be revisited especially how it is being used—not only to the business performance but meeting religious obligation. Therefore, the objective of this chapter is to trace the development of zakat accounting and its application especially in agribusinesses. The chapter will use available literature, reports and secondary sources. The chapter will start with the tradition of agriculture zakat, the rationale why accounting is needed in agriculture, and the historical development and evolution of agriculture zakat accounting, and finally how the current practice of agriculture zakat accounting meets the business performance and religious obligation.

Keywords Agriculture zakat • Zakat accounting • Agribusiness zakat

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2.1 Introduction

Agriculture is one of the important economic sectors for developing countries as it employs most of global population, and the main source of food and income for people who live in poverty. Venturing into agriculture, for instance through agricultural business (herein agribusiness), is one of the most effective strategies to improve food security which is essential to many countries' economic development. Furthermore, agriculture has been an important source of food production for mankind since ancient times and therefore, should not be neglected.

Participating in agriculture and venturing into business are highly encouraged in Islam. There are many verses from the Qur'an and traditions of the Prophet Muhammad that emphasized on the importance of agriculture and business. Agriculture as professions or earnings through agriculture is an honorable endeavor from Islamic perspectives. This is due to muslims who are involved in food production is not only looking after himself, but also the rest of the community. From Islamic economics point of view, production function is regulated by the concept of livelihood (*al-Rizq*) as well as lawful (*halal*) and unlawful (*haram*) sources of earnings (Borhan and Ab. Aziz 2009). In addition, agriculture in Islam is viewed in Islam as an obligation of the muslim society (*fard al-Kifayah*) in ensuring food security and this is seen as a very important job that will give revenues and sources of income (Borhan and Ab. Aziz 2009).

Muslims are obligated to pay zakat once they achieve the minimum assessable quantity (*nisab*) and this includes businesses. Zakat calculation depends on the source of income with certain percentage is being deducted. The obligation of paying zakat not only as to share the wealth between the rich and the poor, it is also a form of religious obligation (*ibadah*) and purify one's wealth. For the purpose of this study, this chapter focuses on zakat business on agricultural produce and livestock. Due to its economics potential and increasing trend of venturing into agribusiness, it is important to look at how zakat accounting is being formally used. Furthermore, as zakat payment is based on religious obligation, it is very important that the calculation is done correctly and transparent through a proper financial record. The importance of financial records in business management is mentioned in the Qur'an. Therefore, this chapter studies the importance of zakat accounting especially how it is being used—not only to the business performance, but meeting religious obligation. It also traces the development of zakat accounting and its application, especially in agribusinesses. This chapter is qualitative in nature and uses document research as the main source of analysing related papers, journal articles and other published sources and Islamic primary resources, such as the Qur'an and Hadith.

This chapter is organized as follows. Following the introduction, Sect. 2.2 will explain about zakat. Section 2.3 highlights the importance of zakat accounting while Sect. 2.4 how traditionally zakat is calculated and used until now. Section 2.5 presents the issues of formulating Zakat accounting on agriculture and livestock and Sect. 2.6 suggests recommendations for future studies. Finally, some conclusions are drawn.

2.2 Understanding Zakat

Zakat means to purify. Zakat is a compulsory charity of 2.5% for every muslim’s total wealth who is financially stable and once they reach the *nisab*, the amount is to be handed to the respective recipients of zakat (*asnaf*). In Islam, it is the third pillar of Islam and one of the highest forms of worship (*ibadah*) as stated in the Qur’an and hadith. Furthermore, Al-Qardawi (1999) highlighted that the word zakat is repeated 30 times in the Qur’an and how it is related to ibadah, in conjunction with the command of salah, is mentioned 27 times. Hoque (2022, p. 1) explained that “Zakah is based on the philosophy that concentration of resources/wealth of the society in the hands of few is a negation to social well-being with equity and social justice”. It is based on the Qur’anic verse.

In the Qur’an, Allah says:
In the wealth of the rich there is a share of the poor. (Adh-Dhariyat 51:19)

The main purpose of zakat is to transfer a portion of wealth from the rich to the poor to maintain socio-economic stability and enhance the well-being of the underprivileged through poverty alleviation (Hoque 2022; Hoque et al. 2015; Kasri 2016). Business zakat can play a significant role in reducing poverty among muslim entrepreneurs, as the funds can be utilized to finance various social programs and projects aimed at uplifting the underprivileged (Hoque 2022). Thus, to bridge the gap between the rich and the poor.

There are different types of zakatable items as summarized in Fig. 2.1. Mainly, zakat is categorized into two, wealth (*al-maal*) and individual (*al-fitr*). Zakat on business, agriculture and livestock are categorized under wealth.

The concept of business zakat is relatively new, let alone agribusiness zakat. MASB (2006, p. 12) defined business zakat as an “obligatory contribution assessed based on business assets owned by an entity that satisfy certain conditions and is to be distributed to specified categories of beneficiaries.” Hoque (2022) explains that zakatable amount for muslim entrepreneurs is on the net worth of the business for spending for the well-being of the underprivileged. It is assessable and payable on the net current assets of a business, irrespective of whether profit has been earned or unearned.

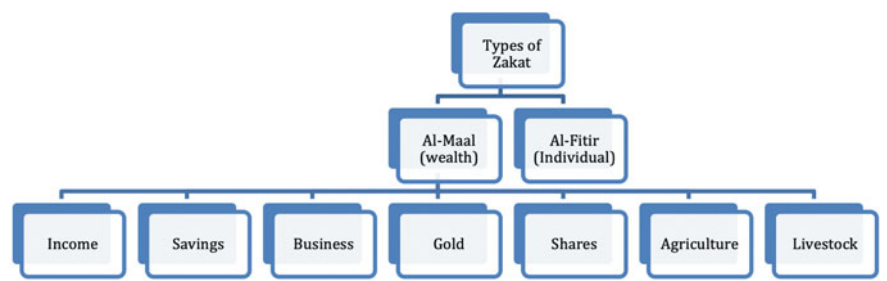


Fig. 2.1 Zakatable items. Source Migdad (2019)

2.3 The Importance of Zakat Accounting

Islamic accounting has been discussed and examined by scholars in the area (Ahmed et al. 1994; Kamla et al. 2006; Napier 2009; Napier and Haniffa 2011; Alam 2022). A reference to the Qur'an embedded in the longest verse provides the instruction and guide for the recording of transaction Al Baqarah—282;

O you who have believed, when you contract a debt for a specified term, write it down. And let a scribe write [it] between you in justice. Let no scribe refuse to write as Allah has taught him. So let him write and let the one who has the obligation dictate. And let him fear Allah, his Lord, and not leave anything out of it. But if the one who has the obligation is of limited understanding or weak or unable to dictate himself, then let his guardian dictate in justice. And bring to witness two witnesses from among your men. And if there are not two men [available], then a man and two women from those whom you accept as witnesses - so that if one of the women errs, then the other can remind her. And let not the witnesses refuse when they are called upon. And do not be [too] weary to write it, whether it is small or large, for its [specified] term. That is more just in the sight of Allah and stronger as evidence and more likely to prevent doubt between you, except when it is an immediate transaction which you conduct among yourselves. For [then] there is no blame upon you if you do not write it. And take witnesses when you conclude a contract. Let no scribe be harmed or any witness. For if you do so, indeed, it is [grave] disobedience in you. And fear Allah. And Allah teaches you. And Allah is Knowing of all things.

(Al-Baqarah 2:282)

The verse clearly notes that when an event creating obligation between two parties occur, resulting debt, the transaction should be recorded in writing to preserve justice in accordance with the understanding and knowledge of the scribe (accountant). It also justifies the practice to ensure that evidence is available to reflect the obligation of parties and be used if necessary, when there is dispute on the transaction. Contrary to the view that Islamic accounting should be based on cash accounting, the verse indicates that transaction which results in obligation such as debt is to be recorded, denoting accrual accounting is acceptable. From the zakat perspective, recording the obligation and the wealth of a person or an entity would assist in coming up with the amount of zakat payable (Ahmed et al. 2016).

Safeguarding the quality of accounting information, it is expected the recorded evidence must have certain characteristics fulfilling the intended need of the users. Among the characteristics proposed (Napier and Haniffa 2011) are conformity of the economic event with *Shari'ah*, relevance of the information recorded, understandability, materiality, reliability and faithful representation. In order for the event to be worthy of recording, the main condition is that the activity must comply with the requirement of *Shari'ah*. If the event involves prohibited activities like usury (*riba*), although it may have a monetary value, according to *Shari'ah*, it holds no actual value and therefore should not be recorded in the accounts. Similarly, should the items, are not acquired through proper mean, such as stolen goods, it would not be recorded as assets or accumulated wealth of the entity as it does not have any value. Hence, from the *Shari'ah* perspective, the assets accumulated from stealing is not recognized as wealth subject to zakat.

The information recorded must also be relevant to the respective transaction undertaken by both parties to guarantee the rights of parties to the contract are properly detailed. The relevancy of the information will make it clear to all parties of the contract their expected obligations and rights. In determining the amount of zakat, only relevant information is needed to come to a just amount (Napier and Haniffa 2011). Understandability of the information recorded contributes to easy reference for all parties to the contract, where the report is clear as evidence to the obligations created. Similarly, in coming up with the zakat amount all parties can easily understand how the amount is calculated as the recorded information is understood by all parties. Hence, this also reduces the chances that either party has different expectation from the contract agreed.

Materiality on the other hand denotes, not only to the weight or value carried by the quantitative measures assigned to the transaction, but also all information which can influence the decision of the users. A good example is in the disclosure of assets in transit and risk faced by the entity. Disclosing this information can change the decision of the users. In zakat, disclosing the purpose and uses of the assets may render the asset to be included or excluded from the calculation or even will be charged at a different percentage. In agriculture zakat as an example (Mohd Shukri bin Hanapi 2014), crops consumed by the farmers are excluded from zakat and should the crop be planted with proper irrigation build by the farmers, it will be charged a lower amount.

Reliability relates to the truthfulness of the information recorded. In determining zakat amount, it is important for the record to show the true wealth of the individual so as the amount due can be accurately determined. If information regarding the asset or wealth is concealed and inaccessible, it becomes challenging to ensure justice. For instance, this lack of transparency could result in a lower amount being paid than the actual due, thereby adversely affecting the rights of the recipient. On the other hand, if the hidden information caused the amount due to be more than the actual, it will be unjust to the individual, as he in fact may not be charged zakat.

Lastly faithful representation denotes the quality of information which are rid of any errors or misstatements. The recorded information must be handled diligently, employing effective control mechanisms to ensure that the accountant has taken all necessary precautions to prevent any possibility or opportunity for errors. Similar to the above such will preserve justice for both zakat payers and recipient deriving the correct amount to be collected. This includes proper valuation of the assets or wealth subject to zakat (Ahmed et al. 2016).

Akhyar Adnan and Barizah Abu Bakar (2009) explained that the discourse on zakat and zakat accounting is not limited to religious studies but also on issues of social economics such as tackling poverty. The development of the Islamic banking and finance industry has warranted the formalization of zakat calculation and report for the industry (Akhyar Adnan and Barizah Abu Bakar 2009; Kamla 2009; Alamad 2019) as issued by The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI). This is the first formalized and standardized zakat calculation and accounting disclosure required for Islamic entities. However, this is only focused and meant for the Islamic finance industry and not for other Islamic institutions or

corporations. The rest of the corporation however follows business zakat calculation and has been practiced in their respective jurisdiction based on the accounting practices guided by the zakat authorities, respectively. Acknowledging that there are no formalized accounting practices or standard for agricultural zakat accounting comprising of both livestock and agricultural produce, the study aims to explore the historical development in the area and provide more insight for the future.

Small and Medium Enterprises (SMEs) are important and has significant roles in developing countries. According to the World Bank (n.d.), SMEs represent about 90% of businesses and more than 50% of employment worldwide and formal SMEs contribute up to 40% of national income (GDP) in emerging economies. Studies have shown that many small businesses do not keep complete records of accounts due to lack of knowledge in accounting and the cost of engaging professional accountants (Mbroh and Attom 2012). This is a very important issue to tackle as it will lead to the problem of business zakat calculation and payment. This is further supported by Mohamad Ibrahim et al. (2016) that incomplete financial records will affect business activities because business law required a complete financial record for the purposes of the audit, bank loans, calculation of corporate tax as well as affecting calculation of business zakat. The reason for this is explained by Abd Moen et al. (2012), financial management and accounting records are practiced informally by small businesses. Sibanda and Manda (2016) reveal that the biggest indicator of failure in small businesses is a lack of cash flow management and leads them to fall behind on payments to its creditors. Therefore, by having a proper and systematic financial record, it will allow the small businesses to flourish and ease the process of business zakat payment. However, it is important to note that financial records for zakat accounting treatment is different from the conventional accounting.

2.3.1 Traditional Zakat Accounting

While the field of zakat is wide, there is still lack of coverage of the importance of zakat accounting particularly to agribusiness, and most of the literatures highlighted the importance of paying zakat on agricultural products for muslims while they are actively participated in agricultural sector.

2.3.2 The Need of Information for Accounting

Revisiting the importance of accounting in Islam it is pertinent to acknowledge the need of information generated from the accounting field to be used by the government and public as stakeholders in ensuring the fair distribution of economic resources in the society and country (Napier and Haniffa 2011). In order to effectively implement the obligatory zakat in the country, the zakat collectors need to ensure that the respective wealth has been accumulated to a certain nisab (level) which warrants the owner

to pay zakat. Without proper accounting information, this will not be possible as zakat itself has some parameters which needs to be satisfied before it can be levied. Hence zakat accounting warrants the provision of relevant information for the assessment of zakat ensuring the respective zakatable assets are properly valued, determining that all conditions are met (Hamat 2014). In his paper, Hamat (2014) also promote the idea that zakat accounting should not only be a static record of historical financial information, but must also incorporate a sustainable aspect reflecting the current environment, societal needs and local context, and such information must always be reviewed timely to reflect the latest situation.

This paved way for innovation in zakat accounting for agriculture and livestock as the previous classical views can be further developed considering the nature of assets at this time, the zakat rate and also exemption of expenses. Such practice is not foreign as it has been developed even during the period of Khulafa Rashidin (Hamat 2014), where Khalifah Umar had levied zakat on horses (for livestock) and also zakat on peanuts, olives and cotton (for agriculture). This further shows the evolvement and development of zakat accounting even during the reign of the Khulafa Rashidin.

2.3.3 Zakat on Agriculture

The obligation on zakat for agriculture is quoted from the Qur'anic verse as follows:

O believers! Donate from the best of what you have earned and of what We have produced for you from the earth. Do not pick out worthless things for donation, which you yourselves would only accept with closed eyes. And know that Allah is Self-Sufficient, Praiseworthy.

(Al Baqarah 2:67)

The verse highlights the donation (Zakat) from the produce of Earth (agriculture) bestowed upon the people. In interpreting this verse, four main views are derived in identifying the respective produce which will be subject to zakat. The first view focuses on four main produce, namely wheat, barley, date and raisin which has been mentioned in the Hadith of the Prophet. Ibn Majah and al Daraqutni report from Amr bin Shu'aib from his father and from his grandfather that "The Messenger of God (p) only enacted zakat on wheat, barley, date, and raisin." Ibn Majah's version adds "corn."

The second view champion by Maliki and Shafie school of thoughts consider produce that are edible and can be preserved. Hence, this opens up more produce which falls into this category as it includes major staple food items such as wheat, barley, corn, grains and also rice. The third view states that nonperishable produce which can be preserved and measured will be subjected to zakat. Scholars with this view incorporate produce such as grain, cotton, sesame, selected fruits and vegetables as produce subject to zakat as long as they fit the criteria of being nonperishable and can be preserved. The last view stems from the Hanafi school of thoughts derived the literal connotation of the verse where they consider any produce stemming from the

Earth are subjected to zakat as long as it is cultivated with the purpose of producing profit.

The summary of these classification derived by the scholars can be summarized as follows (Table 2.1).

The *nisab* of the produce for it to be levied zakat is at 5 wasq (weight measuring units used during the time of the Prophet). This has been contemporary converted by scholars being equivalent to 825 L or 652.8 kg (Qaraḍāwī 2011).

There is also a question of the passage of time (*hawl*) if this will also be applicable in accessing the zakat for agriculture. Majority of the scholars agreed that the essence of time does not apply to agriculture zakat, as it is levied upon each harvest rather than the passing of time.

The applicable rate of zakat charged on the produce is stated at 10% if the crops are naturally cultivated and watered through rain or steams. However, if the crops and cultivated and watered by irrigation made by the farmers, the zakat is charged at 5%.

There are discussions on the issues of whether the zakat is levied without deducting the cost of farming such as rental of land, seedling, fertilizers and harvesting. The majority opines that these costs should be deducted before zakat is levied. This however is given to the respective localities and tradition to decide on as there might be differences in tradition and customs, which can affect the view whether costs should be excluded or included.

2.3.4 Zakat on Livestock

Zakat for livestock from the classical text is focused on camels, cows and sheep. Guidance is given on the rate of zakat to be given and the respective zakatable level (*nisab*) for each of the animals' categories. There are some disputes on *nisab*, but this will not be subject for lengthy discussion in this paper. The section will detail the respective zakat assessment and importantly on the criteria of animals to be given as zakat.

In accessing livestock zakat, it is also important to ensure that all these livestock satisfy several conditions (Qaraḍāwī 2011). Firstly, the condition of *nisab* in which the minimum number for zakat to be due from livestock is set. There are no disputes on *nisab* for camels which is set at 5 camels and sheep which is set at 40 sheep. However, there are differences of opinion between school thoughts for the *nisab* of cow, ranging from a minimum of 5 or 32 or 50 (Qaraḍāwī 2011). Secondly, the livestock have passed the defined period (*hawl*) of one year. The defined period will be the measurement of time that a year has lapsed from the previous zakat assessment and should there be any growth since, will be subject to zakat.

The third condition states that the livestock are pastured naturally and are meant for breeding and weight gaining. Their main purpose is for reproduction, milking and growth. This brings to the fourth condition that the livestock, must not be used for other service provision such as riding, agriculture activities such as cultivating

Table 2.1 Views from Islamic Scholars (Fuqaha')

No.	Essence of views	Fuqaha'					
		Madhab Abu Hanifah	Abu Yusuf bin Muhammad	Hassan Basri, Thawri & Sya'bi	Madhab Malik bin Anas	Madhab al-Syafi'iy	Madhub Ahmad bin Hanbal
1	Types of crops with clear and explicit text			✓			
2	Every crop that grows on earth/ planted with the purpose of taking the produces of the earth	✓	✓				✓
3	Durable and lasts long when kept		✓		✓	✓	
4	Dried fruits				✓		
5	Filling					✓	✓
6	Staple/basic food					✓	
7	Regardless whether staple food or otherwise	✓					✓

Source Mohd Shukri bin Hanapi (2014)

land or harvest and transporting loads. Basically if the livestock are used for other than breeding and growth, they will be excluded in the assessment of zakat.

2.3.5 *Zakat on Camels*

Camels was specifically mentioned in the Hadith of the Prophet for livestock zakat as quoted in the following.

Anas narrated that Abu Bakr, the truthful wrote this message when he was sent:

In the name of God, most merciful, most gracious. This is the obligation of *sadaqah* imposed on Muslims by the Messenger of God (P), as ordained to him by God. Whoever is asked to pay it according to these rules must give it, and whoever is asked to pay more should refuse. On each 24 camels or less, zakat is due in sheep. On each five camels, one sheep is required. Once they reach 25 and up to 35 one female camel, one to two years old, is required. From 36 to 45, there is one she-camel two to three years old. If they reach 46 to 60, there is one she-camel three to four years old due, one that can be bred. If they reach 61 to 75, one she-camel four to five years old is due. If they reach 76 to 90, there is two she-camels two to three years old due. If they reach 91 to 120, there are two she-camels, three to four years old due. If they are more than 120, for each 40 there is one she-camel two to three years old, and for each 50 there is one she-camel three to four years old. A person who owns [up to] four camels is not zakatable unless he volunteers, but if they reach five camels, one sheep is due on them as zakat.

This can be summarized as follows (Table 2.2).

2.3.6 *Zakat on Cows*

Similarly, as camels, cows are also specifically mentioned in the hadith of the Prophet as one of the livestock to be levied zakat.

Bukhari, in his Sahih collection, reports from Abu Dharr “I came to the Prophet and he said ‘I swear by He who holds my soul in His hand,’ or ‘I swear by the one beside whom there is no God’. No man who has camels, cows or sheep and does not pay their right due but on the Day of Judgement will be trampled by them at their largest and heaviest. They will be stepping on him with their hooves and ramming him with their horns, and when the last one is done with him the first is brought back until judgement has been given to all people.” However there are conflicting views on the assessment of zakat for cows. It is stated that the *nisab* should stand at 50 before zakat is due. However, it is also argued that cow although is smaller than camel is actually bigger and more valuable than sheep. Sheep on the other hand has fixed *nisab* at 40. Hence, should the stand that *nisab* is fixed at 50 for cows, it will not be equitable. This is however understandable as during the time of the Prophet it is mentioned that cows were only present in Yemen, hence there is no clear numbers provided on the *nisab*. Following the analysis by (Qaraḍāwī 2011), it is agreeable that if we were to follow the discussion of previous scholars, perhaps it is agreeable

Table 2.2 Nisab on camels

No. of camels		Zakat due
From	To	
5	9	1 sheep
10	14	2 sheep
15	19	3 sheep
20	24	4 sheep
25	35	1 female camel between 1 and 2 years old
36	44	1 female camel between 2 and 3 years old
45	60	1 female camel between 3 and 4 years old
61	75	1 female camel between 4 and 5 years old
76	90	2 female camels between 2 and 3 years old
91	120	2 female camels between 3 and 4 years old
121	129	3 female camels, 2–3 years old
130	139	1 female camel, 3–4 years old and 1 female camel, 2–3 years old
140	149	2 female camels, 3–4 years old and 1 female camel, 2–3 years old
150	159	3 female camels, 3–4 years old
160	169	4 female camels, 2–3 years old
170	179	1 female camel, 3–4 years old and 3 female camels, 2–3 years old
180	189	2 female camels, 3–4 years old and 2 female camels, 2–3 years old
190	199	3 female camels, 3–4 years old and 1 female camel, 2–3 years old
200	209	4 female camels, 3–4 years old or 5 female camels, 2–3 years old

Source Qaraḍāwī (2011)

in the first stand that such silence in the *nisab* gives room for each localities to decide on the amount taking into consideration local context and threading carefully with the guidance provided for zakat of camels and sheep. It is also agreed that the anonymously agreed *nisab* for cows stand at 30, hence no zakat should be charged for those below.

Reflecting on the above, the suggestion stands that *nisab* for cows can follow the minimum of 5 and be collected in the form of sheep similar to that of camels. For above 30 then every ten will be charged one cow.

Referencing to the *nisab* at 30th, following is derived (Table 2.3).

2.3.7 Zakat on Sheep

The zakat for sheep follows the description which has been provided to Anas from Abu Bakar when he was sent. The following provides guidance for the zakat of sheep:

Table 2.3 Nisab on cows

No of cows		Zakat due
From	To	
30	39	1 cow, one-year old
40	59	1 cow, two-years-old
60	69	2 cows, one-year-old
70	79	1 cow, one-year-old and 1 cow, two-years-old
80	89	2 cows, two-years-old
90	99	3 cows, one-year-old
100	109	1 cow, two-years-old and 2 cows, one-year-old
110	119	2 cows, two-years-old and 1 cow, one-year-old
120		3 cows, two-years-old or 4 cows, one-year-old

Source Qaraḍāwī (2011)

In the name of God, most merciful, most gracious. This is the obligation of sadaqah imposed on Muslims by the Messenger of God (P), as ordained to him by God. Whoever is asked to pay it according to these rules must give it, and whoever is asked to pay more should refuse..... In the sadaqah on sheep, if they are naturally, cost-free pastured, and number between 40 and 120 sheep, there is one sheep due. For more than 120 and up to 200, there are two sheep. For more than 200 up to 300 there are three sheep. For more than 300, the amount of zakat is one sheep for each 100 or a fraction therein. If a person owns less than 40 naturally cost-free pastured sheep, there is no sadaqah unless the person wishes to volunteer...

This can be summarized as follows (Table 2.4).

The above zakat accounting for livestock is based on the classical reference and since then, this has been further developed with inclusion of other animals, as example horses during the leadership of Umar Al Khatab.

It is interesting to observe, in addition to the conditions levied on the livestock in accessing zakat, there also exists the condition for the animal given as zakat (Al-Qardawi 1969). The first condition is to ensure that the animals chosen to be given as zakat must be free from any defects, may be its illness, bone fracture, old age and

Table 2.4 Nisab for sheep

No of sheep		Zakat due
From	To	
1	39	Nothing
40	120	1 sheep
121	200	2 sheep
201	300	3 sheep
301	400	4 sheep
401	500	5 sheep

Source Qaraḍāwī (2011)

flaws either from birth or from any accidents. This ensure the animal chosen is well and in the best of health to be given to the recipient of zakat. The second condition is that the animal selected for zakat must comply with the gender requirement as stated especially for camels. For cows and sheep, scholars have different views on this, though the preference is still giving out female as it will be beneficial for the recipients. Scholars who are indifferent on the gender for cows and sheep opined that it is more on the market value rather than the gender.

The third condition centers on the age of the animal to be surrendered as zakat. It is agreed that the age as specified classically should be followed as this is beneficial for the payers and recipient of zakat. It is understandable that if the animal is too young chances of survival may be lower, where else if it is older, it may already be in the breeding phase. The final condition is on the quality of the animal to be given as zakat. It has been guided that the animal should be of average quality among the herd. Taking the best from the herd may cause losses to the payer and may affect the future growth of the livestock.

The first information in accessing livestock zakat is more quantitative in nature, which referring to the accounting filed is easily available through the records of outstanding stock of the owner, which can be further verified by a physical stock count. However, the second requirement on the age, health, gender and quality of the livestock is more qualitative and needs to be properly maintained. The current recording system especially those accounted in the records may not have this information. Hence, this will provide a challenge for the payer and collector to access the animals given for zakat in the absence of such information. This brings in the importance of capturing qualitative information through zakat accounting for accessing zakat and evaluating the respective zakatable assets.

2.4 Issues Zakat Accounting on Agriculture and Livestock

Perusing through the requirement for accessing, evaluating and computing the zakat due, it is pertinent that zakat accounting information can cater for these needs. Zakat accounting for agriculture and livestock especially have not been in the limelight when compared with zakat for businesses, savings and income. Considering this, to move forward, it will be good to understand the challenges faced in zakat accounting, especially for agriculture and livestock.

2.4.1 Criteria for Livestock

In paying the livestock due for zakat, there are several criteria which needs to be fulfilled as explained in the previous section. The status of health of the respective livestock to be given as zakat has never been reported in financial statement or has been incorporated as relevant information for accounting. In addition to that, the

age of the respective livestock is also needed to ensure validity of zakat payment. Similarly, age has not been a common practice to be reported in financial reports. However, this is a crucial information as part of acceptable zakat payment.

Incorporating such information would need further discussion especially in accounting for livestock. Both side of zakat payer and collector needs to agree on what to be incorporated in the report and where to report it.

2.4.2 Deduction of Costs

Costs incurred in maintaining and operating the livestock and agricultural activities is another challenge to be addressed. The production conditions have differentiated the zakat rate based on the activities undertaken, whether it is fully relying on natural resources or to some extent used man-made resources such as irrigation. This again needs to be properly recorded, and appropriately apportioned and allocated. The percentage of natural resources used will also affect the rate of zakat charged on the livestock and agricultural produce.

On another note, there are issues of subsidies or government assistance in preparing the land, providing seedlings, fertilizers and irrigation. In such cases, the classical view of natural resources used may not be accurate. Although irrigation is made, this is totally borne by the government or provider of resources. This would then not form as part of the cost incurred by the farmers.

2.4.3 Valuation and Conversion to Cash Equivalent

Another question in mind is the permissibility of converting the zakat due with cash rather than giving the livestock or agricultural produce. Referring to the zakat due for camels below 35 is levied sheep. Should the farmer do not rear sheep, it would mean that they need to buy sheep to be given as zakat. In such case if they have money, they would prefer to pay rather than acquire sheep for zakat.

In allowing payment by cash, what is the expected value for the zakat, would it follow the market value or perhaps the negotiated value in acquiring the livestock or agricultural produce. This creates an opportunity for the valuation to be used as part of the asset valuation for the purpose of zakat accounting for livestock or agriculture produce. If this is acceptable it would be interesting to look at the required periodic valuation of such assets subject to zakat to reflect the current market value and local circumstances.

2.5 Way Forward

2.5.1 Asset or Business Purpose

It is agreeable that for zakat of agriculture and livestock it would be levied on the produce and animals, respectively and not on other assets of the business (Al-Qardawi 1969). This is evident from the command that zakat will be of produce cultivated from the Earth, while livestock on the animals for breeding. Hence, zakat on business which is not in agriculture nor livestock will be treated differently calculated based on the net working capital or net assets approach as formally standardized for Islamic finance industry by AAOIFI (Mohd Shukri bin Hanapi 2014).

This then warrants a specific standard for zakat accounting for agriculture and livestock be looked into and considered to ease the payers and collectors in determining the zakat amount. This will also serve as a platform to further discuss the viability of a dynamic and sustainable zakat accounting standard and practice, taking into consideration the local context and current development in the respective community (Hamat 2014). It is observed that different countries, communities and localities have different customs and traditions, which may affect the valuation, practices and recording of accounting information for agriculture and livestock zakat.

2.5.2 Regulatory

The regulatory from plays an important role to ensure justice is served within the community they are supervising. Aside from introducing specific guideline and standard for the practice of zakat accounting or agriculture and livestock, regulators are also expected to be updated with the current market valuation, practices and acceptable norms which can affect the payers, collectors and recipients of zakat. Hence regulators are expected to be able to guide and enforce the standard introduced to be followed and implemented by all parties.

By actively ensuring the regulation and guidance relevant to the market and society, the institution of zakat can enhance its efficiency and provide justice to all stakeholders, offering clear direction in the process.

2.5.3 How to Capture the Quality of Agricultural Produce and Livestock

It has been emphasized in previous section that in zakat for agriculture and livestock, quality of the produce and animals form as part of the consideration in accessing zakat and also to evaluate the payment of zakat agrees to the required conditions (Al-Qardawi 1969). It is then a need to ensure, all the qualitative information be captured

in the accounts of the payers and collectors to maintain that zakat obligation has been fulfilled accordingly. Failure to provide and preserve such information will result in ineffectiveness in the payment of zakat which will also bring forward instances of injustice to the payers and recipients.

The recording of this information in the financial report of the entity and the respective disclosure needed will need to be discussed both by the accountants and *fiqh* scholar to be consistent on the required information needed. Manner of recording and disclosures and access to this information are also necessary.

2.6 Conclusion

In this chapter, we have reviewed the tradition of the collection of agriculture zakat where zakat is paid based on *nisab* and *hawl*. As there is an increasing trend where people are venturing into agribusiness, it is very important that muslims entrepreneurs to have knowledge on zakat payment as it is a religious obligation, thus a proper financial record of zakat payment and collection is required and this can be seen in the verses of Qur'an. Therefore, the requirements to have a proper financial record have always been in the doctrines of Islam. This also shows that manner of recording and disclosures and access to this information are also necessary in Islam. A number of accounting standards and guidelines have been developed but the focus on zakat is still scarce, especially for the agribusiness. Such standards and guidelines need to be in line with the true spirit of zakat in Islam. This study realized the issues and challenges such as presenting the explicit cost to reflect the quality of zakatable commodity, deduction costs, and valuation and conversion to cash equivalent, as these may affect the rate of zakat charged on the livestock and agricultural produce. Thus, some recommendations are provided in efforts to provide a fair and proper assessment of zakat on corporate wealth based on the current practice. For instance, a specific standard for zakat accounting for agriculture and livestock especially for agribusiness. Regulatory body is required as it plays an important role to ensure justice is served within the community they are supervising, especially the muslim entrepreneurs. Finally, method of assessment on how to capture the qualitative information in the accounts of the payers and collectors need to be developed in order to maintain that zakat obligation has been fulfilled accordingly in order to preserve justice for both zakat payers and recipients. All these efforts are required in order to ensure current and future practice of agriculture zakat accounting meets the business performance and religious obligation.

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Chapter 3

Perspectives on the Preparation and Presentation of a Statement of Cash Flows under IAS 7: An Historical Approach



Can Öztürk and Charles Richard Baker

Abstract This chapter provides perspectives on the preparation and presentation of the statement of cash flows under IAS 7 of the International Financial Reporting Standards by adopting an historical approach. It focuses on the transformation attempts of the statement of cash flows along with the influence of such attempts on the statement of financial position. It analyzes and discusses the proposed changes on this statement offered through (1) the Discussion Paper on preliminary views on Financial Statement Presentation that was published by the International Accounting Standards Board (IASB) in 2008 right after the compliance of IAS 1 (2007) Presentation of Financial Statements to other comprehensive income items, (2) the staff draft of Exposure Draft IFRS X Financial Statement Presentation that was issued by the staff of the IASB in 2010, (3) Exposure Draft ED/2012/1 Annual Improvements to IFRSs 2010–2012 Cycle that was published by the IASB in 2012, (4) staff Discussion Paper of the United Kingdom’s Financial Reporting Council that was published in 2016, and (5) the Exposure Draft ED/2019/7 General Presentation and Disclosure that was issued by the IASB in 2019 toward the objective of improved financial communication.

Keywords International financial reporting · Statement of cash flows · IAS 7 · Improved financial communication

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3.1 Introduction

International Financial Reporting Standards (IFRS) regulate the preparation and presentation of financial information of the publicly accountable entities for the purpose of transparency, accountability, and understandability in the global context. In this regard, a complete set of financial statements under IFRS requires the preparation and presentation of a statement of financial position (balance sheet), a statement of profit or loss and other comprehensive income, a statement of changes in equity, and a statement of cash flows, along with the disclosures of the financial statements.

Regarding the complete set of financial statements, the preparation and presentation of a statement of financial position, a statement of profit or loss and other comprehensive income, and a statement of changes in equity are regulated by IAS 1 Presentation of Financial Statements versus IAS 7 that regulates the accounting policies for the preparation and presentation of a statement of cash flows (IASB 2020a, b).

Historically, IAS 7 had been designed to regulate the preparation and presentation of statement of changes in financial position (statement of source and application of funds) which indicates the change in net working capital (Paolone 2020, p. 8). In 1992, however, an exposure draft of IAS 7 was prepared by the International Accounting Standards Board (IASB) to replace the statement of changes in financial position with a statement of cash flows. Therefore, this existing standard has been in force since 1994.

Statement of cash flows is related to reporting of cash and cash equivalents rather than just reporting cash consistent with the presentation on the statement of financial position. In this regard, the amount of the available cash includes cash on hand and demand deposits versus cash equivalents which consist of short-term (three months or less), highly liquid investments with an insignificant risk of changes in value (IAS 7.6), are part of meeting short-term cash commitments (IAS 7.7). In such context, cash equivalents include some of the followings: “checks that are not forward dated”, “B type liquid funds”, “receivables from reverse repo transactions”, “time deposits whose maturity is less than three months”, “government bond and treasury bill whose remaining maturity is less than three months”, and “receivables from money markets” (Özerhan and Yanık 2015, p. 87).

Since its inception, IAS 7 classifies cash inflows and cash outflows of the entity under three business activities as operating, investing, and financing (IAS 7.10).

In this context,

1. operating activities consist of the principal revenue-producing activities of the entity and other activities that are not part of investing or financing activities (IAS 7.6) and some of cash flows from operating activities covers (a) cash received from the sale of goods and the rendering of services; (b) cash received from royalties, fees, commissions, and other revenue; (c) cash paid to suppliers for goods and services; (d) cash paid to and on behalf of employees; (e) cash payments or refunds of income taxes; and (f) cash received and paid from contracts held for dealing or trading purposes (IAS 7.14);

2. investing activities include the acquisition and disposal of long-term assets and other investments that are not included in cash equivalents (IAS 7.6) and some of cash flows from investing activities cover (a) cash received for the sale of or cash paid for the acquisition of property, plant and equipment, intangibles and other long-term assets, (b) cash received for the sale of or cash paid for the acquisition of debt or equity instruments, (c) cash paid to make loans to other parties and cash received from the repayment of loans made to such parties (IAS 7.16); and
3. financing activities cover the activities that result in changes in the size and composition of the contributed equity and borrowings of the entity (IAS 7.6) and some of cash flows from financing activities include (a) cash received from issuing shares or other equity instruments, (b) cash paid to owners to acquire or redeem the firm's shares, (c) cash received from issuing such as loans, bonds, mortgages and other short-term or long-term borrowings, (d) cash repayments of amounts borrowed; and (e) cash paid for the lease liability from a lessee perspective (IAS 7.17).

Operating section of the statement is prepared under direct method or indirect method (IAS 7.18) versus investing and financing sections are only prepared under direct method (IAS 7.21). In this context, direct method provides the opportunity to report major classes of gross cash receipts and gross cash payments. Therefore, direct method is considered to be a useful approach to predict future cash flows in the literature by Krishnan and Largay (2000), Orpurt and Zang (2009), Bradbury (2011), Farshadfar and Monem (2013), and Clacher et al. (2013).

In this context, (1) Krishnan and Largay (2000) observe that their results suggest that using direct method cash flow data along with earnings and other accrual data enhances accuracy of cash flow prediction; (2) Orpurt and Zang (2009) determines that the improved stock price informativeness of the direct method provides investors the opportunity to estimate future earnings and cash flows; (3) Bradbury (2011) analyzes whether the adoption of direct method is better than the adoption of indirect method in the preparation of the statement of cash flows and determines that (a) direct method leads to better prediction of future firm performance and has a stronger association with share prices, (b) the direct method lowers information asymmetry, and (c) the reconciliation between net income and operating cash flows that accompanies the direct method provides useful information; (4) Farshadfar and Monem (2013) declare that (a) the predictive ability of aggregate operating cash flow in forecasting future cash flows is enhanced by disaggregating operating cash flow into its components and (b) cash received from customers and cash paid to suppliers and employees provide complete picture in increasing the predictive ability of cash flow components in general; and (5) Clacher et al. (2013) determines that statement of cash flows prepared under direct method is value relevant before and after the IFRS adoption in Australia.

On the other hand, Kent and Birt (2021) evaluate circumstances where the direct method is expected to be more useful in the Australian market compared with prior research such as Krishnan and Largay (2000) and Orpurt and Zang (2009) that have mostly evaluated the direct and indirect methods from a market perspective. In this

context, Kent and Birt (2021) predict that direct method provides more value relevant information in the following circumstances: (1) when earnings are of lower quality (earnings are less permanent or entities report losses), (2) entities are in a more stable state (proxied by small absolute changes in accruals/operating cash flow), and (3) when cash flows/accruals are measured with more error using the indirect method.

Compared with direct method, indirect method does not provide such a reporting opportunity because profit or loss is adjusted considering the effects of (a) changes during the period in inventories and operating receivables and payables; (b) non-cash items such as depreciation, provisions, deferred taxes, unrealized foreign currency gains and losses, and undistributed profits of associates; and (c) all other items for which the cash effects are investing or financing cash flows (IAS 7.20), to end up with the net cash flows from operating activities.

In terms of both methods, indirect method is the most preferred method in preparing and presenting statement of cash flows under IAS 7 in the following countries: Belgium, Brazil, Canada, Denmark, Finland, France, Germany, Greece, Israel, Italy, Kuwait, Netherlands, Norway, Oman, Poland, Russia, South Africa, South Korea, Spain, Sweden, Switzerland, Turkey, and UK considering the research of (Akdoğan and Öztürk 2015; Lourenço et al. 2015, 2018). Therefore, it is also called the traditional format of statement of cash flows versus the direct method that is mostly preferred in Australia, Chile, and New Zealand.

In addition, IAS 7 does not require a reconciliation schedule from profit or loss to net cash flows from operating activities if direct method is adopted (IASB 2020b). In such context, IAS 7 of the Australian Accounting Standards Board (AASB 107) has required such a schedule from 2004 to 2010 (AASB 2004, 2007, 2009, 2010) by integrating such an accounting policy into text of AASB 107. In 2011, however; AASB also removed such a requirement to be in line with IAS 7 of the IASB (AASB 2011).

IAS 7 also provides alternative accounting policy choices in reporting interest and dividend received as well as interest and dividend paid (IAS 7.33, 7.34) for firms other than financial institution. These policy choices influence the comparability of the financial information related to cash flows for the inter-company analysis (Table 3.1).

In the context of IAS 7, the objective of this chapter is to analyze the proposed changes over a certain period in history on the preparation and presentation of the statement of cash flows to improve its effectiveness toward better financial communication. For this purpose, (1) discussion paper on preliminary views on Financial Statement Presentation that was published by the IASB in 2008 [in short DP (2008)], (2) staff draft of Exposure Draft IFRS X Financial Statement Presentation that was

Table 3.1 Classification of cash flows related to interest and dividend

Interest received	Operating or investing
Interest paid	Operating or financing
Dividend received	Operating or investing
Dividend paid	Operating or financing

issued by the staff of the IASB in 2010 [in short ED (2010)], (3) Exposure Draft ED/2012/1 Annual Improvements to IFRSs 2010–2012 Cycle that was issued by the IASB in 2012 [in short ED (2012)], (4) staff Discussion Paper of the United Kingdom (UK)'s Financial Reporting Council (FRC) that was published in 2016 [in short FRC (2016)], and (5) Exposure Draft ED/2019/7 General Presentation and Disclosure that was issued by the IASB in 2019 [in short ED (2019)] have been taken into account.

This chapter has the following structure: Sect. 3.2 presents the literature review pertaining to IAS 7 Statement of Cash Flows; Sect. 3.3 discusses the proposed changes on the preparation and presentation of the statement of cash flows under IAS 7 considering discussion papers and exposure drafts stated above, and finally, Sect. 3.4 presents concluding remarks.

3.2 Literature Review on IAS 7 Statement of Cash Flows

In terms of the statement of cash flows, there are several research papers dealing with the preparation and presentation of this statement under IAS 7. They provide observations related to this statement from practices of capital markets such as Mechelli (2009), Pekdemir and Kepçe Yönet (2010), Bond et al. (2012), and Brabcová (2019).

Mechelli (2009) analyzes the reporting of the statement of cash flows under IAS 7 in Italy for the year 2005 which consists of the first-time adoption of IAS 7 in this country. The application of direct or indirect method, the diversity of the starting point of the indirect method such as net profit, profit before tax, “profit before interest, dividends, and taxes”, the classification of dividend and interest received and paid, and taxes paid were analyzed. In addition, Pekdemir and Kepçe Yönet (2010) analyzed the Turkish practice of the IAS 7 for the years 2007, 2008, and 2009 in the same context. Both research states that there is a high degree of heterogeneity which may weaken comparability and non-compliance to IAS 7 which may increase the risk of misleading financial information.

Bond et al. (2012) analyze the effect of the integration of the indirect method into the text of the Australian version of IFRS between 2006 and 2009 and observe whether some companies switched from direct method to indirect method and what is the rationale behind this change of accounting policy. Among the nine companies, all moved to indirect method particularly in year 2008, but two of them stated their rationales as follows: (1) “This change in presentation more effectively conveys the relationship between its financial performance and operating cash flows”, and (2) “The group believes that the indirect method of presenting cash flows provides more relevant information as it results in increased comparability of the group’s cash flow statement with those of its peer group”.

Brabcová (2019) analyzes the reporting of the statement of cash flows under IAS 7 in the Czech Republic considering the financial statements of the listed entities for the year 2015 and 2016. This paper compares findings related to the presentation of the statement of cash flows under direct and indirect method, interest and dividend

received, interest and dividend paid, influence of foreign currency changes, reconciliation to balance sheet along with the split of individual cash and cash equivalents elements, restricted cash, and cash flow by segment. This paper states that entities adopted mandatory requirements in general, but they did not prepare any voluntary disclosures such as cash flow by segment.

Different from such papers, this review focuses on proposed changes on the statement of cash flows toward meeting the objectives of cohesiveness, disaggregation, liquidity and financial flexibility, and comparability within the framework of improved financial communication and analyses of such changes comparatively.

3.3 Analysis of the Proposed Changes on the Statement of Cash Flows

In this section of the chapter, discussion papers and exposure drafts that have been issued to improve financial statement presentation are analyzed in the context of the statement of cash flows.

3.3.1 DP (2008): Preliminary Views on Financial Statement Presentation

In 2001, IASB and the Financial Accounting Standards Board (FASB) of the United States (US), started on a project on reporting financial performance and conducted those projects independent from each other (IASB 2008, p. 19). In 2004, however, they decided to move together on such projects to ensure the convergence of IFRS into US Financial Accounting Standards. This joint project had three phases (IASB 2008, p. 19). The first phase (phase A) of the project integrated the reporting of comprehensive income into IAS 1 (2007), leading to changes in preparation and presentation of statement of profit or loss and statement of changes in equity. Therefore, IAS 1 became, mostly, in line with Statement No. 130 Reporting Comprehensive Income (SFAS 130). The second phase (phase B) of the project considered issues related to presentation and display of information in the financial statements. For this purpose, IASB prepared and published DP (2008): Preliminary Views on Financial Statement Presentation.

This subsection of the chapter analyzes proposals made by DP (2008) in general and discusses those proposals by exemplifying on the statement of cash flows.

3.3.1.1 Analysis of DP (2008) in the context of Statement of Cash Flows

Regarding the proposals related to the preparation and presentation of the financial statements, such as aggregating and disaggregating information in each primary financial statement, defining totals and subtotals, and revisiting the use of direct or indirect method in presenting cash flows from operations (IASB 2008, p. 19), DP (2008) developed three objectives which consist of the rationales behind these proposals: (1) cohesiveness, (2) disaggregation, and (3) liquidity and financial flexibility (IASB 2008, pp. 30–31).

In the context of cohesiveness objective, DP (2008) argues that the financial information presented in the financial statements should be presented in a way that reveals an entity's financial position, financial performance, and cash flows holistically and cohesively by establishing clear relationships between items across financial statements and displaying data in a way that clearly associates related information across the statements (IASB 2008, p. 30). Therefore, it is in favor of the removal of the inconsistencies in the presentation of financial statements. For this reason, DP (2008) emphasizes that the statement of cash flows is the only statement that reports financial information by separately classifying it according to business activities, and this should also be the case in presenting a statement of profit or loss and other comprehensive income and a statement of financial position so that the operating income and operating cash flows can be compared with each other, and operating assets and operating liabilities can be analyzed with each other for the purpose of analyzing the financial health of the business organization.

In the context of disaggregation objective, DP (2008) argues that disaggregation of information reported in the financial statements should be done in a way that makes it useful in assessing the amount, timing, and uncertainty of the entity's future cash flows (IASB 2008, p. 30). For this purpose, additional items should be added into the financial statements to explain the components of an entity's financial position, financial performance, and cash flows (IASB 2008, p. 31). For instance, if certain expenses such as rental or utility expenses are significant to an entity's financial performance, disaggregation of these items rather than aggregation may help users of financial information in predicting the entity's future cash flows.

In the context of liquidity and financial flexibility objective, DP (2008) argues that information presented in the financial statements should provide the users of financial information the opportunity to analyze the entity's ability to meet its obligations, including its obligations related to operating and financing activities as well as to invest in business opportunities (IASB 2008, p. 31).

To meet the stated objectives, DP (2008) makes the following proposals in the context of financial statements and particularly in the context of statement of cash flows in connection with the statement of financial position (IASB 2008, p. 74):

1. Financial statements of a business organization except the statement of changes in equity and the statement of profit or loss and other comprehensive income, are divided into five sections (IASB 2008, p. 35): (a) business section, (b) financing section, (c) equity section, (d) income tax section, and (e) discontinued operations

section. In this context, the traditional format of statement of financial position classifies assets, and liabilities considering current and non-current distinction (IAS 1.60) versus the proposed format of statement of financial position reports assets and liabilities considering current and non-current distinction and under the business section, financing section, income tax section, and discontinued operations section. Considering these sections, traditional and proposed formats of statement of financial position (Table 3.2) are provided below.

2. Compared with the traditional statement of financial position which classifies assets and liabilities, considering current and non-current distinction rather than operating, investing, and financing activities (IASB 2008, p. 121), proposed statement of financial position reports assets and liabilities considering both current and non-current distinction as well as operating, investing, and financing activities (IASB 2008, pp. 108–109).
3. Business section of the proposed statement of financial position includes assets and liabilities of entity's continuing business operations such as producing goods or providing services and their related changes (IASB 2008, p. 37). To improve the transparency, two categories are prepared to report financial information within the business section: (a) operating category and (b) investing category (IASB 2008, p. 38). In the proposed statement of financial position, the operating category includes operating assets and liabilities that are related to the entity's primary revenue and expense generating activities versus investing category includes investing assets and liabilities that are not related to the entity's primary revenue and expense generating activities. Instead, these assets and liabilities lead to generate a return such as interest and dividends.

In line with the proposed statement of financial position, (1) proposed statement of cash flows allocates cash inflows and outflows related to the operating and investing assets and liabilities into business section and (2) cash flows related to financing

Table 3.2 Traditional and proposed formats of statement of financial position

Traditional format	DP (2008)
Statement of financial position	Statement of financial position
<i>Assets</i>	<i>Business</i>
<ul style="list-style-type: none"> • Classification of assets regardless of operating, investing, and financing activities 	<ul style="list-style-type: none"> • Operating assets and liabilities • Investing assets and liabilities
<i>Liabilities</i>	<i>Financing</i>
<ul style="list-style-type: none"> • Classification of liabilities regardless of operating, investing, and financing activities 	<ul style="list-style-type: none"> • Financing assets • Financing liabilities
	<i>Income taxes</i>
	<i>Discontinued operations</i>
<i>Equity</i>	<i>Equity</i>

Table 3.3 Traditional and proposed formats of statement of cash flows

Traditional format	DP (2008)
Statement of cash flows	Statement of cash flows
<i>Operating activities</i>	<i>Business</i>
<ul style="list-style-type: none"> • Operating cash flows from continuing operations • Operating cash flows from discontinued operations 	<ul style="list-style-type: none"> • Operating cash flows • Investing cash flows
<i>Investing activities</i>	<i>Financing</i>
<ul style="list-style-type: none"> • Investing cash flows 	<ul style="list-style-type: none"> • Financing asset cash flows • Financing liability cash flows
<i>Financing activities</i>	<i>Income taxes</i>
<ul style="list-style-type: none"> • Financing cash flows 	<i>Discontinued operations</i>
	<i>Equity</i>

assets and liabilities are allocated into financing section compared with the traditional statement of cash flows which reports cash flows considering operating, investing, and financing activities (IASB 2008, p. 35) (Table 3.3).

4. Traditional statement of financial position reports cash in the current assets versus the proposed statement of financial position reports cash in the financing section as a financial asset (IASB 2008, pp. 109, 121). Therefore, “interest received on cash” is reported in the financing section of the proposed statement of cash flows to be in line with the proposed statement of financial position (IASB 2008, p. 111) (Table 3.6).
5. Traditional statement of financial position reveals non-owner source of finance in the current and non-current liabilities, including lease liabilities (IASB 2008, p. 121) versus proposed statement of financial position shows such financing sources except for lease liabilities in the financing section and lease liabilities in the operating section by also considering current and non-current distinction (IASB 2008, p. 108).

In line with the proposed statement of financial position, the proposed statement of cash flows reports (1) cash flows related to lease liabilities in the operating section, (2) cash flows from non-owner source of finance except for lease liabilities in the financing section, and (3) cash flows from owner source of finance in the equity section compared with the traditional statement of cash flows which reports both owner and non-owner source of finance, including lease liabilities in the financing section (Tables 3.5 and 3.6).

6. Traditional statement of financial position reports, current and deferred income tax assets, and liabilities in the current and non-current context (IASB 2008, p. 121) versus the proposed statement of financial position has a separate section of reporting taxes considering current and non-current distinction (Table 3.2).

In this regard, traditional statement of cash flows usually reports taxes paid in the operating section (IAS 7.35). However, the proposed statement of cash flows reports the payment of such tax amounts in a separate section to be in line with the proposed statement of financial position (Table 3.3).

7. Compared with the traditional statement of financial position which reports non-current assets held for sale in the current assets as well as liabilities of such assets in the current liabilities under IFRS 5 (IASB 2008, p. 121; 2020d), the proposed statement of financial position reports changes of such assets and their liabilities in a separate section titled “discontinued operations” (Table 3.2).

In line with the proposed statement of financial position, proposed statement of cash flows also reports cash flows of such assets and liabilities in a separate section rather than in the operating section as it is in traditional format (Table 3.3).

8. To establish the financial relationship between the statement of financial position, statement of profit or loss and other comprehensive income, and the statement of cash flows, DP (2008) declares that operating category of a statement of cash flows should be prepared under direct method for the purpose of meeting the objectives of cohesiveness, disaggregation, and liquidity and financial flexibility (IASB 2008, p. 76).

In this context, the adoption of direct method provides the users of financial information the opportunity (1) to establish a relationship among the information about operating assets and liabilities, operating income and expenses, and operating cash inflows and outflows through the cohesiveness objective; (2) to observe operating cash inflows and outflows separately to assess the amount, timing, and uncertainty of an entity’s future operating cash flows through the disaggregation objective; and (3) to analyze the relationships of operating cash inflows and outflows to assess an entity’s ability to generate enough cash from operations to pay debts, reinvest in operations and make dividend payments to owners through the liquidity and financial flexibility objective.

9. In line with the operating category of the proposed statement of financial position which includes operating assets, operating category of the proposed statement of cash flows also includes the cash flows from investing in operating assets such as purchase or sale of the items of property, plant, and equipment (IASB 2008, p. 74) compared with the traditional statement of cash flows reporting such cash flows within the investing section (Tables 3.5 and 3.6).
10. To meet the objective of liquidity and financial flexibility, DP (2008) argues that cash equivalents should be excluded from cash reported on the proposed statement of financial position because short-term investments including the cash equivalents may be subject to some risk of price change due to unexpected changes in the credit environment or the perceived credit quality of the issuer (IASB 2008, p. 57). In line with this proposal, the proposed statement of cash flows also, declares the amount of cash, only.
11. In terms of reporting interest received and paid as well as dividend received and paid for the firms other than financial institution, DP (2008) proposes no

Table 3.4 Classification of cash flows related to interest and dividend under DP (2008)

	Traditional format	DP (2008)
Interest received	Operating or investing	Financing
Interest paid	Operating or financing	Financing
Dividend received	Operating or investing	Investing
Dividend paid	Operating or financing	Financing

accounting policy choice to improve the comparability of financial information (Table 3.4).

12. Since the DP (2008) prefers the direct method in the reporting of operating cash flows, it also, proposes the reconciliation schedule of profit or loss or net income to net cash flows from operating activities (IASB 2008, p. 77).

3.3.1.2 Observations on the Exemplary Statement of Cash Flows

DP (2008) provides two examples of statements of cash flows: (1) traditional format (Table 3.5) (IASB 2008, pp. 122–123) and (2) proposed format (Table 3.6) (IASB 2008, pp. 110–111). The following observations were gathered below:

1. Traditional format reports cash flows under three sections versus proposed format reports cash flows under five sections.
2. Traditional format does not classify operating and investing activities under a main title, versus proposed format classifies operating and investing activities under the main title of “business”.
3. Traditional format reports operating cash flows under indirect method and provides net cash flows from operating activities of 139,459 through reconciliation from net profit to net cash flows from operating activities versus proposed format prefers direct method to meet cohesiveness, disaggregation as well as liquidity and financial flexibility objectives.
4. Compared with traditional format, proposed format provides inflows and outflows related to operating section by adopting a disaggregated approach. For instance, rather than just reporting “total cash collected from customers”, the statement disaggregates “total cash collected from customers of 2,812,742 considering the customer profile of the entity: (a) cash received from wholesale customers of 2,108,754, and (b) cash received from retail customers of 703,988.
5. Both traditional and proposed formats report investing and financing cash flows under direct method.
6. Compared with traditional format, cash flows from investing in operating assets are presented in the operating section. Therefore, capital expenditures of 54,000, proceeds from disposal of property, plant, and equipment of 37,650 were transferred from investing section to operating section.
7. Compared with traditional format, proposed format reports “proceeds from reissue of treasury shares” of 84,240 in the equity section and interest received

Table 3.5 Traditional format of statement of cash flows

	For the year ended 31 December
	2010
OPERATING ACTIVITIES	
Net profit	538,469
<i>Adjustment to reconcile net profit to cash flow from operating activities of continuing operations:</i>	
Gain on sale of investments	(18,250)
Income from investments	(31,260)
Realized gain on cash flow hedge	(3,996)
Gain on sales and disposal of property, plant, and equipment	(22,650)
Loss on discontinued operations, net	21,060
Depreciation and amortization	279,120
Other non-cash expenses	54,066
<i>Changes in selected working capital items</i>	
Increase in trade and other receivables	(417,267)
Decrease in inventory	60,250
Decrease in advances from customers	(244,605)
Increase in trade payables	80,556
Changes in other assets and liabilities	(143,452)
NET CASH FROM OPERATING ACTIVITIES OF CONTINUING OPERATIONS	152,041
NET CASH FROM OPERATING ACTIVITIES OF DISCONTINUED OPERATIONS	(12,582)
NET CASH FROM OPERATING ACTIVITIES	139,459
INVESTING ACTIVITIES	
Capital expenditures	(54,000)
Proceeds from disposal of property, plant, and equipment	37,650
Proceeds from sales of financial assets	56,100
Settlement of cash flow hedge	3402
NET CASH FROM INVESTING ACTIVITIES	43,152
FINANCING ACTIVITIES	
Proceeds from issue of short-term debt	162,000
Cash dividends paid	(86,400)
Proceeds from reissue of treasury stock	84,240
Cash paid on lease liability	(33,500)
NET CASH FROM FINANCING ACTIVITIES	126,340
Effect of foreign exchange rates on cash	3209

(continued)

Table 3.5 (continued)

	For the year ended 31 December
NET INCREASE IN CASH	312,161
Cash at the beginning of the year	861,941
Cash at the end of the year	1,174,102

on cash of 8619, proceeds from issue of short-term debt of 162,000, interest paid of 84,514, and dividend paid of 86,400 in the financing section.

8. Compared with traditional format, proposed format reports net cash flows from discontinued operations of 12,582 and income taxes paid of 281,221 in their specific sections.

3.3.2 ED (2010): Staff Draft on Financial Statement Presentation

Following DP (2008), ED (2010) was prepared by the staff of the IASB and the FASB to develop a standard on financial statement presentation as part of the boards' joint project. This subsection of the chapter analyzes proposals made by ED (2010) in general and discusses those proposals by exemplifying on the statement of cash flows.

3.3.2.1 Comparative Analysis of ED (2010) and DP (2008) in the context of Statement of Cash Flows

ED (2010) reflects the cumulative and tentative decisions made by the boards concluding with their joint meeting in April 2010. In this context, the following issues are proposed in this draft:

1. In line with the DP (2008), ED (2010) also adopts the cohesiveness objective of the financial statements. For this purpose, direct method is the only allowable accounting treatment to report cash flows from operating activities under ED (2010) (IASB 2010a, p. 39).
2. In line with DP (2008), this draft not only represents (a) business section, (b) financing section, (c) income tax section, (d) discontinued operations section on the statement of financial position, and statement of cash flows, but also it introduces multi-category transaction section to record a multi-category transaction such as business combination (IASB 2010a, p. 24).
3. Since the rationale behind the changes on the statement of cash flows is based on the changes on the statement of financial position, it is necessary to analyze the differences between the proposed statements of cash flows of DP (2008)

Table 3.6 Proposed format of statement of cash flows under DP (2008)

	For the year ended 31 December
	2010
BUSINESS	
Operating	
Cash received from wholesale customers	2,108,754
Cash received from retail customers	703,988
<i>Total cash collected from customers</i>	2,812,742
Cash paid for goods	
Materials purchases	(935,544)
Labor	(418,966)
Overhead—transport	(128,640)
Pension	(170,100)
Overhead—other	(32,160)
<i>Total cash paid for goods</i>	(1,685,409)
Cash paid for selling activities	
Advertising	(65,000)
Wages, salaries, and benefits	(58,655)
Other	(13,500)
<i>Total cash paid for selling activities</i>	(137,155)
Cash paid for general and administrative activities	
Wages, salaries, and benefits	(332,379)
Contribution to pension plan	(170,100)
Capital expenditures	(54,000)
Lease payments	(50,000)
Research and development	(8478)
Settlement of share-based remuneration	(3602)
Other	(12,960)
<i>Total cash paid for general and administrative activities</i>	(631,519)
<i>Cash flow before other operating activities</i>	358,657
Cash from other operating activities	
Disposal of property, plant, and equipment	37,650
Sale of receivable	8000
Settlement of cash flow hedge	3402
<i>Total cash received for other operating activities</i>	49,052
Net cash from operating activities	407,709
Investing	

(continued)

Table 3.6 (continued)

	For the year ended 31 December
Sale of financial assets	56,100
Dividend received	54,000
Net cash from investing activities	110,100
NET CASH FROM BUSINESS ACTIVITIES	517,809
FINANCING	
Interest received on cash	8619
Total cash from financing assets	8619
Proceeds from issue of short-term debt	162,000
Interest paid	(83,514)
Dividends paid	(86,400)
Total cash from financing liabilities	(7914)
NET CASH FROM FINANCING ACTIVITIES	705
<i>Change in cash from continuing operations before taxes and equity</i>	518,514
INCOME TAXES	
Cash taxes paid	(281,221)
<i>Change in cash before discontinued operations and equity</i>	237,293
DISCONTINUED OPERATIONS	
Cash paid from discontinued operations	(12,582)
NET CASH FROM DISCONTINUED OPERATIONS	(12,582)
<i>Change in cash before equity</i>	224,711
EQUITY	
Proceeds from reissue of treasury shares	84,240
NET CASH FROM EQUITY	84,240
Effect of foreign exchange rates on cash	3209
CHANGE IN CASH	312,161
Beginning cash	861,941
Ending cash	1,174,102

and ED (2010) along with the analysis of the differences between the proposed statements of financial position of DP (2008) and ED (2010).

4. In line with DP (2008), the business section is divided into two categories in the draft statement of financial position and draft statement of cash flows: (a) operating and (b) investing category (Table 3.7). Compared with DP (2008), however; draft statement of financial position proposes a subcategory titled as *operating finance* which includes operating finance liabilities such as a lease obligation within the operating category because ED (2010) considers that operating finance activities are directly related to an entity's operating activities as

Table 3.7 Comparative formats of statement of financial position

DP (2008)	ED (2010)
Statement of financial position	Statement of financial position
<i>Business</i>	<i>Business</i>
<ul style="list-style-type: none"> • Operating assets and liabilities • Investing assets and liabilities 	<ul style="list-style-type: none"> • Operating assets and liabilities <ul style="list-style-type: none"> – <i>Operating finance liabilities</i> • Investing assets and liabilities
<i>Financing</i>	<i>Financing</i>
<ul style="list-style-type: none"> • Financing assets • Financing liabilities 	<ul style="list-style-type: none"> • Debt • Equity
<i>Income taxes</i>	<i>Income taxes</i>
<i>Discontinued operations</i>	<i>Discontinued operations</i>
<i>Equity</i>	

well as they provide a source of long-term financing for the entity (IASB 2010a, pp. 19–20).

In line with the draft statement of financial position of ED (2010), (a) cash flows from operating activities also includes the cash flows from operating finance liabilities, but reporting of such cash flows does not have a subcategory within the operating section of the draft statement of cash flows (IASB 2010a, p. 21) (Table 3.8).

5. Compared with DP (2008), draft statement of financial position carried cash to operating current assets rather than reporting it in the financing assets of the financing section (IASB 2010b, p. 22). Therefore, debt financing and equity financing items were merged under one section which creates a debt category and equity category leading to the observation of a complete picture on financing

Table 3.8 Comparative formats of statement of cash flows

DP (2008)	ED (2010)
Statement of cash flows	Statement of cash flows
<i>Business</i>	<i>Business</i>
<ul style="list-style-type: none"> • Operating cash flows • Investing cash flows 	<ul style="list-style-type: none"> • Operating cash flows • Investing cash flows
<i>Financing</i>	<i>Financing</i>
<ul style="list-style-type: none"> • Financing asset cash flows • Financing liability cash flows 	<ul style="list-style-type: none"> • Debt/equity financing cash flows
<i>Income taxes</i>	<i>Income taxes</i>
<i>Discontinued operations</i>	<i>Discontinued operations</i>
<i>Equity</i>	

aspects of the entity in terms of reporting its owner and non-owner source of finance (IASB 2010b, p. 23) (Table 3.7).

In line with the draft statement of financial position of ED (2010), cash flows from financing activities report cash flows related to debt and equity financing under one section (IASB 2010b, p. 24) (Table 3.8).

6. In line with DP (2008), cash is reported in the draft statement of financial position rather than cash and cash equivalents. In addition, ED (2010) emphasizes that cash does not include short-term investments, including cash equivalents in the draft statement of financial position by stating that “cash does not include ‘short-term investments’ regardless of their liquidity or nearness to maturity” (IASB 2010a, p. 28). In this context, short-term investments including cash equivalents are classified in the investing section of the draft statement of cash flows (Table 3.10).
7. In line with DP (2008), ED (2010) adopts the same reporting policies for taxes and discontinued operations (Table 3.8).
8. In line with DP (2008), ED (2010) reports the purchase and sale of a property, plant, and equipment, intangible assets, and capital expenditures within the operating category of the draft statement of financial position and statement of cash flows because these assets are used as part of an entity’s day-to-day business (IASB 2010a, p. 19; 2010b, p. 24).
9. In line with DP (2008), ED (2010) declares that investing assets and liabilities are used to generate a return and may yield a return for the entity such as interest, dividends, royalties, equity income, gains, or losses. Therefore, dividend received on equity investments and interest received on debt investments are reported in the investing section of the statement of cash flows (IASB 2010a, p. 21).
10. In terms of reporting interest received and paid as well as dividend received and paid for the firms other than financial institution, ED (2010) proposes no accounting policy choice to improve the comparability of financial information (Tables 3.9 and 3.10) (IASB 2010a, pp. 21–24).
11. Compared with DP (2008), ED (2010) proposes the preparation of a reconciliation schedule from operating income (profit or loss from operating activities)

Table 3.9 Classification of cash flows related to interest and dividend under ED (2010)

	Traditional format	DP (2008)	ED (2010)
Interest received	Operating or investing	Financing	Investing
Interest paid	Operating or financing	Financing	Financing
Dividend received	Operating or investing	Investing	Investing
Dividend paid	Operating or financing	Financing	Financing

Table 3.10 Proposed format statement of cash flows under the ED (2010)

	For the year ended 31 December
	2010
BUSINESS	
Operating	
Cash collected from customers	2,812,742
Cash paid for labor	(810,000)
Cash paid for materials	(935,544)
Cash contribution to pension plan	(340,200)
Other operating cash outflows	(260,928)
Cash paid for lease	(50,000)
Capital expenditures	(54,000)
Disposal of property, plant, and equipment	37,650
Sale of receivable	8000
Net cash from operating activities	407,709
Investing	
Net change in short-term investments	(300,000)
Interest received	8619
Dividend received	54,000
Sale of securities	56,100
Net cash from investing activities	(181,281)
NET CASH FROM BUSINESS ACTIVITIES	226,428
FINANCING	
Proceeds from issue of short-term debt	162,000
Interest paid	(83,514)
Dividends paid	(86,400)
Proceeds from reissue of treasury shares	84,240
NET CASH FROM FINANCING ACTIVITIES	76,326
<i>Net cash flows from continuing operations before taxes</i>	302,754
INCOME TAXES	
Total cash paid for income tax	(281,221)
<i>Change in cash before discontinued operations and effect of foreign exchange</i>	21,533
DISCONTINUED OPERATIONS	
Net cash flows from discontinued operations	(12,582)
Effect of foreign exchange	3210
Change in cash	12,161
Beginning cash	61,941

(continued)

Table 3.10 (continued)

	For the year ended 31 December
Ending cash	74,102

rather than from net income to cash flows from operating activities (IASB 2008, p. 77; 2010a, p. 40).

3.3.2.2 Observations on the Exemplary Statement of Cash Flows

ED (2010) provides an example of a statement of cash flows that was partially derived from the example presented in DP (2008) to provide comparability. Therefore, the following observations were gathered by comparing the examples provided in DP (2008) (Table 3.6) (IASB 2008, pp. 110–111) and ED (2010) (Table 3.10) (IASB 2010b, p. 24):

1. Cash collected from customers of 2,812,742 that was separately reported under cash received (a) from wholesale customers and (b) from retail customers in DP (2008), was merged and reported as a single line item in the ED (2010).
2. Cash paid for labor of 810,000 that was separately reported under cash paid (a) for goods, (b) for selling activities, and (c) for general and administrative activities in DP (2008), was merged and reported as a single line item in the ED (2010).
3. Cash paid for materials of 935,544 that was separately reported under cash paid for goods in DP (2008), was reported as a single line item in the ED (2010).
4. Cash paid for contribution to pension plan of 340,200 that was separately reported under cash paid (a) for goods, and (b) for general and administrative activities in DP (2008), was merged and reported as a single line item in the ED (2010).
5. Other operating cash outflows of 260,928 that were separately reported under cash paid (a) for goods, (b) for selling activities, and (c) for general and administrative activities in DP (2008), were merged and reported as a single line item in the ED (2010).
6. In the DP (2008), cash payment for lease of 50,000 that was separately reported under cash paid for general and administrative activities, was reported as a single line item in the ED (2010) without the subcategory of operating finance given in the draft statement of financial position.
7. Capital expenditures of 54,000 that were separately reported under cash paid for general and administrative activities, as well as disposal of property, plant, and equipment of 37,650 and sale of receivables of 8000 that were separately reported under cash from other operating activities were reported as a single line item in the ED (2010).
8. Interest received of 8619 that was reported in the financing section in the DP (2008), was transferred to reporting in the investing section in the ED (2010).
9. Equity section of 84,240 that was proposed in DP (2008), was merged with the financing section in the ED (2010).

3.3.3 *ED (2012): Annual Improvements to IFRSs 2010–2012 Cycle*

ED (2012) discusses the clarification of the reporting of the interest paid on the statement of cash flows for the amount of interest that is capitalized into the cost of qualifying assets whose acquisition, construction, or production necessarily takes a substantial period of time (more than one year) (IAS 23.5, IAS 23.8). Such assets include (a) inventories, (b) manufacturing plants, (c) power generation facilities, (d) intangible assets, (e) investment properties, and (f) bearer plants (IAS 23.7).

Under IAS 23 (IASB 2020c), the capitalization of interest is required if the interest is directly attributable to qualifying asset (IAS 23.9) and interest paid that is capitalized according to IAS 23 is reflected in the statement of cash flows (IAS 7.32); however, there is no explicit statement where such capitalized interest paid is classified in the statement of cash flows under IAS 7 or IAS 23 (IASB 2012, p. 38).

To report capitalized interest paid on the statement of cash flows, ED (2012) proposes the following considering the nature of the underlying asset to which interest payments were capitalized (IASB 2012, p. 38): if the qualifying asset is an operating asset such as inventory, capitalized interest paid is reported in the operating section versus if the qualifying asset is an investing asset such as property, plant, and equipment, intangible asset or investment property, capitalized interest paid is reported in the investing section (IASB 2012, p. 37).

3.3.4 *DP (2016): Staff Discussion Paper of the UK's Financial Reporting Council*

To improve the preparation and presentation of a statement of cash flows under IAS 7 and thus leading to the enhancement of the usefulness of financial statements, staff of the UK's FRC prepared a DP in 2016 (FRC 2016). This subsection analyzes these proposals and provides examples of the statement.

3.3.4.1 *Analysis of the DP (2016) in the context of Statement of Cash Flows*

DP (2016) makes proposals on the following issues (FRC 2016): (1) the usefulness of information about cash flows, (2) the classification of cash flows, (3) cash equivalents and the management of liquid resources, (4) reconciliation of operating activities, and (5) direct or indirect method.

The Usefulness of Information about Cash Flows

According to IAS 7, investing and financing transactions that do not require the use of cash are reported elsewhere in the financial statements rather than on the face of the statement of cash flows (IAS 7.43). Reporting of such non-cash transactions include (a) the acquisition of assets either by debt financing or by means of a lease; (b) the acquisition of an entity by issuing shares; and (c) the conversion of debt to equity (IAS 7.44).

In this context, DP (2016) proposes the reporting of the operating transactions that do not require the use of cash in addition to such investing and financing transactions (FRC 2016, p. 13), so that the transparent reporting of all transactions that do not require the use of cash is ensured and a holistic picture regarding such transactions of an entity is provided.

The Classification of Cash Flows

In the context of the classification of cash flows, DP (2016) analyzed five issues (FRC 2016, p. 15): (1) definition of operating activities, (2) the reporting of cash payments to acquire property, plant and equipment within cash flows from investing activities, (3) the disclosure of the aggregate cash flows that represents increases in operating capacity separately from those that are required to maintain operating capacity, (4) the reporting of cash flows from dividend and interest received and paid, and (5) the reporting of taxes paid within the cash flows from operating activities.

1. According to IAS 7, operating activities are the principal revenue-generating activities of the entity and other activities that are not investing or financing activities (IAS 7.6).

In this context, DP (2016) rejects the inclusion of “other activities that are not investing and financing activities” in the operating section of the statement of cash flows because such operating section includes not only operating cash items, but also non-operating cash and hard to classify cash items (FRC 2016, p. 15). Thus, operating section deviates from its main purpose of reporting cash transactions with customers, employees, and suppliers. To solve this issue, DP (2016) proposes that the definition of operating activities should be narrowed down to reporting cash received and cash paid from operating activities as well as non-operating items, and items that do not fall within investing and financing categories should be reported in an additional, separate section of this statement so that the operating section truly reflects the cash flows from operating activities (FRC 2016, pp. 15–16).

2. In line with DP (2008) and ED (2010), the DP (2016) proposes that the cash payments to acquire property, plant, and equipment that are currently reported within cash flows from investing activities (IAS 7.16(a)) should be classified within the operating section because such assets support operating activities. This will help to calculate free cash flow as a measure used when assessing cash flows available to pay dividends (FRC 2016, p. 16; IASB 2019b, p. 46).

3. According to IAS 7, the disclosure of the aggregate cash flows that represents increases in operating capacity (expansion) separately from those that are required to maintain operating capacity (replacement) is expected (IAS 7.50 (c)). However, DP (2016) suggests that the cash outflows related to “expansion” and “replacement” should be reported. In this context, DP (2016) offers two options: (1) cash paid related to the replacement capital expenditure is reported in the operating section versus cash paid related to the expansion capital expenditure is reported in the investing section, but DP (2016) considers that this classification is complex and requires judgmental analysis to classify expenditure as an expansion versus (2) all capital expenditure regardless of replacement or expansion is reported in the operating section, therefore such reporting is pretty much straightforward and separate disclosure to declare the amount of replacement and expansion is encouraged (FRC 2016, p. 17).
4. To minimize the diversity of reporting dividend received and paid as well as interest received and paid (IAS 7.33, 7.34), DP (2016) proposes the ways to minimize diversity in reporting interest and dividend received and paid as follows (FRC 2016, pp. 19–20):

Dividend paid: The classification of dividend paid in the operating section should be canceled because dividend is paid to capital providers. Therefore, it should be only classified in the financing section.

Dividend received: The classification of dividend received, and other payments received from investments in the operating section should be canceled because they are received by the investor company. Therefore, they should be only classified in the investing section.

Interest received: DP (2016) proposes the classification of interest received considering the nature of the activity rather than being an accounting policy choice. If the interest received is related to the cash received from customers, that collected interest component should be reported in the operating section of the statement (FRC, 2016, p. 33). On the other hand, interest received related to investments will be reported in the investing section (FRC 2016, p. 20).

Interest paid: If the interest paid is related to the cash paid for financial liabilities, that component of interest paid should be reported in the financing section of the statement. In addition, if an operating asset is purchased through debt financing, loan received and payment to creditor should be reported in the financing activities, but the purchase price should be recorded as a cash outflow from operating activities (FRC 2016, p. 19) (Table 3.11).

5. According to IAS 7, cash flows arising from taxes on income is classified within the cash flows from operating activities if they cannot be specifically identified with financing and investing activities (IAS 7.35).

In this context, DP (2016) is against allocating tax cash flows to separate sections because this allocation is relatively complex and arbitrary, and investors are in favor of making pre-tax basis analysis. Therefore, the reporting of taxes paid should not

Table 3.11 Classification of cash flows related to interest and dividend under DP (2016)

	Traditional format	DP (2008)	ED (2010)	DP (2016)
Interest received	Operating or investing	Financing	Investing	Operating or investing
Interest paid	Operating or financing	Financing	Financing	Financing
Dividend received	Operating or investing	Investing	Investing	Investing
Dividend paid	Operating or financing	Financing	Financing	Financing

be within the operating section and it should be in a separate section in the statement of cash flows (FRC 2016, p. 20) in line with DP (2008) and ED (2010).

Cash Equivalents and the Management of Liquid Resources

In line with DP (2008) and ED (2010), DP (2016) is in favor of reporting cash rather than cash and cash equivalents. According to IAS 7, cash equivalents consist of short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value (IAS 7.6). Regarding the concept of “short-term investment”, IAS 7.7 defines “short-term” as three months or less from the date of acquisition of such investment.

However, DP (2016) argues that it is arbitrary to define which investments are sufficiently close to cash to qualify for inclusion in “cash equivalents” because it emphasizes that there is no clear reason why a maturity of three months is better compared with two or four months (FRC 2016, p. 22). In addition, DP (2016) argues that the concept of “insignificant risk of changes in value” is subjective to define due to some risk of price change attributable to, e.g., sudden changes in the credit environment or the perceived credit quality of the issuer.

Due to the stated issues above, DP (2016) proposes that the statement of cash flows should focus on cash rather than cash and cash equivalents for the purpose of liquidity management of entities. Therefore, liquid resources should only include the assets that are readily convertible into cash without restriction and a separate section should be devoted to management of liquid resources along with necessary disclosure requirements for (a) the entity’s policy for the management of liquid resources; and (b) the assets that are regarded as liquid resources, and changes in them (FRC 2016, pp. 23–24).

Reconciliation of Operating Activities

In the existing requirements of IAS 7, a reconciliation schedule is not required if the operating section of the statement of cash flows is prepared under direct method as stated before but is presented at the operating section of this statement under indirect method (FRC 2016, pp. 26–27). Such a schedule can start with any line item of the income statement such as profit before tax or profit after tax (FRC 2016, p. 26).

Necessary adjustments are made on the profit before or after tax considering (a) items that do not represent cash flows such as depreciation; (b) items that relate to the “investing” and “financing” sections rather than operating; and (c) changes in working capital.

This schedule is important because it establishes the relationship between a measure of operating performance and operating cash generation, and it provides information on changes in working capital (FRC 2016, p. 26). Therefore, the assessment of quality of earnings, future earnings, and cash flows as well as the efficiency of resource management can be analyzed.

In this context, DP (2016) proposes that a reconciliation should be provided between operating income and cash flows from operating activities in line with ED (2010). Since the number of items decreases in adjusting the operating income, the reconciliation is expected to improve transparency and understandability (FRC 2016, p. 26).

Since the reconciliation does not provide information about the cash flows of the entity, DP (2016) suggests that it should be presented as a supplementary disclosure rather than within the statement itself (FRC 2016, p. 28).

Direct or Indirect Method

Even if the current IAS 7 permits both direct method and indirect method, DP (2016) is against arguing on permitting or requiring a specific accounting policy choice or the cancellation of direct method even if the indirect method is the traditional one. Instead, it suggests arguing on which more detailed and significant information on the components of cash flows from operating activities such as cash received from customers and working capital amounts, should be required to disclose in terms of relevance and usefulness (FRC 2016, p. 31).

3.3.4.2 Observations on the Exemplary Statement of Cash Flows

DP (2016) provides an example of a statement of cash flows that was derived from the example presented in IAS 7 to provide comparability. Therefore, the following observations were gathered by comparing the examples provided in IAS 7 (Table 3.12) (FRC 2016, p. 35) and DP (2016) (Table 3.13) (FRC 2016, p. 36):

1. Example provided in IAS 7 and proposed format are based on indirect method in reporting operating cash flows.
2. DP (2016) is against for a discussion of an accounting standard requiring or permitting either the direct method or indirect method as well as prohibiting the direct method, but it implicitly proposes the indirect method with a reconciliation schedule through (Tables 3.13 and 3.14).
3. DP (2016) is in line with DP (2008) and ED (2010) in terms of reporting cash flows from investing in operating assets in the operating section toward reporting free

Table 3.12 Traditional version of statement of cash flows under IAS 7

Statement of cash flows for an entity other than a financial institution		
Cash flows from operating activities		
Profit before taxation	3.350	
Add: depreciation	450	
Add: foreign exchange loss	40	
Deduct: investment income	500	
Add: interest expense	400	
	3.740	
Deduct: increase in trade and other receivables	500	
Add: decrease in inventories	1.050	
Deduct: decrease in trade payables	1.740	
Cash generated from operations	2.550	
Interest paid	(270)	
Income taxes paid	(900)	
<i>Net cash from operating activities</i>		1.380
Cash flows from investing activities		
Acquisition of subsidiary X net of cash acquired	(550)	
Purchase of PPE items	(350)	
Proceeds from sale of equipment	20	
Interest received	200	
Dividend received	200	
<i>Net cash from investing activities</i>		(480)
Cash flows from financing activities		
Proceeds from the sale of share capital	250	
Proceeds from long-term borrowing	250	
Payment of lease liabilities	(90)	
Dividend paid	(1.200)	
<i>Net cash flows from financing activities</i>		(790)
Net increase in cash and cash equivalents		110
Cash and cash equivalents at beginning of period		120
Cash and cash equivalents at end of period		230

cash flow information, but it also proposes to declare a subtotal before net cash flows from operating activities titled as “cash generated from operations, before capital expenditure” of 3050 to clearly observe cash generated from operations.

4. Compared with DP (2008) and ED (2010), DP (2016) does not propose the inclusion of lease liabilities in the operating section. They remain in the financing section.

Table 3.13 Proposed statement of cash flows under DP (2016)

Statement of cash flows for an entity other than a financial institution		
Cash flows from operating activities		
Cash generated from operations, before capital expenditure	3.050	
Purchase of PPE items	(350)	
Proceeds from sale of equipment	20	
<i>Net cash from operating activities</i>		2.720
Cash outflow relating to takeover defense		(500)
Cash flows from investing activities		
Acquisition of subsidiary X net of cash acquired	(550)	
Interest received	200	
Dividend received	200	
<i>Net cash from investing activities</i>		(150)
Cash flows from financing activities		
Proceeds from the sale of share capital	250	
Proceeds from long-term borrowing	250	
Payments to providers of debt finance	(270)	
Payment of lease liabilities	(90)	
Dividend paid	(1.200)	
<i>Net cash flows from financing activities</i>		(1.060)
Income taxes paid		(900)
Net increase in liquid resources		110
Management of liquid resources		
Purchase of short-term investments	(180)	
Sale of short-term investments	85	
<i>Net cash invested in liquid resources</i>		(95)
Increase in cash		15
Cash at beginning of period		25
Cash at end of period		40

5. In line with DP (2008) and ED (2010), DP (2016) proposes to report taxes paid in a separate section of the statement of cash flows.
6. Short-term investments, including cash equivalents are reported in a separate section titled as “management of liquid resources”.
7. In line with DP (2008) and ED (2010), DP (2016) proposes to report cash rather than cash and cash equivalents in the statement of cash flows.
8. Interest paid of 270 was transferred from operating section to financing section.

Table 3.14 Reconciliation of profit and cash flows from operating activities

Profit from operating activities (operating profit)		3.790
Non-cash income and expenses	450	
Depreciation		450
Changes in working capital:		
Deduct: increase in trade and other receivables	(500)	
Add: decrease in inventories	1.050	
Deduct: decrease in trade payables	(1.740)	
		(1.190)
Cash generated from operations, before capital expenditure		3.050

3.3.5 ED (2019): General Presentation and Disclosure

ED (2019) was published to improve how information is communicated in the financial statements, with a focus on performance reporting about the statement of profit or loss but it proposes some amendments to statement of cash flows as well (IASB 2019a, p. 5). In this context, proposed amendments to statement of cash flows are analyzed below along with an example of the statement.

3.3.5.1 Analysis of ED (2019) in terms of the Statement of Cash Flows

ED (2019) proposes the following amendments related to the statement of cash flows.

1. The operating section under indirect method uses operating profit as the starting point rather than profit or loss to understand how operating profit or loss is converted into operating cash flows (IASB 2019a, p. 71; 2019b, p. 45). This is in line with ED (2010) and DP (2016).
2. In the operating section, “cash flows from operations” is replaced by “cash flows from operating activities before income tax” (IASB 2019c, p. 28).
3. Accounting policy choices to report dividend and interest received and paid are removed (IASB 2019a, p. 72). In this regard, ED (2019) is in line with ED (2010) within the framework of the following rationales (IASB 2019b, p. 47) for the firms other than financial institution: (a) dividend payments are part of financing in nature, (b) interest received and dividend received are usually related to income from investments, and (c) interest paid refers to the cost of obtaining financing. In addition, ED (2019) is partially in line with DP (2016) because classification of interest received depends on nature of activity under DP (2016) as stated before (Table 3.15).
4. Compared with ED (2012), ED (2019) proposes the classification of capitalized interest paid in the financing section of the statement of cash flows to avoid from potentially arbitrary allocations between operating and investing activities

Table 3.15 Classification of cash flows related to interest and dividend under ED (2019)

	Traditional format	DP (2008)	ED (2010)	DP (2016)	ED (2019)
Interest received	Operating or investing	Financing	Investing	Operating or investing	Investing
Interest paid	Operating or financing	Financing	Financing	Financing	Financing
Dividend received	Operating or investing	Investing	Investing	Investing	Investing
Dividend paid	Operating or financing	Financing	Financing	Financing	Financing

(IASB 2019a, p. 72; 2019b, p. 47) as well as to be consistent with interest paid recognized as an expense in profit or loss.

3.3.5.2 Observations on the Exemplary Statement of Cash Flows

ED (2019) provides an example of a statement of cash flows that was derived from the example presented in IAS 7 to provide comparability. Therefore, the following observations were gathered by comparing the examples provided in IAS 7 (Table 3.12) (FRC 2016, p. 35) and ED (2019) (Table 3.16) (IASB 2019c, pp. 28–31):

1. Profit before taxation of 3350 of traditional statement of cash flows is replaced by the operating profit of 3290 on the ED (2019) statement of cash flows as the new starting point of the reconciliation process.
2. Due to change in the starting point of the reconciliation process, foreign exchange loss, investment income, and interest expense are not part of the reconciliation.
3. Interest paid of 270 that is reported in the operating section is transferred to financing section.
4. Taxes paid is reported in the operating section but a new line item “cash from operating activities before income tax” is proposed before taxes paid so that investors can make pre-tax basis analysis in line with DP (2016).
5. Different from the proposals of DP (2008), ED (2010), and DP (2016), ED (2019) proposes the reporting of cash and cash equivalents.

Table 3.16 Proposed statement of cash flows under ED (2019)

Statement of cash flows for an entity other than a financial institution		
Cash flows from operating activities		
Operating profit	3290	
Add: depreciation	450	
	3740	
Deduct: increase in trade and other receivables	500	
Add: decrease in inventories	1050	
Deduct: decrease in trade payables	1740	
Cash from operating activities before income tax	2550	
Income taxes paid	(900)	
<i>Net cash from operating activities</i>		1650
Cash flows from investing activities		
Acquisition of subsidiary X net of cash acquired	(550)	
Purchase of PPE items	(350)	
Proceeds from sale of equipment	20	
Interest received	200	
Dividend received	200	
<i>Net cash from investing activities</i>		(480)
Cash flows from financing activities		
Proceeds from the sale of share capital	250	
Proceeds from long-term borrowing	250	
Payment of lease liabilities	(90)	
Interest paid	(270)	
Dividend paid	(1200)	
<i>Net cash flows from financing activities</i>		(1060)
Net increase in cash and cash equivalents		110
Cash and cash equivalents at beginning of period		120
Cash and cash equivalents at end of period		230

3.4 Conclusion

This chapter provides perspectives to improve the statement of cash flows reported under IAS 7 through (1) the Discussion Paper on preliminary views on Financial Statement Presentation that was published by the IASB in 2008, (2) the staff draft of Exposure Draft IFRS X Financial Statement Presentation that was issued by the staff of the IASB in 2010, (3) Exposure Draft ED/2012/1 Annual Improvements to IFRSs 2010–2012 Cycle that was published by the IASB in 2012, (4) staff Discussion Paper of the UK's FRC that was published in 2016, and (5) the Exposure Draft ED/2019/7 General Presentation and Disclosure that was issued by the IASB in 2019.

Several changes were proposed toward the design of the statement of cash flows for better financial communication to meet cohesiveness, disaggregation, as well as liquidity and financial flexibility objectives, but those attempts did not turn out to be an IFRS accounting policy. Therefore, the statement of cash flows still reports cash inflows and outflows under operating, investing, and financing activities rather than other additional proposed sections. Both direct and indirect method are valid for reporting operating cash flows, and a reconciliation schedule has not offered in the last ED (2019). Toward the objective of analyzing free cash flow, cash flows from investing into operating assets were not transferred from investing to operating despite several attempts in DP (2008), ED (2010), and DP (2016), but the removal of dividend paid from operating cash flows has been proposed as a positive contribution to free cash flow calculation (IASB 2019b, p. 46).

In addition, the proposal of eliminating accounting policy options for interest and dividend received and paid as well as reporting capitalized interest paid in the financing section will provide comparability and consistency of the reporting of cash flow information if ED (2019) is approved by the IASB as a standard.

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Chapter 4

The Evolution of Institutional Environments in the Development of Accounting Regulations and Practices in Malaysia



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Abstract This paper presents several important institutional issues comprising economic and governmental pressures, the legal system category, cultural backgrounds and global pandemic crisis to offer understanding into Malaysia's accounting practices since 1957. The isomorphism conception under the institutional theory is used to provide a grasp of the position of institutional factors which explain the development of Malaysian accounting regulations and practices. An archival review is made on the websites of accounting professional bodies, journal articles, accounting reference books and other related documents from 1957 until present. This paper adds to offering an overall view of Malaysia's political, economic, and regulatory atmosphere and accounting and financial reporting framework. Utilizing the isomorphism conception, this review adds on to the worldwide accounting research literature by explaining institutional factors which explain the development of accounting regulations and practices in Malaysia. This whole-inclusive approach would help to understand the current practices and assist to steer the reformation of accounting regulatory in the future. This paper would be useful to academics, practitioners and higher authorities, who strive to improve accounting practices, disclosures and regulations.

Keywords Isomorphism · Accounting practice · Institutional environment

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4.1 Introduction

Since the historic independence from Britain in 1957, the accounting system in Malaysia has seen the progression from the dependency on the British accounting regulations and practices to the passing of the Companies Act 1965 and Accountants Act 1967, leading to the establishment of the Malaysian Institute of Accountants (MIA). Subsequently, amendments were made to the statutes and regulations, and the Financial Reporting Act 1997 established, to better regulate the accounting practices, as influenced by the domestic, global and regional developments.

There are numerous allusions in the literature to the idea that accounting is a product of the environment in which it operates (Tahat et al. 2018; Ali 2007; The Committee to Strengthen the Accountancy Profession [CSAP], 2014; Almujaed et al. 2017, Alon and Dwyer 2016; Phang and Mahzan 2013; Olamide and Temitope 2016). The interaction of institutional, environmental, economic and political factors, cultural background and the global pandemic crisis has been influential in the development of accounting practices and financial reporting framework. In Malaysia, the major post-independence evolution of accounting practices and regulations include the amendment of the Companies Act 1965 in 1985, the repeal of the Companies Act 1965 and the coming into force of the new Companies Act 2016, the activation of the MIA in 1987 and the enactment of the Financial Reporting Act 1997, leading to the establishment of the Financial Reporting Foundation (FRF) and Malaysian Accounting Standards Board (MASB). In this chapter, accounting regulations refer to the relevant authorities that govern the accounting practices. Meanwhile, accounting practices refer to the accounting profession, standards and conceptual framework which is explained in detail in subsequent sections. The institutional theory's isomorphism concept is used to describe the influence of institutional factors in the development of Malaysian accounting regulations and practices since its independence in 1957. The subsequent sections of this chapter will cover an overview of the accounting regulations of Malaysia; challenges in the accounting regulations of Malaysia; an overview of the accounting practices and financial reporting in Malaysia; institutional factors influencing the development of accounting regulations and practices and conclusion.

4.2 An Overview of the Accounting Regulations of Malaysia

As former British colonies, Malaysia, made up of the Federation of Malaya, Sabah and Sarawak, inherited the regulatory principles from the accounting profession in the United Kingdom (UK) (CSAP 2014). The Federation of Malaya gained independence in 1957, and was joined by the British colonies of Sabah, Sarawak and Singapore in 1963 to form the Federation of Malaysia. The post-independence year of 1958 saw the incorporation, under the Companies Ordinances (1940–1946), of a self-regulatory accountancy body, the Malayan Association of Certified Public

Accountants. With the formation of MIA in 1967, the MICPA regulatory role shifted to technical assistance for the Malaysian regulatory bodies, tasked with defining the country's business and financial landscape (MICPA n.d.).

(a) Involvement of Professional Accounting Bodies

The development of accounting standards in Malaysia were influenced by the Malaysian professional accounting bodies, namely the MIA and the MICPA. Prior to the formation of the MASB, accounting standards were developed by MIA and MICPA. As a result of the development of these standard-setting bodies, the standard of reporting has improved over time although it was then still largely based on the provisions of the original *Companies Act 1965* (Tong 2019). When the Financial Reporting Act was gazetted in March 1997, the two professional bodies stopped issuing accounting standards which signalled the move of the Malaysian accounting standard setting process from the private sector accountancy bodies to the public statutory body (Tong 2019).

(i) *Malaysia Association of Certified Public Accountants (MICPA)*

The accountancy profession and Malaysia's economic development have a formal relationship dating back to 1958 when the then Malayan Association of Certified Public Accountants (MACPA) was established as a self-regulatory accountancy body under the Companies Ordinance (1940–1946) (IFAC 2021a). In 1968, MACPA issued the first accounting guidance which dealt with a specimen company accounts. Subsequently, the association became Malaysian Association of Certified Public Accountants (MACPA) on 6 July 1964 and was finally renamed Malaysian Institute of Certified Public Accountants (MICPA) on 29 January 2002 (MICPA n.d.). It is a private sector accountancy body that regulates the practices of its members who carry the title of Certified Public Accountants (CPA).

In 1978, MICPA was admitted as a member of the International Accounting Standards Committee (IASC). The IASC was set-up in 1973 and was responsible for the setting of International Accounting Standards (IAS) and issuance of guidelines called Standing Interpretations Committee (SIC) (Arshad n.d.). The government's new economic policy (NEP) adopted in 1971 saw increased Bumiputra's¹ holdings in big corporations and reduced foreign ownership, which led to numerous corporate mergers and takeovers. MICPA was asked to intervene on behalf of the government which was concerned about the lack of reporting and accounting rules and guidance for companies. MICPA's single-handed role in setting standard lasted for a long time, until MIA joined in 1985 (Sood 2006).

(ii) *The Malaysian Institute of Accountants (MIA)*

Malaysia's accounting profession is governed by the Accountants Act 1967, which was enacted after the country's formation in 1963. Under this Act, MIA was founded

¹ The Bumiputras comprise the Malays, the Orang Asli of Peninsular Malaysia and various indigenous people of Sabah and Sarawak.

in 1967 as the national accountancy body that regulates, develops, supports and enhances the integrity, status and interests of the profession in Malaysia. Section 22 of the Act prescribes that a person who holds himself as an accountant without being an MIA member commits an offence. The existence of coercive isomorphism was evidenced by the introduction of the Act, which demonstrated the government's roles in regulating and controlling the accounting profession by allowing only properly competent individuals to the profession.

Despite being founded by a statute, MIA remained dormant and focussed primarily on the accountants' registration in Malaysia until 1987. However, in 1987, the operations of the MIA were raised to that of a national accountancy body and began to issue accounting standards (Tong 2019). Initially, all the standards previously developed by the MICPA were adopted by MIA. As a member of the Board of IASC and Public Sector Committee of IFAC, the MIA became actively involved in global standard setting (Sood 2006). After going through the necessary due process to ensure that the IASs adopted from the IASC are suited to the Malaysian environment, MIA began to release its own accounting standards (Sood 2006).

Even though adoption of IASs led to more comprehensive disclosure of corporate information, some local reporting requirements relating to specific local industries such as aquaculture and insurance were not met. Therefore, MICPA and MIA worked together and issued accounting standards known as the Malaysian Accounting Standards (MASs). Examples of these standards are MAS 1 *Earnings Per Share*, MAS 6 *Accounting for Goodwill* and MAS 8 *Accounting for Pre-Cropping Costs*. The process of the adoption of IASs and the development of MASs continued until 1997 when the MASB was established to take over the role of standard setting in Malaysia and as at 31 December 1996, 24 IASs, 8 MASs and 8 technical bulletins have been issued (Tong 2019, Arshad n.d.).

(b) Involvement of Relevant Authorities

The accountancy profession in Malaysia is also regulated by the Companies Commission of Malaysia (CCM) and the Audit Oversight Board (AOB) (IFAC 2021b). The CCM is a statutory body formed from a merger between the Registry of Companies (ROC) and the Registry of Business (ROB) in April 2002. However, unlike the direct regulatory role of MIA over the profession, empowered by the Accountants Act, 1967, the CCM regulates companies and businesses through its administration and enforcement of several legislations that include the Companies Commission of Malaysia Act 2001, Companies Act 2016, Interest Schemes Act 2016, Registration of Businesses Act 1956, Limited Liability Partnerships Act 2012, Trust Companies Act 1949 and Kootu Funds (Prohibition) Act 1971, and other subsidiary legislations. Hence CCM, through comprehensive enforcement and monitoring activities is the leading authority for the improvement of corporate governance.

The AOB, established under the Securities Commission Act Malaysia 1993, came into force on 1 April 2010 to oversee the accounting profession via an effective audit oversight framework to promote confidence in the quality and reliability of audited financial statements of public-interest entities and schedule funds in Malaysia (SC n.d.). Other regulatory bodies include the Central Bank of Malaysia (CBM), the

Securities Commission (SC) (Sood 2006), and the Malaysian Stock Exchange (Bursa Malaysia).

The regulators and professional bodies work closely together to promote and recognize excellence in corporate reporting. An example of how companies are encouraged to voluntarily disclose information that is useful and relevant to financial information users is the hosting of competitions for various disclosure awards (Tong 2019), such as the National Annual Corporate Report Awards (NACRA) jointly organized by Bursa Malaysia, MIA and MICPA.

(c) Malaysian Accounting Standards Board (MASB) and Financial Reporting Foundation (FRF)

Prior to 1997, the financial statements in Malaysia focussed merely on traditional stewardship accounting and reporting (Tong 2019). However, this reporting tendency began to change when the Malaysian government approved the Financial Reporting Act of 1997 (FRA 1997). Under the Act, the Financial Reporting Foundation (FRF) and Malaysian Accounting Standards Board (MASB) were established in 1997.

FRF, as a trustee body, is responsible to oversee the MASB's performance, financial and funding arrangements, and as an initial source of views for the MASB on proposed standards and pronouncements. The MASB, on the other hand, was given the mandate to issue accounting standards in Malaysia, taking over the responsibility from MICPA and MIA. According to Sood (2006), the shift in standard setting represented a change in attitudes of various Malaysian groups regarding standard setting. Findings by Sood (2006) indicated that there were mixed feelings among the interest groups. Some accountants insisted that the board should be within MIA's jurisdiction, while others questioned the board's competence to enforce the accounting standards. However, Sood (2006) found that generally all agreed that having an independent body to develop the accounting standards in Malaysia is a good idea. Members of MASB, appointed by the Minister of Finance, include a chairman, the accountant general, advisors from the SC, Companies Commission of Malaysia (CCM), MIA, and six other members with expertise in accountancy, law, business and finance, and FRA 1997 specifies that at least five of these members are members of MIA. Hence, other parties' participation and their multiple inputs put into the standard setting process together with a strong legal backup for standard enforcement would lead to the development of accounting standards that produce high-quality financial statements (Sood 2006).

The accounting regulatory framework of accounting was designed with goals of producing high-quality and reliable information to meet the needs of external users. In reality, it plays a critical role in ensuring that companies' financial statements are prepared in conformity with the rules and regulations. In Malaysia, Section 27 of the FRA 1997 requires all companies incorporated under the Companies Act to comply with the accounting standards issued and adopted by the MASB (Arshad n.d.)

Improvements in Malaysian companies' financial reporting attract more potential investors to the capital market (Sood 2006).

(d) Companies Act 1965 and its Amendment

Before Malaysia (then Malaya) achieved her independence on 31 August 1957, the Companies Ordinances (amendments) of 1940, 1946 and 1956 became the first documented financial reporting regulations and continued to play a prime role in regulating financial reporting after the independence of Malaysia (Tong 2019). Following Malaysia's independence, agriculture sector was the largest contributor of workforce during the First Five-year Plan (1956–1960). The second Five-Year Plan (1961–1965) focussed on rural development which includes investment for infrastructure and social services. In response to the growing sophistication of the economy, the Companies Act, 1965 was established (CSAP 2014) and the Companies Ordinances abolished (Tong 2019).

Ali (2007) reported that accounting in Malaysia appeared to have been energized following the economic recession in 1985–86, but before the Asian Financial Crisis in the third quarter of 1997, with major amendments to the Companies Act 1965, the activation of MIA and discussion about the establishment of MASB. The Companies Act was substantially revised in 1985 and became effective from 1 February 1986. The overall goal of the amendment was to entice foreigners to invest in the country, by emphasizing the need for individuals involved with companies to be more accountable to the minority shareholders, which include the foreigners (Ali 2007). Thus, the amended Companies Act contained more comprehensive disclosure requirements (Tong 2019). However, Ali (2007) found that revised Companies Act 1965 is superficial as

the pressure for change coming from the economic recession was related directly to the emergence of a “modern” system of accounting – but not for its effective and appropriate administration in the Malaysian social environment. It created a perceived need for “structural” (as oppose to in-depth) changes to the accounting system. (Ali 2007, p. 140)

The original Companies Act 1965 was replaced with a new Companies Act 2016 in April 2016 after the Companies Bill 2015 was approved in Parliament. Under this new Act, companies must comply with the approved accounting standards issued by the MASB and thus eliminate the conflict between the old Act and the approved accounting standard. Also, the Ninth Schedule of the original Act has been taken out, which means that the new Companies Act no longer prescribes accounting treatments and disclosure requirements for financial reporting (Tong 2019).

4.3 Challenges in the Accounting Regulations of Malaysia

Issues raised in the World Bank's Report on Observance of Standards and Codes in Accounting and Auditing (ROSC AA) released in 2012 marked the start of possible landmark development in the regulatory framework of the profession, 55 years after

independence. The MIA has been brought back into the limelight following the review of the regulatory framework and governance structure of MIA which revealed (1) perceived split identity of MIA hinders its effectiveness, (2) effectiveness of the MIA Council is in question, (3) MIA leadership in accountancy education lacks visibility, (4) distortion of the identity of accountants, (5) challenges in enforcing professional standards and rules, (6) the lack of technical competence to enhance accounting knowledge and practice, (7) rules for practicing accountants need to be modernized and (8) the need to strengthen funding for accountancy development (CSAP 2014).

As part of the country action plan to address issues raised in the ROSC AA, the Committee to Strengthen the Accountancy Profession in Malaysia (CSAP) was established, with members drawn from several regulators, including MIA. CSAP (2014) stated the challenges outlined in this report “signal the need for a total reset of the governance of the accountancy profession in Malaysia” (CSAP 2014, p. 40). Fifteen recommendations were put forward, the main thrust being “to revamp the governance structure of the accountancy profession, replacing the MIA with a new structure with better checks and balances...” (CSAP 2014, p. 40). This led to the first recommendation for “a new regulatory body (hereinafter referred to as ‘NRB’) be established in Malaysia” (CSAP 2014, p. 41).

The passing of MIA’s regulatory powers to NRB, however, is “an uncomfortable idea for those who prefer the institute to stay as it is” (Oh 2017). Since then, MIA has been proactive, which included setting up of an internal CSAP taskforce that meets at least once a month (Lee 2018). In an interview with the then MIA’s President, Salihin Abang, and Vice President, Dato’ Narendra Kumar Jasani, the VP stated that 13 recommendations have either been adopted or in the process of being implemented, with two recommendations still pending, namely the competency framework for the local accountancy graduates and the regulatory framework. To this, the then President added “In the end, the MIA may still retain its regulatory functions. If you want to change the MIA’s role, then you have to change the Accountants Act 1967. Under the Accountants Act 1967, we are the regulator of the accountancy profession in Malaysia... With this mandate, and the role enacted by parliament, we are the custodian taking care of the whole profession in Malaysia” (Lee 2018).

The sentiment to maintain MIA as the statutory regulatory of the profession was echoed by the then deputy finance minister, in his keynote address at the MIA International Accountants Conference in October 2018, when he said, “the government wanted to strengthen the MIA’s powers and was looking into amending the act to further empower regulation and enforcement of the profession” (Oh 2019). To date, the new Accountants Act has not been passed. Following the CSAP report in 2016, the Securities Commission (SC) was assigned by the Minister of Finance to form an implementation committee (IC) to draft the amendments of the Accountants Act 1967. The MIA was one of the several stakeholders represented on the IC.

4.4 An Overview of the Accounting Practices and Financial Reporting in Malaysia

In the post-independence Malaysia, the strong influence of the accounting institutions and practices of the United Kingdom (UK) was evident as the development of accounting and accounting practices can be traced to the then MACPA, now MICPA. It would not be totally wrong to say that as the only *Malaysian-grown professional accounting* body, the 20 local founding members (Ali 2001 as cited in Ali 2007) mainly comprised, if not all, accountants who have been trained under the tutelage of the British accountants.

Subsequently, financial reporting of Malaysian companies was statutorily obligated to comply with the minimum disclosure requirements laid out in Ninth Schedule of the Companies Act 1965. The Companies Act 1965 and the later Accountants Act 1967, were likewise both based on the laws and regulations developed in the United Kingdom (UK) (UKessays 2018a, b).

The formal adoption of the UK-based accounting standards in 1979, began with the adoption of the International Accounting Standards (IAS), issued by the International Accounting Standards Committee (IASC), that was founded in 1973 and later replaced by the International Accounting Board (IASB) in 2001. Malaysia, in the form of MICPA joined as an associate member in 1975 and later joined by MIA from 1995 to 2000 (Wikipedia 2021a). The IASs, however, were inadequate as the accounting and reporting needs of specific industries such as aquaculture and insurance were not addressed, which led to the issuance of Malaysia's home-grown Malaysian Accounting Standards (MASs) in 1980s, jointly by MIA and MICPA (Arshad n.d.).

Following the statutory formation of MASB in 1997, Malaysian companies are to comply with MASB approved accounting standards, comprising the Malaysian Financial Reporting Standards (MFRS) and the Interpretations Committee's IC Interpretations, and the Malaysian Private Entities Reporting Standards (MPERS). Malaysian SMEs may opt to comply with either MFRS or MPERS. Technical pronouncements are also issued to complement the MASB approved accounting standards, in ensuring the financial statements present a true and fair view of an entity's financial position, performance and changes in financial position. Issues arising from existing and potential differing practices and the need for consistent application and implementation of MFRS for the benefit of capital markets led to the setting up of the MFRS Application and Implementation Committee (MAIC) by the MASB in January 2019.

(a) Convergence to IFRS

In Malaysia, the initiative to converge with IFRS in line with the global standard setting development, started when the MASB standards were rebranded to financial reporting standards (FRS) in 2005. The standards' numbering conformed to the IFRSs issued by the IASB except for some modifications (Arshad n.d.). In 2006, a batch of 21 financial reporting standards (FRSs) had been issued by the MASB which

were adopted from the new IFRSs and IASs issued by the IASB. The FRS standards, also known as FRS framework, has been made compulsory for non-private entities to prepare and present their financial statements.

On 1 August 2008, MASB declared its intention to achieve full convergence of FRSs applicable in Malaysia with IFRSs issued by IASB by the year 2012 for all entities other than private entities, which means full compliance with IFRS both in terms of content and timing of implementation (Tong 2019). This is a reflection of Malaysia's commitment towards one global financial reporting language (Sidik and Rahim 2012).

In moving towards full convergence, the MASB issued a new Malaysian Financial Reporting Standards (MFRS) framework in November 2011, which is fully consistent with the IFRS framework. The accounting standards under the new framework was renamed to MFRS standards on 1 January 2012. Compliance with the MFRS framework became effective on 1 January 2012, for all entities other than private entities, except for those covered by MFRS 141 *Agriculture* and IC Interpretation 15 *Agreements for Construction of Real Estate* (IC 15), including its parent, significant investor and venture (Arshad n.d.).

The main purpose of the convergence is to close the gap between financial reporting standards (FRS) and the IFRS, making financial statements more transparent and comparable (UKEssays 2018a, b). In their study on the evolution of accounting standards in Nigeria, Olamide and Temitope (2016, p. 11) opined that the adoption of IFRS was “triggered by the nation's sense of belonging since IFRS has already been embraced by over 122 countries”. Several other literatures concurred the adoption of or convergence with IFRS as necessary for the evolving accounting and reporting environment (Phang and Mahzan 2013; Sidik and Rahim 2012; Ocansey and Enahoro 2014; Phan et al. 2016; Alon and Dwyer 2016; Tahat et al. 2018).

Following the announcement of full convergence, several studies looked into the challenges faced by entities in terms of standards complexity, lack of technical expertise among preparers and auditors, under-developed local capital markets, insufficient guidance for first-time application of the IFRS, lack of practical knowledge on standards application, convergence cost and problematic fair value accounting (Larson and Street 2004; Jermakowicz and Gornik-Tomaszewski 2006; Phang and Mahzan 2013).

Full convergence of MFRSs in Malaysia with the IFRSs issued by IASB was achieved by the year 2012 which marked an advancement of reporting standards in Malaysia as it has brought financial reporting in Malaysia in tandem with other countries that have adopted the IFRSs and enhances the credibility and transparency of financial reporting in Malaysia (Tong 2019; Sidik and Rahim 2012). According to FRF and MASB Annual Report (2018), for annual periods beginning on or after 1 January 2018, all non-private entities in Malaysia are now required to use a

single set of high quality, globally accepted accounting standards, namely the MFRS Framework.

(b) Development of the Malaysian Private Entities Reporting Standard (MPERS)

To alleviate the compliance burden that the complex IFRS imposed on private entities, MASB introduced the Private Entity Reporting Standards (PERS) in 2006. As a result, starting in 2006, there existed a two-tier financial reporting framework: the FRS framework and the Private Entity Reporting Standard (PERS) framework (Tong 2019). A private entity is “a company incorporated under Companies Act 2016 that is not required to prepare or lodge any financial statements under any law administered by the SC or the CBM; and is not a subsidiary or associate or, or jointly controlled by, an entity which is required to prepare or lodge any financial statements under any law administered by the SC or the CBM” (Tong 2019, p. 18).

In February 2006, private entities in Malaysia were exempted from complying with the MFRSs but can choose to apply the PERS framework. PERS is a set of accounting standards issued or adopted by the MASB for application by all private entities. However, owing to a huge gap between IFRSs used by non-private entities and the PERs by the private entities, the MASB issued Malaysian Private Entities Reporting Standard (MPERS) in February 2014, which is based on the IASB’s International Financial Reporting Standard for small and medium-sized entities (IFRS for SMEs) with minor amendments and adaptations. MPERS is a self-contained standard with 35 sections (Tong 2019) that address all aspects of financial reporting by private entities.

With that, the private entities had the option of adopting voluntarily the MFRS framework used by public entities or making mandatory transition to the new MPERS framework by 1 January 2016 (Tong 2019). Thus, with the adoption of the new MPERS framework in 2016, the private entity reporting in Malaysia is brought at par with the current global reporting (Tong 2019).

The significant efforts made over the years to improve the quality of financial reporting in Malaysia has enhanced the credibility of financial statements, which contributes to the efficiency of financial and capital markets operation by allocating capital for the productive economic purposes while also promoting financial and capital markets confidence (CSAP 2014).

(c) Development of Conceptual Framework

Other than developing and issuing standards, the MASB also issued Conceptual Framework for Financial Reporting and this framework is based on the IASB’s framework. The Conceptual Framework explains the goal and concepts for general purpose financial reporting. The framework goal is to help MASB develops MFRS standards (standards) that are based on consistent concepts; help preparers to develop consistent accounting policies when no standard applies to a particular transaction or other event, or when a standard allows for a choice of accounting policy and to help all parties to understand and interpret the standards (IFRS Foundation n.d.).

The original framework for the Preparation and Presentation of Financial Statements 2007 was issued by MASB, similar to the then IASB framework for the

Preparation and Presentation of Financial Statements. In November 2011, the original framework was replaced by the Conceptual Framework for Financial Reporting, for the preparation and presentation of financial statements in compliance with the Malaysian Financial Reporting Standards (MFRSs). Then in 2018, a revised Conceptual Framework for financial reporting was issued by MASB. It is identical to the revised IASB's Conceptual Framework for financial reporting. The 2018 Conceptual Framework is effective immediately for the MASB and its Interpretations Committee. The Conceptual Framework is not a standard, but when there is no MFRS standard applicable to a transaction, a reporting entity may refer to the Conceptual Framework to develop or select appropriate accounting policy for that transaction or event (Tong 2019).

(d) Accounting and Reporting of Shariah Compliant financial transactions

According to Mohammed et al. (2016), MASB was actively involved in the establishment of Islamic accounting standards in the early 2000s to ensure smooth reporting of Islamic Financial Institutions (IFIs). The debate on Islamic standard gave rise to two separate issues namely; (1) concerned with IFIs with regard to preparers' need for assistance in preparing their financial statements for transactions that differ from those of conventional banking system; (2) Muslim accountants were concerned whether the accounting treatment given in the IFRSs are consistent with Shariah's principles. Further research by Mohammed et al. (2019) revealed that there is a need for precise guidelines or standards for IFIs within the IFRS framework to reassure the public that they offer *Shariah* compliance products approved by Shariah Advisory Council, without the need for specific Islamic accounting standard.

The accounting standards approved by MASB applicable to Islamic transactions carried out by entities are also subjected to the Financial Reporting Act 1997. However, the International Financial Reporting Standards (IFRS) which were adopted by MASB may not have particularly addressed Islamic financial transactions in reaching their conclusions. As a consequence, the standing committee (FRF MASB 2020a) was tasked to advise the board on whether current or proposed approved accounting standards can be applied to Islamic financial transactions (FRF MASB 2020a).

The standing committee is made up of representatives from accounting profession, regulators academia as well as takaful and banking professions. The functions of the standing committee include: (1) identifying technical concerns pertaining to Islamic finance for review and discussion; (2) identifying different approaches to address the concerns by carrying out research and benchmarking; (3) providing clear recommendations to the board on the implementation of approved accounting standards to an Islamic finance transaction; (4) helping the board in the following areas:

- Preparing documents relevant to Islamic financial reporting for the board's approval.

- Bringing the Islamic financial reporting challenges and possible solution(s) to the IASB either directly or indirectly through the Asian-Oceanian Standard-setters Group (AOSSG) or any other body.
- Preparing documentations and recommendations on Islamic finance accounting issues for the Shariah Advisory Council of CBM or SC, when needed (FRF MASB, 2020a).

MASB, in 2001, issued MASB *i-1* (later renamed FRS *i-1*), *Presentation of Financial Statements of Islamic Financial Institutions*. This was withdrawn as MASB ceased its policies of issuing Islamic accounting standards and is of the opinion that such standards are largely similar to the conventional standards in issue. On 15 September 2009, the MASB issued the statement of principles *i-1* (SOP *i-1*) *Financial Reporting from an Islamic Perspective*, which confirmed that MASB approved accounting standards apply to Shariah compliant financial transactions and events, unless the Shariah prohibits it (FRF MASB 2020b).

In the extremely rare circumstances of a Shariah prohibition, the MASB requirement need not be complied with, and “MASB will undertake to issue alternative guidance”. Also, if an Islamic accounting issue is not addressed in existing standards, guidance is provided in FRS 108 *Accounting Policies, Changes in Accounting Estimates and Errors*, and SOP *i-1* for management to exercise its judgement in developing and applying an accounting policy that ensures information provided to financial statement users is relevant and reliable (FRF MASB 2020c).

Complementary guidance that has been issued include the technical releases, as given in Table 4.1.

(e) COVID-19 Implications on Accounting and Reporting Practices

The detection of the novel Coronavirus disease (COVID-19) in Wuhan City, China in December 2019, followed by the announcement by the World Health Organization as a worldwide pandemic in March 2020, has brought about devastating economic and far-reaching social consequences (Wikipedia 2021c). To curb the spread of the pandemic, the Malaysian government initiated the movement control order (MCO), which took effect on 18 March 2020. The MCO includes a series of quarantine, closure of educational institutions, order to limit or suspend business operations, inter-state and international travel restrictions.

Table 4.1 MASB technical releases for Shariah compliant transactions (TR *i*)

Technical release	Title of TR <i>i</i>	Effective date
TR <i>i-1</i>	Accounting for zakat on business	1 July 2006
TR <i>i-2</i>	Ijarah	2006, and withdrawn
TR <i>i-3</i>	Presentation of financial statements of Islamic financial institutions	2009, and archived
TR <i>i-4</i>	Shariah compliant Sal contracts	2010, and archived

Source FRFMASB (2020d)

While the concern on people's health and safety is of paramount concern, and some businesses have even benefitted, the movement control restrictions (MCO) have its drawbacks. The MCO coupled with the lockdowns imposed by many countries, the cut in supply chain for goods from affected countries, the dilemma of financial institutions and borrowers alike arising from borrowers' inability to repay their loans have had severe impact on almost all businesses, either directly or indirectly (Grant Thornton 2020).

The Malaysian government has also put in place several measures to provide temporary reliefs to individuals and companies detrimentally affected socially and economically, one of which is the enforcement of the *Temporary Measures for Reducing the Impact of Coronavirus Disease 2019 (COVID-19) Act 2020* (in short, "COVID-19 Act") on 23 October 2020 (The Star 2020). The Act provides for amicable settlement of contractual obligations disputes without going through the legal process, restricts, albeit temporarily, debt recovery options and the enforcement of a contractual obligation against a defaulting party who demonstrates an incapacity to perform an obligation (Zain & Co. 2021).

As most business transactions are formalized through the creation of contracts, the mitigating effect of the COVID-19 Act is felt in several accounting areas, such as rent concession for a leased asset, revenue recognition, expected credit losses from inability to meet scheduled loan repayment, defined benefit obligations to employees. Such never-encountered-before contractual transactions ultimately pose challenges in accounting and reporting of financial performance of business entities, including the small medium enterprises (SMEs).

In Malaysia, the impact of COVID-19 first became an issue for financial reporting in the June quarter with MFRS134 *Interim Financial Reporting* requiring disclosure of "*the nature and amount of changes in estimates of amounts reported in prior interim periods of the current financial year or changes in estimates of amounts reported in prior financial years*" (MASB Secretariat 2020). The high degree of uncertainty influences the expectations of financial statement users in predicting future financial performance and emphasizes the importance of using realistic estimates and judgement. Reassessment of assumptions and estimates is particularly crucial as the appropriateness of the measurement basis used in prior periods and disclosures is questionable. For example, the going concern basis in relation to MFRS 101 *Presentation of Financial Statements* cannot be applied when businesses are faced with impending cessation, the need to consider unpredictable factors in determining the estimates for impairment of assets due to anticipation of a weaker future demand for goods and services and the greater reliance on unobservable inputs due to the unavailability or decrease in market observable inputs for fair value measurement of an asset or liability.

To ensure the accounting profession remains agile and resilient in adapting to the complex and heightened uncertainty posed by the pandemic crisis, MIA has "developed a dedicated web page to provide essential resources, updates and guidance, including information from relevant authorities..." (MIA 2021). Other business regulatory bodies, such as the CBM, the stock exchange, the Companies Commission of Malaysia (CCM), the Inland Revenue Board (IRB), have also provided guidance

and temporary relief measures to alleviate the hardship caused by the crisis. For example, CBM announced loan moratoriums for individuals, SMEs and corporations, and the CCM has allowed companies to apply for extension to lodge their financial statements with the Registrar of Companies.

Similarly, the accounting standards setter, MASB, various accountancy bodies such as MICPA, accounting firms such as Grant Thornton, PwC, KPMG have provided technical guidance and the latest relevant information to help entities with their financial reporting. On 5 June 2020, MASB amended MFRS 16 *Leases*, COVID-19 related rent concessions to help lessees more easily account for COVID-19 related rent concessions, such as rent holidays and temporary rent reductions or deferral of lease payments. On 6 April 2021, a subsequent amendment to MFRS 16 *Leases* on *Covid-19-Related Rent Concessions beyond 30 June 2021*, extends the practical expedient provided in 2020 for rent concessions due on or before 30 June 2022 (FAF MASB 2020e).

Malaysian account preparers are also guided by implementation documents and articles issued by MASB's international counterpart, the IASB. To date COVID-19 related guidance issued by MASB and IASB supporting implementation available for the accounting practitioners are as given in Table 4.2.

Table 4.2 MASB's COVID-19 related guidance

Date of issue	Title
MASB issued guidance	
25 March 2020	COVID-19: MFRS 9 <i>financial instruments</i> : expected credit loss considerations
9 June 2020	Q&A requirements in MFRS that Malaysian reporting entities may need to consider in respect of the impacts of COVID-19
20 October 2020	Recognition of revenue from sale of residential property upon enactment of the COVID-19 Bill 2020
IASB supporting implementation	
<i>Education documents</i>	
27 March 2020	IFRS 9 and COVID-19 accounting for expected credit losses applying IFRS 9 <i>financial instruments</i> in the light of current uncertainty resulting from the COVID-19 pandemic
10 April 2020	IFRS 16 and COVID-19 Accounting for COVID-19 related rent concessions applying IFRS 16 <i>Leases</i>
13 January 2021	Going concern—a focus on disclosure requirements in IFRS standards relevant for going concern assessments which may involve a greater degree of judgement than usual in the current stressed economic environment arising from the COVID-19 pandemic
<i>Articles</i>	
28 October 2020	Applying IFRS standards in 2020—impact of COVID-19

Source FRF MASB (2020f)

4.5 Institutional Factors Influencing the Development of Accounting Regulations and Practices

This chapter explains the institutional factors influencing the development of accounting regulations and practices using the institutional theory. The institutional theory has been used widely to explain the accounting practices (Carpenter and Feroz 2001). The conception under the institutional theory used in this chapter is isomorphism. Isomorphism is a practice that imposes one component to adapt to other components in the population that share out with related circumstances (DiMaggio and Powell 1983). The isomorphism mechanism is categorized into coercive, normative and mimetic. Coercive isomorphism is the most cited type of institutional force. Formal pressure is a regulatory practice in which supervisory body has the power to establish regulations, scrutinize compliance and impose penalties if appropriate. The formal pressures possibly come in the forms of enforcement, inducement and invitation (DiMaggio and Powell 1983). Mimetic isomorphism advocates the imitation of effective organizational practices that is socially accepted—being legitimate. The imitation of best practices normally occurs when there is an ambiguity in circumstances or the requirements to adhere to specific requirements. Meanwhile, the normative isomorphism is normally promoted by professional and occupational groups (Rahaman et al. 2004). This isomorphism normally promotes certain norms, values and beliefs that eventually are shared within and outside organizations.

In Malaysia, institutional isomorphism has a significant impact on the development of accounting regulations and practices. It is interesting to note that in preparing for the IFRS convergence in Jan 2012, the social legitimacy coercive, mimetic and normative influences are all at play (Phang and Mahzan 2013). Changes in the Malaysian accounting arena stemmed from the socio, economic and political influences (Ali 2007), and are consistent with, among other factors, the findings of extant literature.

In this chapter, it is noted that coercive pressures have significantly influenced the development of accounting regulations and practices in Malaysia since independence till present. The highest coercive influence comes from the internal stakeholders, namely the Malaysian firms from the various industries and including multinational organizations. However coercive influence from “other external stakeholders such as international investors, overseas business operations and overseas subsidiaries are relatively low” (Phang and Mahzan 2013, p.112). Also, just like other countries, such as Vietnam (Phan et al. 2016) and Kuwait (Almujamed et al. 2017), coercive forces also come from important international players such as the International Monetary Fund (IMF) and the World Bank (WB), who have been providing the necessary support for Malaysia’s development initiatives. Malaysia is a member of the IMF soon after independence, on 7 March 1958 (International Monetary Fund n.d.). The WB’s presence in Malaysia, through a finance hub set-up in Kuala Lumpur in 2016, and the sharing of expertise, is supporting Malaysia’s development priorities and journey to developed nation status (The World Bank n.d.).

Governmental pressure was instrumental to the reactivation of MIA in 1987 (Ali 2007; Sood 2006). A proposal for merger with MICPA to form Malaysian Institute of Chartered Accountants (MICA) was rejected by the government in 1985, claiming that MIA was already there to regulate the accounting profession. As revealed in the MIA 1988 bounded document, the government urged MIA to be active due to the loss of trust in the profession among local and foreign firms, which was detrimental to the nation's aspirations to become an industrialized country (Ali 2007).

The directive by the government for MIA to be active also fell within the characteristics of the implementation processes of the new economic policy (NEP), which saw government's intervention through direct involvement in the socio-economic activities. The NEP was formulated in the aftermath of 13 May 1969 racial riots and started with the Second Malaysia Plan (1971–1975) until the Fifth Malaysia Plan (1986–1990), which sought to achieve national unity through socio-economic restructuring of the society and poverty eradication (Wikipedia 2021b).

The capital providers and other stakeholders' need for corporate information in making economic decisions has shaped the financial reporting environment in Malaysia. The provision of corporate information to these users has been initiated by the Ninth Schedule of the Companies Act 1965 which formally established the reporting requirement in the Malaysians' financial statements and remained relatively unchanged until 1985 (Arshad n.d.). It is the responsibility for the companies to ensure the accuracy and fairness of account according to the Act's requirement (Tong 2019).

The emergence and development of multinational concerns and the growth of international financial markets in the late 1980s and early 1990s gave significant changes in the financial reporting practices in Malaysia which showed more influential role by regulatory authorities such as CBM and SC. In line with the objectives for the set-up of SC in 1983, the SC's guidelines require public corporations to shift from the traditional stewardship reporting system to a full disclosure-based reporting (Tong 2019). Coercive forces from stakeholders, especially regulatory enforcement affect the readiness of Malaysian public listed companies to implement IFRS (Phang and Mahzan 2013). This is supported by findings from Scott (2008) that companies are forced to get ready themselves for IFRS convergence due to worry about non-compliance and attempt to elude penalties from supervisory bodies. This conforms to institutional isomorphic pressures according to Almujaed et al. (2017). The coercive isomorphism from the government has forced the disclosure of corporate information beyond the minimum statutory disclosure requirements and Malaysia began adopting the four IASs (IASs 1 to 4) in 1978 (Tong 2019).

In line with mimetic isomorphism, Malaysia is influenced by changes in the UK's legal, economic and political environments as a Commonwealth member (UKEssays 2018a, b). The country's status as former British colonies has a mimetic influence on the tendency to follow the style of UK accounting institutions and practices in the accounting field. This is especially true now that the MASB evaluates and updates the Malaysian accounting standards when the UK accounting standards changed (UKEssays 2018a, b), which is even more rational now that they have converged. A

recent example is the publication of the Amendment to MFRS 16 *Leases on Covid-19-Related Rent Concessions beyond 30 June 2021*, which is “a word-for-word” IASB’s Amendment to IFRS 16 *Leases on Covid-19-Related Rent Concessions beyond 30 June 2021* (FRF MASB 2020e).

Apart from complying with the requirement in the Ninth Schedule of the original *Companies Act 1965*, the items in specimen company accounts were significantly influenced by United Kingdom and Australia’s accounting practices. (Tong 2019; Sood 2006). The rationale for this influence can be related with normative isomorphism under institutional theory because its earlier members were trained or had professional qualifications from accountancy bodies in the United Kingdom or Australia. Therefore, these particular groups tend to adopt similar practices used in those countries.

Normative pressures come mainly from the accounting profession, through membership in the International Federation of Accountants (IFAC) (Phan et al. 2016; Almujaed et al. 2017). Malaysia is represented by MIA and MICPA, and as members, the profession is committed to “serve the public interest by enhancing the relevance, reputation, and value of the global accountancy profession” (IFAC n.d.). Also, cultural factors, mainly religion, morals and values pose normative influence on the accounting environment in Malaysia. In this multicultural and multiconnection society, the official religion is Islam. Examples of how the accounting environment is impacted is that Islamic culture “does not encourage borrowing as against western culture that is anchored on borrowing” (UKEssays 2018a, b). Hence, the adoption of a dual banking system, in which the Shariah compliant Islamic financial institutions operate alongside its conventional counterparts. These include the legal and cultural dimensions (Almujaed et al. 2017; Tahat et al. 2018) and the normative influence of the accounting profession (Alon and Dwyer 2016; Phan et al. 2016; Almujaed et al. 2017; Sidik and Rahim 2012).

4.6 Conclusion

Continual development in the accounting regulations and practices is critical to the nation-building process of any country. The accountancy profession is continually challenged by the evolving economic landscape from business-related influences such as globalization and digitization in delivering their expertise in economic and financial strategies to improve economic and industrial progress.

The current chapter adds to offering an overall grasp of Malaysia’s political, economic, and governing ecosystem, and particularly emphasizes on bring to light its accounting and financial reporting framework. Moreover, this chapter fills the gap in global accounting study by applying institutional theory to explain institutional environments and connect them to the development of Malaysian accounting regulations and practices including IAS/IFRS. Finally, this chapter offers insightful development of accounting practices in responding to the global pandemic COVID-19.

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Chapter 5

Customer Relationship Management (CRM) Importance for Banking: Examples from Turkish Banks During the Years



Esra Demirbaş

Abstract The rapid and continuous worldwide technological developments have created significant changes and developments in all sectors, especially in the service sector, since the last quarter of the twentieth century. As a result of these developments, which also affected Türkiye, profound changes were observed in the marketing of financial services and banking products and services, which are among the leading players in the service sector. According to the global conjuncture, the Turkish service sector has developed rapidly in different business lines, primarily financial and health services and tourism, where customer relationship management CRM's first applications emerged. The banks of the past, which were only collecting and safely keeping deposits, have turned into today's institutions that act with a customer-centric approach and aim to make a long-lasting profit from the client's satisfaction and loyalty. However, private Turkish banks and State-owned ones have looked like a customer-centric approach by offering modern financial products and services, including CRM, to meet individual and corporate customers' various needs and expectations. This conceptual study emphasizes the progress and importance of customer relationship management for the banking sector and relationship marketing in which CRM is grounded. Furthermore, a few empirical studies that highlight the main effects of CRM on Turkish bank customers and implications for the future are taken place in this work. The Turkish banking sector has adapted to worldwide standards and holds institutions with professional services and modern operating systems, which will undoubtedly be good examples of CRM applications.

Keywords Customer relationship management · Relationship marketing · Customer loyalty · Customer satisfaction · Turkish banking sector

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5.1 Introduction

Toward the end of the twentieth century, political and economic liberal actions, technological developments, and relatedly globalization created many changes in the world. These new worldwide evolutions have also influenced the marketing management approach and many sectors, including banking, the financial industry, and its leading actor.

As a result of the technological revolution, technology-based remote access distribution channels and new payment methods emerged. The ATM has replaced the cashier teller; the bank branch has mainly modified mobile phones and call centers; the Internet returned the mail; credit cards, bank cards, and electronic cash have taken the place of traditional cash transactions (Sherif 2002).

In this new, developing, globalized, and competitive environment, new marketing strategies and practices have emerged to capture opportunities with the lowest risk to survive in the challenging global and domestic competition environment. Accordingly, new financial services, products, and business processes have emerged. Customer relation management joints are in the picture, just at this point. In order to capture a maximum number of customers available in the target market, it has become a priority of banks to pay maximum attention toward their customers through (from now on referred to as CRM), which is a widely implemented strategy for managing a company's interactions with customers, internal clients, and sales prospects. "It involves using technology to organize, automate, and synchronize business processes—principally sales activities but also those for marketing, customer service, and technical support. The overall goals are to find, attract, and win new clients, nurture and retain those the company already has, entice former clients back into the fold, and reduce the costs of marketing and client service. Measuring and valuing customer relationships is critical to implementing this strategy" (Rathod 2012, p. 49).

Customers have even more knowledge related to increasing competition, developments in transportation and communication technologies, and the impact of globalization.

CRM is a companywide business strategy that should be managed with a holistic marketing approach in which customers' expected value from an organization and customers' satisfaction, loyalty, and retention should be deeply considered by all departments and all stakeholders besides the marketing department. This attitude would bring a permanent and profitable customer portfolio to the institution.

The principal business drivers of CRM are "increasing customer lifetimes, reducing costs, and improving efficiency" (Rathod 2012, p. 50).

First, relationship marketing, where CRM has been grounded, is reviewed. Then the transformation through the CRM approach and the importance of CRM for banking operations are discussed. A brief overview of the development of the Turkish banking sector and a few empirical studies that emphasize the main effects of CRM on Turkish banks' customers and implications for the future are taken place in this work.

5.2 Relationship Marketing

CRM appeared in the literature following the relationship marketing philosophy and is accepted as the heart of relationship marketing. Therefore, it will be better to overview relationship marketing to understand the basis of the CRM concept better.

Berry (1983, p. 25), the father of “relationship marketing,” defined it as “attracting, maintaining, and—in multi-service organizations—enhancing customer relationships.” In line with this, Berry (1983) outlined five strategical factors to strengthen relationship marketing: Creating a core service to establish a customer relationship, tailoring the connection to each customer, enhancing the core service with additional benefits, pricing services to foster customer loyalty, and engaging employees in marketing campaigns to help them deliver excellent service to customers.

Grönroos (1990, p. 138) extended Berry’s (1983) initial relationship marketing definition with the perspectives of “other stakeholders’ relationships besides customers, mutual benefits, promise-keeping, and profitability.” Grönroos (1990, p. 138) clarified this new approach as “marketing is to establish, maintain, and enhance relationships with customers and other partners, at a profit, so that the objectives of the parties involved are met by a mutual exchange and fulfillment promises.” Keeping promises is essential to maintain and developing customer relationships (Calonius 1988). “Establishing a relationship can be divided into two parties: Attracting the customer and building a relationship with that customer” (Grönroos 1994, p. 9). “The relationship marketing concept has broadened to include all forms of relational exchange, not just those relationships dealing with one’s customers. Relationship marketing broadly refers to marketing activities directed toward establishing, developing, and maintaining all successful relational exchanges” (Morgan and Hunt 1994, p. 20). All relationships should be reliable; in other words, they should be based on trust (Grönroos 1994), which is the “willingness to rely on an exchange partner in whom one has confidence” (Moorman et al. 1993, p. 3). Furthermore, there is “a shift from a transaction to relationships focus” in relationship marketing (Webster 1992, p. 14).

Customer and service providers repeated interactions facilitate relationship marketing which “allows service providers to become more knowledgeable about customers’ requests and needs” (Berry 1995, p. 238). At this point, the previous emphases on internal marketing (George 1977; Grönroos 1978, 1981; Berry 1981, 1983; Berry and Parasuraman 1991) become outstanding. As service providers perform well, customers remain with them (Berry 1983). Nevertheless, high employee turnover, called “the cycle of failure” (Schlesinger and Heskett 1991), is the enemy of relationship marketing and relatedly customer relationship management. This obstacle does not only negatively influence service quality and customer retention but also profitability. Long-term employees who know more about the company and know well available customers’ profiles and attitudes establish trust and good bonds with customers. “Any business that gains its customers’ trust, relatedly their loyalty, will always have and keep its competitive advantage and be one step ahead in the market” (Koçer 2017, p. 713).

Meanwhile, companies should try to keep the right customers in terms of profitability and volunteer to develop relationships and find the right employees to spend long years with them (Reichheld 1993). “Segmentation based on customer relationship profitability analysis is a prerequisite for customer retention decisions” (Grönroos 1994, p. 5). Building a highly loyal customer base must be embedded in the primary business strategy of a company (Reichheld 1993).

Companies should move from short-term transaction-oriented objectives to long-term relationship-building ones with relationship marketing (Kotler 1992).

Moreover, there is a positive connection between a strong interest in service quality and a growing interest in relationship marketing. Relationship marketing, “an expensive alternative to mass marketing,” is becoming more feasible due to rapid and successive developments in information technology. Progress in information technology supports the efficiency of relationships as (Berry 1995, p. 238):

- (i) *Monitoring the purchasing behavior and overall relationship with existing customers.*
- (ii) *Individualizing services, promotions, and pricing related to customers’ needs.*
- (iii) *Offering coordinated and integrated different services to the same customer.*
- (iv) *Enhancing effective mutual communication between the company and the customer.*
- (v) *Defecting the probability of service errors and breakdowns.*
- (vi) *Augmenting core service offerings with valuable extras.*
- (vii) *Tailoring necessary customer interactions.*

Gummesson (1999, p. 24) defined relationship marketing broadly within comprehensive management and social context: “Total relationship marketing is marketing based on relationships, networks, and interaction, recognizing that marketing is embedded in the total management of the networks of the selling organization, the market, and society. It is directed to long-term win–win relationships with individual customers, and value is jointly created between the parties involved. It transcends the boundaries between specialist functions and disciplines.” This definition covers all parties’ relationships in the market.

Gummesson (2002) stated three core issues for relationship marketing treatment of each customer as an individual, collaboration and value creation, and keeping long relationships. First, relationship marketing addresses each customer as an individual, epitomized in the expression of one-to-one marketing. There is the traditional marketing approach’s heterogeneity instead of homogeneity. Secondly, you collaborate and compete inside and outside the organization in total relationship marketing. Collaboration partners create value together. Finally, the longer the relationship with a customer, the higher the profit. This result is primarily due to two effects of customer loyalty: “Reduced marketing costs when fewer customers defect; and increased customer share” (Gummesson 2002, pp. 50–52).

Berry’s five relationship marketing strategies (2002, pp. 62–69) can be used “combination or simultaneously.” The extended explication of those strategies is (i) “Core service strategy”: The ideal core service should attract new customers by meeting their requests with highly qualified service, establishing long-term bonds

with multiple parties, and providing additional benefits over time, (ii) “Relationship customization”: Discovering individual customers’ specific characteristics and requirements and using all these clues to answer their needs by tailoring services according to those customers will bring the opportunity to keep them in the portfolio instead of sneaking up on competitors. Customization will enhance electronic data processing. (iii) “Service augmentation” means offering extras that are not available in competitors and doing business with retained customers, such as private banking. (iv) “Relationship pricing”: A unique, beneficial price offers customers such as reducing loan interest for the remaining ones or no credit card or electronic fund transfer (EFT) fees. (v) “Internal marketing”: Service companies should also focus on their internal customers, who are their employees, besides external customers.

Relationship marketing will increase marketing productivity (Sheth and Parvatiyar 1995). Holding old customers is always less costly than acquiring new ones (Reichheld and Sasser 1990). “The longer a customer stays in a relationship, the more profitable the company is. Statistically confirmed that a customer who has been with a bank longer than five years is far more beneficial than a new one for one year. Consumers-marketing partnering could bring quick responses by the marketers leading to greater efficiency. Relationship marketing allows individual consumers to act with their abilities and requirements and the flexibility to choose their tasks, resulting in cost reduction and efficiency increase.” For example, “banking services are performed through ATMs” or electronic banking applications (Sheth and Parvatiyar 1995, pp. 263–264).

5.3 CRM as a New Management Strategy

CRM is a technique for obtaining new customers, keeping existing ones, and simultaneously understanding, foreseeing, and managing an organization’s current and potential customers’ demands (Brown 2000). CRM is a creative method for building trust and long-term relationships (Mylonakis 2009). CRM segments customers into diverse groups due to different needs to offer better service to them (Day 2003).

CRM, which is “the heart of relationship marketing, involves treating each customer differently according to their characteristics, shifts marketing away from short-term transactional marketing toward developing longer-lasting relationships with a lifetime value perspective built on upon permission, trust and listening and responding to customers” (Chaffey and Smith 2008, p. 352).

Relationship marketing “is grounded in establishing a learning relationship with each customer, starting with your most valuable ones. There are four key steps for putting a one-to-one marketing program to work: Identifying your customers, differentiating among them, interacting with them, and customizing your product or service to fit each customer’s needs” (Peppers et al. 1999, pp. 151–152). Implementation of one-to-one marketing steps positively influences CRM’s marketing strategy in terms of winning back loyalty, prospecting, and cross-selling (Karahan and Kuzu 2014).

Buttle and Burton (2002) explained CRM as creating and managing long-term mutually beneficial relationships with strategically important clients. CRM is a management strategy that aims to make enduring connections with customers with the “establishment, development, maintenance, and optimization of long-term mutually valuable relationships between consumers and the organizations. Successful customer relationship management focuses on understanding the needs and desires of the customers and is achieved by placing these needs at the heart of the business by integrating them with the organization’s strategy, people, technology, and business processes” (Das 2012, p. 69).

In traditional CRM, “customers are passive, responding to a company’s actions primarily through their purchasing behavior” (Reinartz et al. 2004, p. 295).

“CRM is the process of acquiring, retaining, and increasing the number of profitable customers. CRM is a business strategy of selecting and managing customers to optimize long-term value” (Özilhan 2010, p. 22). CRM is a strategy to manage customers by focusing on understanding them as individuals instead of as part of a group (Lambert 2010).

Malthouse et al. (2013, p. 272) explained CRM as a process that “entails the systematic and proactive management of relationships as they move from the beginning (initiation) to end (termination), with execution across the various customer-facing contact channels.”

On the other hand, social networking platforms have assigned customers an active role instead of the past passive situation. “Customers can easily express and distribute their opinions to large audiences, and companies are likely to find it increasingly difficult to manage the messages that customers receive about their products/services, besides having more information about competitive products available anywhere on mobile devices” (Malthouse et al. 2013, p. 270). Companies can involve their consumers in different processes on social media platforms, from product development to advertising video creation (Kara 2013).

Malthouse et al. (2013, pp. 271–275) created the “social CRM house” concept, consisting of two dimensions CRM and social media. CRM is the composition of “relationship initiation (acquisition), maintenance (retention), and termination.” Customers who have become active participants due to social media might generate content related to a specific brand hence being engaged with that company, with a continuum ranging from low to intensively elevated levels. Malthouse et al. (2013) recommended determining CRM strategies based on the level of engagement. The customer’s attention is affected by the company’s contact point. Although the traditional objective of CRM has been to maximize customer lifetime value (CLV) which is a derivative of the relationship with the customer, the index of CLV no longer fully captures a customer’s value contribution to the company; CLV additionally measures the future value that the company derives from its relationship with the client since the emergence of social media. Besides CLV, customer referral value (CRV), customer influence effect (CIE), customer influence value (CIV), and value to other stakeholders should also be considered in social CRM. Successful data and information technology structures and management are also prerequisites of a social CRM.

The main objective of CRM is to retain current customers by increasing their loyalty and selecting new ones that bring higher profitability (Hansotia 2002).

CRM has evolved into a crucial component of numerous enterprises and organizations. Organizations can better serve customers, collect and analyze customer data, and manage their connections with customers by implementing CRM systems that categorize organizational information systems. In order to increase customer equity, numerous banks have announced plans to create and manage more important contacts with their clients. At the same time, to improve customer happiness, this condition calls for creating and nurturing successful customer connections. (Karahan and Kuzu 2014).

Chary et al. (2012, p. 22) proposed the following six critical business requirements for CRM:

- (i) *Create a customer-focused organization and infrastructure.*
- (ii) *Gaining an accurate picture of customer categories.*
- (iii) *Assess the lifetime value of customers.*
- (iv) *Maximize the profitability of each customer relationship.*
- (v) *Understand how to attract and keep the best customers.*
- (vi) *Maximize the rate of return on marketing campaigns.*

For successful CRM management, banks must collect up-to-date customer information and use that data to decide when to provide the most pertinent items (Lau et al. 2003). Additionally, the CRM concept creates the ability to choose profitable customers, integrate customers' offers through channels, personalize marketing messages, and improve pricing policy (Richards and Jones 2008). "If a bank focuses its activities on meeting customers' needs, the proportion of consumers who are leaving the banks reduce 25% and meanwhile, cost of new customer acquiring also diminishes" (Catalan-Matamoros 2012, p. 4).

CRM is a key to creating a superior customer experience. It manages the customer relationship by establishing a clear understanding (know), by developing services and products based on the added value for target groups (target), and then by making it possible for the actual sale and delivery of services and products through the chosen channels (sell). It also establishes long-lasting, profitable customer relationships through after-sale services (service) (Hussain et al. 2009).

The cross-selling opportunities of CRM bring banks the chance to attract customers by cross-selling products and services, adding to existing ones (Laketa et al. 2015).

"The contact point of customers and employees authorized and responsible to serve holds great importance in CRM. The CRM process consists of three steps: identifying requirements as the first step and setting up customer standards as the second. Customer access is the last step" (Odabaşı 2000, p. 18). CRM is "a customer-oriented approach in an institution that is holistically accepted and acted by all internal and external stakeholders, rather than managing the job by using modern technology" (Civelek 2004, p. 73). CRM can be summarized as "offering the right product or service, to the right customer, at the right time, at the right price, and at the right place" (Sullivan and Harper 1997, p. 10).

5.3.1 CRM in Banking Sector

Banks are financial institutions that accept deposits, collect funds, and transfer these funds to individuals, corporates, and governments as short-term and long-term loans in need of funds. Today's banks perform different transactions besides deposits and loans, such as "supporting the implementation of credit and monetary policies in the country, acting as an intermediary in financial transactions, performing purchase and sale transactions of securities, safeguarding valuable assets, offering payment facility instruments such as credit cards and debit cards, acting as an intermediary in foreign trade transactions" (Yetiz 2016, p. 107).

The importance of the CRM concept is increasing in service sectors. CRM is an essential tool to establish relational bonds with customers, gain their confidence, successively their loyalty, and increase profitability by establishing long-term relationships. "Clients are the most valuable asset of a bank that belongs to the service field. Thus, it is indisputable that banks could not ignore being customer-centric and conducting CRM-based operations" (Koçer 2017, p. 714).

Traditional financial products such as payment facilities, credit limit allocation, credit cards, insurance services, or electronic banking services are not sufficient anymore for modern bank customers. Therefore, banks should innovate and offer new advanced customers friendly products to ease clients' life. Consequently, today's banking system should improve its product by considering individual and corporate customers (Demirel 2007a, b).

The evolving customer structure in the globalizing world has seriously forced banks to reorganize and review their strategy with a customer-centric view. Banks started to conduct customer-oriented marketing, data-based marketing, and relationship marketing approaches through the end of the last century. CRM arouse as a lifesaver for banks (Gümüşboğa 2016). All banks in the Turkish market had to move away from mass service production and have directed to customer relationship management which focuses on the individualistic request of each customer. Hence, private or tailor-made service concepts arose, and customers have transformed into private clients for most banks since the second half of the 1990s. "Customer relationship management aims to go beyond customer satisfaction and provide value to customers" (Yücel 2013, p. 1643). "CRM pushes all banks managers and employees to act customer-oriented and to serve customers by developing products and services beyond their expectations with the support of information technologies which lead to bank activities" (Girginer and Yılmaz 2007, p. 62).

Laketa et al. (2015, p. 241) broadly explained CRM's importance for the banking sector as follows:

CRM concept is the tendency of the banking sector to establish and maintain long-term relationships with customers to provide value for customers and banks. This concept allows banks to identify, segment, communicate and build long-term relationships with customers individually. In today's business environment, banks aim to identify customers and adjust offers to meet customers' needs to maximize profits. Using modern technologies, CRM is becoming a method to maintain existing structures and development of high-quality customer base. It involves the development of a marketing strategy through a better understanding of

the entire customer base, understanding the needs and attitudes of customers, as well as more efficient consideration of profitability and added value that each customer has for the bank.

Meanwhile, Dwyer et al. (1987) recommended considering the customer relationship life, which has three core phases: Customer acquisition, customer enhancement, and customer recovery. “Good long-term relations with customers create customers’ immunity to competition” (Laketa et al. 2015, p. 244).

A customer-bank relationship is established during the acquisition phase. In CRM campaigns, customer service employees assist customers in becoming familiar with the products and services, increasing customer familiarity (Das 2012). Empowerment is an effective tool for successfully controlling individual customer interactions since the service sector has a high degree of integration and interaction in terms of contact participation (Mudie and Cottam 1993). Because it gives a chance to keep clients, service recovery is crucial. Suppose the consumer has been lost but is still desirable. In that case, recovery offers (such as the cancelation of the initiation price or taking care of formalities brought on by the switching) or value-added services could be provided to the customer (Das 2012).

The primary reasons for banks to adjust their business process to customers’ needs are, keeping existing customers, attracting new customers, encouraging customers to strongly cooperate with banks, “informing customers about the portfolio of products, services, and communication channels, to increase profits or prevent losses” (Laketa et al. 2015, p. 242).

The main objectives of CRM could be summarized as: “Increasing profit due to increase in customers’ satisfaction and cross-selling activities; cost reduction in sales and distribution activities; reduction in customers’ support expenses; continuous customers’ purchasing behavior; focus on the management of customer relationships rather than product management” (Demirel 2006, pp. 121–122). Elevating customers’ loyalty will be strong support for institutions to reach these objectives. CRM has six dimensions: “Communicating with customers, customer loyalty, interaction with customers, customer data warehouse, and value delivered to customers” (Demirel 2007a, b, pp. 126–127).

Loyalty is “the customer’s willingness to maintain their relationship with a company or brand; it can be accepted as a customer’s commitment” (Koçer 2017, p. 716).

Customer loyalty can be defined as repurchasing a bank’s products or services in the future or being a customer of that business without considering competitive products, services, and brands, continuing to be retained as a client of the same bank (Oliver 1999). Loyalty has behavioral, relative (attitudinal), and cognitive dimensions (Gümüşboğa 2016). “Behavioral loyalty dimension refers to the fact that a consumer consistently prefers a service or brand and shows repeat purchase behavior” (Marangoz and Akyıldız 2007, p. 197). Jones and Taylor (2007, p. 37) explain two other-relative (attitudinal) and cognitive dimensions as follows:

Relative attitude (an affective evaluation of the brand) has been operationalized in various ways, such as: “Considering the service provider the first choice among alternatives, willingness to recommend, the strength of preference, feelings of attachment to a product, service, or

organization and altruistic behavior such as assisting the service firm and other customers.” A cognitive dimension where loyalty is based on conscious evaluation of brand attributes or rewards and benefits associated with patronage leads the consumer to consider this service provider at the expense of others. The operationalization of the cognitive element of service loyalty has taken several forms, including top of mind, first choice, price tolerance, exclusive consideration (i.e., considering only one service provider when needing this type of service), and identification with the service provider (i.e., thinking of the service provider as an extension of one’s self and acknowledging this by references to “my service provider,” or by collective representations such as “us” and “we”).

“Ensuring customer loyalty brings an increase in customers’ satisfaction and retention to an organization. In addition, loyal customers make positive recommendations about the business to the people around them” (Avcıkurt and Köroğlu 2006, p. 6), creating the word-of-mouth (WOM) effect (Demirbaş 2018).

Well-established, organized, and performed CRM process raises both clients’ satisfaction, retention, loyalty, and banks’ profitability. Adopting the latest technological developments is the cornerstone of a successful CRM process (Celep 2011). Moreover, not only external customers but also internal customers employees should also be considered to obtain high service performance. From top to bottom, all stakeholders, managers, and employees have become customer-conscious people.

“Evolution in information technology, globalized markets, and growing channels of financial transactions, volatile markets, increasing customers’ demands, sophisticated markets, and customers” (Rathod 2012, p. 50) led banks to rethink their business strategy and to develop a new management approach with a customer-centric view, through the end of the last century.

Understanding consumers’ various needs at different stages are essential for a successful connection between customers and banks. Banks’ ability to respond to consumers’ requirements makes customers feel valued as unique individuals rather than just being a small portion of a vast client base. Establishing a long-term symbolic value relationship requires an awareness of consumer expectations regarding service delivery levels and product quality. Management encompasses all marketing initiatives intended to create, nurture, uphold, and manage a successful relationship with the target audience (Das 2012).

CRM process includes four phases (Celep 2011, pp. 471–473): “(i) Determination of customers’ preferences and values: Understanding the segment well. (ii) Acquisition of customers: Determining the solutions to reach the target segment. (iii) Holding customers: Holding customers in the portfolio by conveniently answering their requests. (iv) Strengthening bonds with clients: Keeping contact with clients by offering them extra values which prevent their direction toward competitors.”

CRM brings banks the opportunity of “customer information assimilation and storage, profitability analysis, marketing efforts empowerment, new customers contribution, more effective relationship management, and longer customer retention” (Rathod 2012, p. 50).

Erdoğan summarized CRM and data mining as follows (2019, pp. 91–92):

Technological developments have led to the restructuring of many definitions, such as business, trade, and profitability in the financial sector. Especially banks, which have millions

of customers and billions of raw data belonging to these customers, have given more importance to IT-oriented solutions. Storing billions of raw data also entails an extraordinary responsibility. New concepts and terminologies, such as data mining, also arose due to the storage and process of massive data. Data mining extracts valuable information from existing data piles and makes better banking industry decisions. Various data in databases need to be brought together and prepared properly so that data can be collected and a data repository can be created; data mining allows the extraction of information diamonds from historical data and predicts the consequences of future situations. In this case, data mining helps optimize business decisions, increase the value of each customer and communication, and increase customer satisfaction. Data mining supported CRM will bring a bank good competitive advantage in the sector.

Customer relationship management is primarily concerned with listening to the customers, their requests, and their expectations from a bank. Following the clarification of those features, the general strategy may emerge. Grouping clients into micro-segment will be necessary to understand their needs and offer them their expected values and tailored products and services, achieving high profitability (Kırım 2007). Technological developments as a powerful weapon will always facilitate understanding customers, give quick responses, and develop multiple products to meet their demands simultaneously. CRM is the composition of technical and human relations dimensions. Banks employees are trained to act customer conscious and use the data warehouse effectively. All these attempts bring banks not only contacting many clients privately but offering them tailor-made products. (Demirel 2007a, b) but also cost-effective operation style with diminishing cost due to permanent elaborated and trustful interaction with customers and by increasing profit due to raised clients' loyalty.

CRM should be adopted in a bank's operational, analytical, and organizational areas. "Operational CRM provides a unique source of customer information and supports sales, marketing, and customer service. Analytical CRM is carried out through the collection, processing, and systematization of data used in CRM. Finally, organizational CRM establishes customer interaction through appropriate communication channels. CRM success depends on the integration quality of these three areas" (Laketa et al. 2015, pp. 244–245).

5.3.2 Current Situation and CRM Implementations in the Turkish Banking Sector

"Beginning of banking activities goes through 3500 B.C. Some financial transactions like banking arose in Sumerian, Babylonian, and ancient Greek civilizations. The invention of money and the development of maritime and trade forced the start-up of banking operations. In the early 1900s, modern banking emerged. Banking, which started with foreign banks with the declaration of Tanzimat in the Ottoman Period, gained momentum in the Republican Period in Türkiye" (Yetiz 2016, p. 108).

The development of the Turkish banking system since the republican period is classified (Kaya and Arslantürk Çöllü 2020, p. 12): "National Banks Period

(1923–1933), Public Banks Period (1933–1945), Private Banks Period (1945–1960), Planned Period (1960–1980), and Liberalization in Banking and Internalization Period (1980–2004).”

Continuous developments in technology and communication fields have caused significant changes all over the world, including in the financial industry and its top-rank actor, banking. Turkish banks have also adopted all global changes and development in terms of technological, managerial, and legal perspectives.

Turkish banks generally adopted rules regulating the international banking market called Basel I, declared by Bank for International Settlements (BIS). Türkiye joined the Basel Committee in 2002 and actively prepared the Basel II reconciliation, which consists of three pillars: “Minimum capital adequacy, the supervisory review process, and market discipline. These pillars aimed to standardize the operating and transaction conditions of banks. In addition, the Basel II consensus adopted a more comprehensive approach to rapidly changing risk measurement and management conditions and continued to support the financial system to operate in safer conditions. Turkish banking system also transitioned to the Basel II Criteria, as of July 2012” (Kaya and Arslantürk Çöllü 2020, p. 29).

“Turkish banking system did not lag the developed EU member or other world states’ banking system by implementing regulations and following innovations without delay. For example, Turkey is closer than many countries in compliance with Basel I, II, and III criteria” (Sümer 2016, p. 497).

Banking is a critical and profitable sector that deals with millions of people and has a transaction volume of billions of Turkish Lira in Turkey (Erdoğan 2019, p. 92).

“As of today, the Turkish banking sector under the umbrella of independent supervisory and regulatory boards; with a robust financial structure, high capital adequacy, effective internal audit and risk management, qualified workforce, modern types of transactions and services offered, use of advanced technologies and superior service quality brought the ability to compete with the banking sectors of developed countries” (Sümer 2016, p. 491). “As a result of precautions taken and the regulations made, especially after the crisis in 2001, the Turkish banking sector has strongly structured and has modern management techniques with high-qualified products and services” (Kaya and Arslantürk Çöllü 2020, pp. 30–32).

New products and services began to be offered to the consumer market, such as developing retail banking services, automatic teller machines, consumer loans, credit, and cash cards, home and office banking, and mobile banking. “Society was introduced to new banking products, such as leasing, factoring, and forward and swap transactions, in the last republican period” (Sümer 2016, p. 489).

Turkish banks have applied customer relationship management since the 1990s. They have made technological investments in CRM software, data warehouse, electronic channels, and internal customer training programs.

Effective marketing management; campaign management; cross-selling initiatives to reach the right customers with the right products, through the right channel, at the right time; increased selling productivity in terms of sales representatives and process; increased profitability; accurate collection and unbiased analysis and evaluation of customer data are the paths for banks to achieve long-term profitability by

cutting transaction costs and times while also increasing client loyalty and satisfaction. In the case of good performance, all these activities will bring banks to offer tailor-made products to their clients (Savaşçı and Tatlıdıl 2006).

“Banks in Türkiye receive the explicit consent of the data owner to be able to process the data, as a basis following Article 5 of the Personal Data Protection Law. As a result of the strong bond established based on successful CRM, customers share their confidential information with bank representatives whether knowingly or unknowingly.” Clarifying their customers’ service is critical for banks to develop new strategies. Therefore, the banking sector has made significant investments in measuring how to measure customers’ service perception. Today’s banking sector is as customer-oriented as they have ever been. They continuously monitor their customer satisfaction and successively improve their services. “In this century, banks should provide customers confidence in safely keeping their data to hold their long-term loyalty as a prerequisite of successful CRM” (Erdoğan 2019, pp. 91–92).

In an empirical investigation by Koçer (2017, p.732), “the positive effect of CRM on customer loyalty was observed.” Most attended customers to that investigation underlined their expectations of receiving services, including Parasuraman et al.’s (1985) service dimensions of reliability, responsiveness, assurance, and empathy. The participants emphasized that banks or representatives should consider their special requests and suggestions. This research outlined the following points (Koçer 2017, p. 732):

- (i) *Banks should consider their existing customers’ requests and needs and appropriately answer them in the right way at the right time.*
- (ii) *Banks should make their customers feel memorable with private service or service packages for their individualistic requests and needs.*
- (iii) *Banks should create databases that contain up-to-date customer information by taking advantage of the opportunities provided by modern technology.*
- (iv) *Banks should be proactive and analyze the customer potential of their sector, anticipate the target segment’s needs, and make a difference against their competitors with their new service mix.*
- (v) *The whole organization should understand the importance of CRM, and all stakeholders should strictly follow it.*
- (vi) *Relationships with customers should not only be kept at the business level, but customers’ special days, special situations, and moral values should also be shared with them.*
- (vii) *Customers’ high confidence and loyalty should be gathered, and necessary actions should be taken to keep them in the bank portfolio.*
- (viii) *Banks should establish long-term relationships with customers to extend their profitability over the long term.*
- (ix) *Bank managers should consider increasing the productivity of employees.*
- (x) *Bank managers should also pay attention to their internal customers’- staff-satisfaction to educate them to offer high-qualified service to clients.*

Another empirical research in 2007 emphasized “a positive correlation between the value given to customers and their loyalty. A strong positive relationship arose between communication and customer interaction” (Demirel 2007a, b, p. 137).

Another study’s results stated “CRM dimensions affect customer loyalty. All CRM dimensions contribute to the enhancement of customers’ beliefs positively. An improvement in any CRM dimension will increase clients’ loyalty” (Demirel 2007a, b, p. 77).

As of October 2022, thirty-two retail banks, sixteen investment and development banks, and three participation banks are under Banking Regulatory and Supervisory Agency (BDDK) in Türkiye (www.bddk.gov.tr, 2022). 65% of these retail banks offer private services to their clients under different product names such as one-to-one banking, premium banking, private banking, and excellent benefits as a customer relationship management attitude.

5.4 Conclusion and Discussion

The banking sector has been one of Türkiye’s principal sectors, as in many countries of the world. “The Banking Supervision and Regulation Board establishment in 1999 was a milestone for Turkish banks. Turkish banking sectors have been restructured with necessary regulations and audits and reached bright full ratios, making them an important and successful case study in Europe. There is no doubt that the Turkish banking sector will hold this strong position in the coming years” (Erdoğan 2019, p. 93).

Banks operating in Türkiye have contributed to the worldwide broad and fast-changing trend and have taken the required actions to be active and robust actors (Cesur and Duranlar 2005). With this changing trend, they have moved toward an organizational structure focusing on customers’ demands, satisfaction, loyalty, and retention, striving to continuously improve products and services to reach long-term profit with long-lived clients. “Banks should accept CRM as a lifestyle” in their operations, as Kotler stated (2003, p. 36).

Traditional Turkish depositors of the 1970s are now private banking clients of the millennium (Law et al. 2003) who are well-informed about domestic and global financial rules and products. Today’s sophisticated customers have forced banks to operate with CRM to enhance clients’ satisfaction by delivering their expected value. On the other hand, Turkish banks have strictly followed international banking standards and requirements to keep their strong, financially competent, and good position in the financial arena.

Previous empirical studies have underlined the positive effect of CRM on Turkish bank customers’ loyalty. Higher loyalty means higher and long-life profitability. Hence, banks should maintain CRM attitudes by following new developments and products in the market for necessary adaptations to keep their loyal customers in their portfolio and their profitable operation.

Customer relationship management is a concept that the business world should pay attention to get a significant market share in the globalizing economy. Companies and banks will outperform their competitors and achieve their goals by offering differentiated products or services to their customers. With progressive customer relationship management activities, banks that make their customers feel valuable and essential will be able to survive in the available and coming high and severe competitive environment.

This conceptual study emphasizes the managerial impact of CRM in marketing rather than evaluating it only as a technological tool.

In the modern marketing approach, the objective is a long-term profit of a business related to customers' satisfaction and loyalty. Hence, CRM is the most convenient method to reach that target, especially in the service sector and banking, which is a leading actor in this field.

This work includes a valuable review of relationship marketing and its lifeblood—CRM. It states its importance for the banking sector and its direct and positive impacts on Turkish banks' customers.

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Part III
History of Management and Business

Chapter 6

Banking in Türkiye: History, Evaluation, and Role in the Financial System



Tamer Aksoy  and Adnan Guzel 

Abstract In Turkey, the banking industry produces the most significant and biggest share of the Turkish Finance System. Foreigners made a high number of banking transactions in Turkey during the early years of the Republic. The capital structure of the Turkish banking system held by foreigners has always been a source of debate, and as a result, attempts to promote national industry and banking have been prioritized throughout the Republican Era. The Central Bank was established in 1931, followed by several Turkish-owned banks, and it is still in operation today. Despite the effects of the 1929 Great Depression, World War II, changes in the world's monetary system, the establishment of international financial and economic unions, oil shocks, and frequently encountered financial crises, the most notable development process of Turkish banking dates back to the Republican Era. During this period, banks were founded to give state assistance for any industry or to get financial facilities for major industrial groupings to carry out their activities. Following the 1980s, when globalization accelerated and financial deregulation occurred, the banking industry developed significantly and has become one of the most important industrial businesses supporting Turkey's economic development. During this period, the country's economic policies have been significantly altered, and a free market economy has been introduced. Following the financial crisis that hit Turkey in 2001, critical banking reforms were implemented. Such arrangements have bolstered the Turkish economy and financial system, as well as aided the progress of Turkey's integration into global markets. Following a general overview of banking history in the world, this study makes specific references to developments in Turkey in light of modern banking history, with explanations on today's process for a complicated, supranationalized, and technology-focused structure, the crisis experienced, and the reforms implemented.

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6.1 Introduction

It is difficult to pinpoint the precise date when banking emerged. Banks or any bank-like institutions have always existed throughout the history of mankind, even if not in the current form. Despite the fact that there are indications that numerous financial transactions occurred in 8000 B.C., it is observed that the Hammurabi rules in 1800 B.C. regulated interest rates applicable on loans, i.e., credits. Banking, as we know it today, was developed in the north of Italy in the sixteenth century and expanded across Europe. As a result, modern banking has an approximately 400-year history.

Similar trends to those seen in the rest of the globe may be seen in the history of Turkish banking. In the Ottoman Empire's organizational structure, the treasury, mint, moneychangers, covered bazaar, financial foundations, guilds, and Galata bankers were in charge of financial activities such as the supervision of money supplies, crediting transactions, management of the state's gold and foreign currency reserves, domestic and foreign payments. Foreign banks were established to meet the Ottoman Empire's financial needs during the Crimean War, with privileges granted to the British and French. Foreigners performed large-scale banking transactions up to the early Republican period.

Although foreigners' capital holdings in the Turkish banking system have always aroused reactions, this particular issue was considered during the Economy Congress held in İzmir in 1923, and it was agreed to establish the national Central Bank. The Central Bank of Turkey was established in 1931, followed by the establishment and engagement of several Turkish banks.

Despite the effects of the 1929 Great Depression, World War II, changes in the world's monetary system, the establishment of international financial and economic unions, oil shocks, and frequently encountered financial crises, the most notable development process of Turkish banking dates back to the Republican Period. It has expanded significantly since the 1980s, when globalization and financial liberalization tendencies increased, and has become one of the most important industrial businesses supporting Turkey's economic development.

During the republican period, efforts were made to boost national industry and banking. Banks were established to provide state support to any industry or to get financial facilities for large industrial groups to carry out their activities, while foreign participation into the Turkish banking system increased after 1980. Earlier in this period, when globalization was accelerating and financial deregulation was enacted, only four banks had foreign capital shares, but currently almost all of the banks in the system have foreign shares. During this time, the country's economic policies altered dramatically, and a liberal economy was implemented. Significant reforms were

adopted immediately following the 2001 financial crisis. Such changes bolstered the Turkish economy and financial sector and helped the process of integrating Turkey into global markets.

The banking industry is the most basic and significant component of the Turkish banking system. Following a general overview of global banking history, this study specifically refers to developments in Turkey in light of modern banking history, with explanations on today's process for a complicated, supranationalized, and technology-focused structure, the crisis experienced, and the reforms implemented. The study of banking history will contribute to a better knowledge of today's modern banking institutions, means and rules, financial system and markets, as well as the development processes. This study is divided into three sections. Following an introduction, basic concepts, and general overview of today's Turkish financial system, the world's banking history is analyzed. Turkish banking history is described by separating it into distinct periods. In this framework, Turkish banking history was explored in a way that included both the pre-republic and post-republic periods. The study includes clarifications on the developments in the Turkish banking sector, as well as a general evaluation and conclusion part that concludes the study.

6.2 Concept and Description of Banking Bankacılık Kavramı ve Tanımı

When contemplating their activities and functions in general terms, banks may be defined as “institutions recognizing deposits for and on their behalf, or without acknowledging funds collected through the participation account, or carrying out loan and financial intermediary activities primarily through the sources they provide from the national or international money and capital markets by incurring debts and utilizing loans from their equities.” Banks are the key entities that operate the financial system, as characterized by the definition. Banks thrived for centuries and evolved into the sophisticated organizations we have today. They are the organizational financial institutions that carry out their activities all over the world, providing financial goods and services via constant modifications and the most swiftest and efficient use of technology advancements (Parasız 2011).

In the framework of the economy, banks are the most important entities within the financial intermediation process, including bringing up inactive funds to the economy, increasing efficiency, supplying banknotes and fiduciary money to the economy, and providing payment services to economic units (Aksoy 1998).

The most important function of banks in this regard is the effective management of credit policies and portfolios, payments instruments, security portfolios, liquidity, and risks. Bank loan supply is related to monetary policy. Banks are the most significant monetary institutions in societies, and they play a critical role in the application of monetary policies and the determination of the money supply for

financing economic growth, as well as the provision and maintenance of economic and financial stability (Güzel 1998).

Bank capital structures can be classified in a number of ways, including sole proprietorship, but in the commonly recognized form, they can be classified into five groups.

- (a) **Central Banks:** The Central Banks are responsible for determining money and exchange rate policies, issuing money on behalf of the Grand National Assembly of the Republic of Turkey and circulation of money, maintaining the value of the Turkish Lira, providing financial stability, establishing and managing payment systems to transfer funds and securities in a safe and timely manner, and are the most critical institutions in terms of healthy economic operations. On June 11, 1930, the Central Bank was established in line with the Law on Central Banks numbered 1211, pursuant to the specifically enacted code of law. The Treasury owns 51% of the Central Bank's shares, while the remaining shares are owned by national banks, foreign banks, and commercial entities incorporated in Turkey, as well as Turkish people and legal entities (CBRT 2021).
- (b) **Commercial Banks:** They are also known as deposit banks, and they are financial institutions that offer loans to customers and investors using funds collected from deposit accounts, or they issue securities in both local and international markets, or they benefit from securities. In general, commercial banks earn from the interest they pay on collected deposits and the income generated by the interest rates on the loans they offer (net of interest margin). Today, a significant portion of the money supply is provided by fiduciary money created by commercial banks. If deposit (commercial) banks fail to return the capital and interest on deposited accounts, it is guaranteed that the Saving Deposits and Insurance Fund would pay a share of the capital and interest. The Saving Deposits and Insurance Fund (SDIF) guarantees a portion of the capital and interest payments for commercial Saving Deposits owned by natural persons in the amount of TRY 100.000.
- (c) **Participation Banks:** These are the institutions that carry out their activities by collecting funds through current and participation accounts based on profit-and-loss participation and extending credit. Because Islam absolutely outlaws interest, they carry out loan utilization and money collecting operations within the framework of the model whether or not they share in profit or loss, and hence they are referred to as "Islamic Banking" or "Interest-Free Banking." Participation banks make credit lines available through participation funds, which come to imply money in the personal current and participation accounts of physical and legal entities.
- (d) **Development Banks:** These are the banks that have no power to take deposits while they use the money comprised of their capitals, equity funds managed by them, and internal and international loans received for industrial and commercial investment.
- (e) **Investment Banks:** These are the institutions that carry out operations to make loans available, with the exception of accepting deposit or participation funds,

and/or carry out the tasks assigned to them in line with the terms of the specific laws.

Banks' primary function is to operate as monetary entities that act as intermediaries between depositors and investors.

Throughout history, the basics of banking activities have been lending or borrowing money with or without interest. However, this has evolved into a process in which banks are now defined as “financial entities that supply a wide range of products.” Such banking activities not only expedite the transfer of the economic unit's purchasing power, but also define the options and forms of financing (Aksoy 1998).

Crediting is the fundamental banking function. Banks take current and term deposits from customers or borrow money in the form of loans and lend it to others, making a profit by acquiring securities produced by companies in need of funding. Banks are the most important financial institutions, with the most fundamental functions being financing, loaning, depositing fiduciary money, and sponson (guarantee).

- (a) **Funding:** Accepting payment cash from both domestic and foreign markets. Such funds may be provided not only through deposit accounts, but also through the issuance of securities from local and foreign markets or by crediting.
- (b) **Crediting:** Banks provide credit to various households, businesses, states, and governments in various forms and conditions, or they provide finance for investments by acquiring the firms' securities.
- (c) **Fiduciary Money Production:** Based on the deposit accounts in their portfolio, the generation of additional purchasing power in excess of the deposited amounts is known as fiduciary money.
- (d) **Sponson:** Banks serve as sponson for their clients' local and international commitments. In the case of operations that necessitate warranty, banks offer letters of guarantee for their clients' monetary liabilities. Foreign trade activities, in particular, cannot be regarded to be carried out without the involvement of banks. Factoring, forfeiting, and leasing operations are often carried out by bank affiliates. These contemporary finance strategies contribute to the financing of export–import operations.

6.3 General Overview of the Turkish Banking Sector

Financial institutions, such as financial intermediary institutions, financial instruments, and financial markets, comprise the financial system. The banking sector is the most important element of the Turkish financial system and a major sector that affects the Turkish economy. The banking sector provides financing for economic growth and development by mediating resource transfer in the economy. The largest share in the financial system in Turkey belongs to the banking sector. Banks, portfolio management firms, insurance companies, unemployment Insurance Funds, retirement investment funds, estate investment partnerships, leasing companies, factoring

companies financing companies, intermediaries, reinsurance companies venture funds, and stock investment companies comprise the Turkish financial system. Banks constitute 84% of the balance sheet size of the financial system in Turkey (BAT 2020).

Banks and the banking system are the most notable entities functioning in the Turkish Financial System. As of late March 2021, Turkey has 54 banks, of which 34 were deposit banks, 14 were development and investment banks, and 6 were participation banks. Three of the deposit banks are state-owned, while the remaining eight are privately held. There are 21 deposit banks located abroad that have 51% or more of their shares held by foreigners. Three development and investment banks are state-owned, seven are privately held, and four are owned by foreigners (Table 6.1) (BAT 2020).

The top ten banks have a share of 87% of total assets, 89% of total deposits, and 88% of loans, while banking transactions are significantly focused on the first ten banks.

Loans account for 59% of total assets, liquid assets 15%, and securities 17%. Deposits and non-deposit liabilities account for 81% of total resources, while personal funds account for just ten%. The core capital ratio was 14.5%, while the capital adequacy standard ratio was 18.8% (Table 6.3).

The sector had a 0.74% return on assets and an 8.12% return on equity. In 2020, the interest margin to average assets ratio grew to 3.2%.

Table 6.1 Turkish banking system—number of banks, branch offices, personnel, and their shares within the industry

	Number of banks	Employees (Thousand person)	Number of branches	Shares within the industry		
				Assets	Loans	Deposits
Deposit banks	34	181	9.875	87	86	91
- State-owned	3	62	3.701	38	39	41
- Private banks	8	67	3.643	28	27	30
- Foreign financed	21	52	2.529	20	20	21
SDIF banks	2	0.2	2	—	—	—
Development and investment banks	14	5	64	6	7	0
Participation banks	6	17	1.255	7	7	9
Total	54	203	11.194	100	100	100

Source (BAT 2020)

Table 6.2 Selected balanced assets and resources of the Turkish banking system (2020)

Assets/resources	Billion TRY	Billion USD	Change %
Liquid assets	897	121	15
Financial assets	1.023	138	17
Loans	3.577	482	59
Total assets	6.108	823	100
Deposits	3.455	466	57
Resources other than deposits	1.477	199	24
Equities	601	81	10
Total resources	6.108	823	100

Source BAT (2020)

Table 6.3 Selected ratios from the Turkish banking system (August 30, 2021)

Ratios	Rate
Non-performing loans (gross)/total cash loans (%)	3.67
Provision for non-performing loans/gross non-performing loans (%)	78.01
Net term profit (loss)/average of total assets (%)	0.74
Net term profit (loss)/average of total equities (%)	8.12
Total interest income/average of interest income asset (%)	6.15
Total interest cost/average of total interest liabilities (%)	5.44
Net of interest income (cost)/average of total assets (%)	3.20
Non-interest income/costs (%)	98.19

Source Banking Regulation and Supervision Agency

6.4 Historical Development of Banking in the World

Banking has existed for as long as there has been an economy and commerce. Bank-like systems have always existed, but not in their current form, throughout human history. According to historians, the bank's earliest departure occurred eight thousand years ago (Sevilengül 1997). In truth, lending coins with or without interest is more than just a transfer of purchasing power from one person to another, or the use of money in commerce (Usher 1934). In reality, in the fifth and sixth centuries BC in Mesopotamia, long before the development of money as a medium of transaction, banking transactions such as promissory notes and credit-like banking transactions, as well as real estate mortgages and loans in return for assurance, were known to be used in commercial transactions in the fifth and sixth centuries (İlkin 1983). Although the notions of money and banking are intimately connected, we may demonstrate that the first banking transactions took place in BC if we agree that actual banking activity only begins with the activity of receiving deposits and lending. It is generally agreed that it started around 3500 BC in Sumer and Babylon (Table 6.2).

The earliest documented bank structure is the “Red Temple” near Uruk in Mesopotamia. Banking services developed in the religious structures during this time, as people believed temples to be safe and priests to be trustworthy individuals. People committed their wealth, assets used as money, and jewels to temples. Considering the presents given to the gods during the period, the temples collected a significant amount of wealth. As a result, the first known institutions that play that role of banks were “models,” or temples. The temples’ collected wealth began to be lent to individuals in need throughout time. People who borrow commodities or money in this way repay the loan with a gift (interest) at the end of the maturity period. The fact that a merchant traveling to another city for business obtains a letter from a well-known, prominent, and trustworthy person in his own city to introduce himself is seen as the origin of the “letter of assurance” from financial services. During the excavations, records were unearthed implying that the temples borrowed money like a bank, lent money with interest like a bank, received financial guarantees or guarantors in exchange, and even enslaved free citizens who did not pay their debts by enslaving them and collecting their receivables (Ildız 2013).

Banking services may be traced back to civilizations such as Lydia, China, and Rome, where commerce was first established. The Code of Hammurabi also contains the first legislative restrictions governing financial operations (1792–1750 BC). Debt, that is, lending money, the interest and commission rates to be applied in these interactions, the methods of securing commodities such as grain, agricultural products, or precious metals, or loans through personal surety (movable or real estate mortgage), how the debt will be paid on time, and how the debt will be liquidated in the event of non-payment are all covered by Hammurabi’s laws. In Ancient Egypt, Greece, and Rome, there existed institutions that conducted financial transactions, and rules were enacted to govern how these institutions conducted their banking operations. While usury and compound interest were prohibited in ancient Egypt, interest was not regulated in Ancient Greece as trade expanded and people became wealthier (Parsiz 2000).

Because of the high-interest rates, banks were established by autonomous locations and states. Credit transactions were carried out in ancient Greece through ecclesiastical institutions known as the “market system,” as well as bankers known as “Trapezitai.” Meanwhile, the first state bank occurred in ancient Greece, and the first banking crisis occurred in ancient Rome (Ildız 2013).

The history of world banking and the history of money are inextricably linked. It is unknown when humans first utilized money on the planet. Many things (such as rice, maize, wheat, seashells, salt, whale teeth, sheep, tobacco, silver, gold, and so on) have been used in place of money in credit and commercial transactions throughout history. The early coins, as we know them now, were composed of copper, silver, and gold and had a broad range of applications. In the seventh century B.C., it was printed in Lydia. As a result of Lydia’s subjugation by the Persians, the use of money and banking expanded throughout the Middle East (Yetiz 2016).

After Lydia, printing and currency grew more important in ancient Greek communities and the Roman Empire. Coin manufacture and use have become commonplace in many countries throughout the world (Aydn 2006). Bankers have emerged as a

result of the economy's use of money as a medium of trade. They exchange currency from one country or place for currency from another. Bankers also contributed significantly to the expansion of banking operations by lending the deposits they earned from their clients as high-interest loans to others who wished to borrow, in addition to this type of money-changing activity. Banking and finance transactions in Rome were carried out by "publicanus" (knights) during the Republican period, who supplied money to both private entities and the state, and by bankers comparable to their trapezites during the Imperial period. Since bankers kept track of their transactions in ledgers, they would have been followed up their clients' accounting transactions (Yetiz 2016).

The ongoing battles and Arab invasions between the east and the west hampered trade in the region at the beginning of the Middle Ages. Another critical reason why banking did not develop during this time period is because two main faiths, Islam and Christianity, outlawed and prohibited interest. However, the development of maritime in the Middle Ages, the transportation of precious metals from newly conquered places to Europe, the need for large money transfers as a result of the Crusades, and the growth of trade as a result of the generation of new cities created a need for institutions to mediate monetary transactions. The development of both the banking system and commercial law was aided by the expansion of commerce, particularly between Europe and the eastern countries.

Thus, the term "bank" derives from the Italian word "banco," which means "table, bench, or stool" in Italian. The oldest instances of banks may be found in Mesopotamia, Egypt, Greece, and Ancient Rome. During this time, the Jews from Lombardy, who were regarded as the first bankers, took out financial activity. Because Islam and Christian religions forbade interest, Jews controlled the financial industry during this time period. Jewish bankers used to do business on a table (banco) set up in the marketplace. People would shatter their banks if some of these bankers went bankrupt for failing to meet their obligations (table). That is why the word "bankruptcy" is derived from the word "banco."

After the Arabs' dominance in the Mediterranean waned in the twelfth century, the Italians, particularly bankers from Lombardy, were increasingly influential in financing operations in France, Germany, England, and the east. They developed a "letter of payment," a money transfer method for carrying out operations involving security risks, such as deposits and lending, as well as foreign exchange (money change) and transporting cash from one location to another (money transfer). A banker in another location was ordered to pay a certain amount of money to the individual who delivered the letter using this method (Ortabağ 2018).

The evolution of banking was also swayed by the introduction of paper money. Following the King of England's confiscation of merchants' gold, the gold was left to merchants known as "goldsmiths." Toward the end of the Middle Ages (1400–1453), particularly in several Italian city-states, these were granted to the money changers, in exchange for certificates. These money changers held the people's silver and gold coinage in their safes in exchange for certificates stating that the coins would be returned whenever asked. Individuals presented these documents to vendors instead of going through the hassle of transferring these precious metals themselves when

shopping, and these silver and gold certificates, which can be turned into coins when desired, have gradually replaced money. Recognizing that not all of the silver and gold coins handed to them were required at the same time, the money changers lent some of them to merchants in exchange for interest as the use such certificates, which are much easier to keep than silver and gold coins, became more prevalent as a form of payment, some money changers transitioned into bankers. Banknotes were the name for these certificates, which were issued by banks and did not have a 100% equivalent. As a result, banknotes were paper money that was partially supported by silver and gold, and they gradually replaced silver and gold coins in the market. The money supply in the market expanded in an uncontrolled manner as a result of this (Cassis et al. 2016).

The conquest of Istanbul in 1453 resulted in an upsurge in immigration to Europe and Italy. On the other hand, the Renaissance movement in Europe's enlightenment, discoveries, and inventions generated certain changes in the context of religion, as well as in many other areas, and expedited the growth of financial markets and banking, particularly once interest was accepted as legal. There have been certain advances in the use of the "payment letter," which is utilized as the money transfer method indicated above, with the impact of the Renaissance. The procedure for executing a "letter of exchange," which is then purchased by bankers from the debtor and converted into a discounted loan instrument, has evolved. Bankers employed their own capital as well as money entrusted to them as loans throughout time, which strengthened the banking system and contributed to its development. Many and significant banks were established during this time, particularly in Italy. The Banco di San Giorgio, founded in 1407, is the most renowned bank. This bank has a public structure and is regarded as the world's oldest bank. When Napoleon took control in 1805, however, he closed it down (Yetiz 2016).

The growth of international trade, especially with America, raised the demand for money even more in the seventeenth century. Money is used in practically every country, and the variety of currencies in Europe, as well as changes in their settings throughout time, have made identifying the value of their currency complicated. The uncontrolled increase in the money supply of certificates issued against gold, on the other hand, has caused uncertainty, particularly in places with a high level of international trade. In order to clear up this misconception, the Amsterdam Bank, the first bank in the contemporary sense, was founded in the Netherlands in 1609. The Swedish National Bank, which was founded in 1668 in Sweden, is the world's oldest central bank. On the other hand, due to a scarcity of money, the notion of forming a bank in which money supply and circulation would be done by one hand appeared in England following the war between England and France. In 1694, the Bank of England, the earliest example of modern-day central banking, was founded. In 1800, France founded the Bank of France, which grew to become the country's greatest financial institution. During this time, it was also determined that some German banks would function as joint stock companies. In 1913, roughly 250 years after Sweden established the world's first central bank, the Federal Reserve Bank, the American Central Bank, a significant milestone in terms of central banking and the development of modern banking took place (Usher 1934).

The banking system has expanded significantly since the nineteenth century, thanks to the impacts of the industrial revolution and the growth of international commerce, and has evolved into crucial institutions that finance the economic welfare of countries. During this time, banks have restructured themselves, focusing on specialization as trade, investment, and development banks.

The Great Depression at the beginning of the twentieth century ushered in a new era in the evolution of global finance. The financial industry was working at 1/10 leverage prior to the Great Depression of 1929. In other words, for every lira of equity, banks have provided nearly 10 units of credit. The bankruptcy of nearly half of the enterprises and the unemployment of individuals, along with the Great Depression, which lasted for at least ten years and had a massive impact on the onset of World War II, rendered it impossible to repay the loans. Non-returnable loans have caused damage on the global financial system. During this time, the central banks' actions and assurances within the framework of the traditional economic theory were unsuccessful. Since Keynesian economic theory has not yet existed, and since intervention in the economy through monetary and fiscal policies has not been known in such cases, approximately half of the companies in Europe and America have gone bankrupt in the last ten years, and nearly half of the working population has lost their jobs. During this time, almost 10,000 banks in the USA alone went bankrupt in less than ten years. The world has fallen into a great depression. This extended period of economic stagnation may be deemed to be one of the factors that contributed to World War II. In 1944, at the end of World War II, an international conference was held in Bretton Woods, New York, to discuss and analyze the world's postwar economic order, global reconstruction, and social welfare, as well as the steps that should be taken to establish a stable economic and financial system. The International Monetary Fund (IMF) and the World Bank were founded in line with the decisions taken thereto, as were organizations to govern and monitor the financial and banking sectors in each country (Aydın 2006).

During the twentieth century, advances in the fields of communication and data processing resulted in significant changes in the way banks operate; banks developed quickly and established a worldwide organization. In the 1970s and 1980s, there were numerous worldwide banking and finance crises, which accelerated the trend of state-owned financial institutions and banks being privatized in various nations, particularly in the UK. Financial markets and the banking industry have been more internationalized since 1980s, with financial institutions and financial products diversified and multiplied, and international competition increased. The September 2001 terrorist attack in the USA produced a new external shock to developing nations as well as the US economy and banking system. Investor behavior was badly affected by the attack's ramifications, which impacted the whole globe, including the US economy, the economies of other developing nations, and the political arena. Expectations for a deepening of the recession in developed countries garnered weight. As a result, the 2000s were a time when interest rates were decreased over the world, particularly in the USA, and monetary expansion became more important.

Bank loans were quickly affected by monetary expansion and low-interest rates in the 2000s, and financial markets and institutions flourished swiftly. As competition

grew, bank mergers thrived, and growing bank mergers converted banks into massive financial organizations that might cause significant economic damage if they failed. In the banking industry across the world, the percentage of non-bank financial firms, sometimes known as shadow banking, has risen dramatically.

By late 2000, under the leadership of the USA, central banks in industrialized countries have started to loosen their monetary policies and fund markets by decreasing interest rates in order to revive their economies. One of the most significant challenges facing the banking industry has been converting this surplus liquidity they provided prior to the crisis, into profitable activities. Banks and other financial institutions particularly in the USA increased their credit portfolios by borrowing at low-interest rates. Mortgaged home loans accounted for the majority of the expansion of the credit portfolio. Housing prices have risen as a result of low-interest rates and lending flexibility. Enhanced international liquidity increasing rich country financial institutions' risk appetite, resulting in increased capital flows from developed to poor nations. As an expected result, the local currency in emerging nations valued, interest rates decreased, and development owing to loan volume and foreign demand started to accelerate rapidly. The present global financial crisis, which erupted in this manner and spread throughout the globe in a short period of time, started with a banking panic in America on August 9, 2007.

Because of the lack of confidence among financial institutions, depositors flocked to banks to withdraw their money, and they avoided lending to one another. Banks tried to create liquidity by selling their assets and securities; but, during panicked settings, the interest rates on these assets surged rapidly, and banks faced financing challenges since loans were funded by repo resources rather than deposits. Although the crisis began in the USA, it has now spread to all financial institutions throughout the world, as the banking sector has fully globalized. Central banks of every country have transferred capital to the bank to stabilize the banking and financial system, and many industrialized countries' banking and financial systems are currently being protected by monetary expansion and low-interest policies (Table 6.4).

There have been remarkable breakthroughs in the field of finance in the first two decades of the twenty-first century, and the globalization trend has aided the transfer of the banking system from a national to an international stage. The global financial crisis, the September 11, 2001, terrorist attacks, financial globalization, liberalism, and financial liberalization have had significant effects on the global banking industry. There have been substantial developments and improvements in the banking industry during the previous ten years.

Banks create products, expand their distribution channels, and collect and analyze data in order to meet the changing demands and risks of their customers. The top priorities have been security, privacy, and efficiency. The sector is witnessing the emergence of microfinance, microcredit, and mobile money as the globalization of financial products and services proceeds at an unprecedented pace. Different financial institutions, structured and diversified financial products heralded the dawn of a new age in which the difference between banking and non-banking financial intermediaries gradually disappeared. The way the banks work has moved from conventional branch banking to digital banking as a result of technological innovations.

Table 6.4 Development of banking all over the world

Period	Substantial advancements and steps and milestones
8000 B.C	The first examples of banking and finance
3500 B.C	Documents evidencing the first banking transactions carried out by the priests at the temples in Sumeria and Babylon
1792–1750 B.C	The first banking rules were arranged by the Kingdom of Eshunnance Hammurabi rules, crediting, deposit collection, commissioning procedures, and credit bills were all regulated
1000 B.C	The Greeks, Romans, and Egyptians established banking during the First and Middle Ages. In Egypt, interest rates were limited, and financial regulations were implemented in Greece
800 B.C	The Lydians, a wealthy nation from Anatolia, minted the first currency, which was made of 75% gold and 25% silver alloy
1407	Banco Di San Giorgio, regarded as the world's oldest bank, was founded
1609	The first modern bank "The Bank of Amsterdam" was established
1637	The Bank of Venice was founded, and checks and banknotes were released
1640	Following the King of England's confiscation of merchants' gold, the gold began to be delivered to merchants known as "goldsmiths" in return of certification
1668	The Swedish National Bank, which is considered to be the world's first central bank, was established
1694	Central Bank of England was founded
1913	The Federal Reserve Bank (FED), the largest central bank in the world, was established, forming the basis for contemporary central banking
1944	It was decided to establish the World Bank and the International Monetary Fund
1980	The beginning of the Financial Globalization movement and globalization
2007	The Global Financial Crisis, which originated in the USA and has extended to a large section of the globe, has begun

Source Developed by the authors taking Aydın (2006) as the basis

The coronavirus outbreak, which erupted in the banking industry in late 2019 and spread around the world, prompted bank competitiveness, digitization, and the establishment of new financial service channels. The quarantine imposed to prevent the spread of COVID-19 has halted economic activity in a number of industries, with serious consequences for businesses and individuals. This atmosphere has had an indirect impact on the financial sector.

Some businesses that went bankrupt or had difficulties during this time, as well as people who lost their jobs or took unpaid leave, were unable to repay their loans. As a result of the increased loan provisions, their profitability and capital situations have weakened. On the other hand, as the cost of economic units increased, so did the demand for loans from banks. Because the banks' financial assets in their security portfolios lost value during this time, the banks suffered losses. The magnitude of this loss was exacerbated by open derivative holdings that moved in unanticipated ways as a result of the crisis.

To mitigate the pandemic's negative effects on the banking system, supervisory and monetary authorities in all countries, particularly in the USA and Europe, reduced interest rates, achieved monetary expansion, announced bond purchase programs, and provided the necessary liquidity for banks to continue lending to the real economy. Governments' direct income assistance to businesses and people, on the other hand, had an indirect beneficial effect on banks because it supported borrowers' loan repayments.

6.5 Historical Development of Turkish Banking System

Turkey's banking sector dates back to the nineteenth century. The Turkish financial system's evolution may be separated into two periods: the Ottoman Empire period (1839–1922) and the Republican period (1923–Onwards).

6.5.1 Turkish Banking System During Ottoman Empire Period (Pre-republican Period) (1839–1922)

Banking, which had great strides in the globe with the Romans, has almost vanished with the fall of the Roman Empire. While the expansion of global trade and the need for money transfer transactions as a result of the Crusades spurred the emergence of bankers and the development of the banking system, it is widely acknowledged that modern banking started with the establishment of the Bank of Venice in 1157.

In 1071, Turks moved into and settled in Anatolia. Although non-Turks handled the majority of the economy and trade businesses in Anatolia during this period, Turks who lived in cities throughout time also engaged in trade and crafts, while those who settled in rural regions had nomadic lives. Anatolia is believed to be on a trading route between the east and west. Gold and silver coins were minted and used throughout the Seljuk period, and there was a modest monetary system. However, throughout this period, economic and financial challenges were secondary to the most critical matters confronting societies: justice and security (Akbiyık 2018).

The Ottoman Empire's banking history follows that of the rest of the globe, and there were no notable breakthroughs in the field of finance until the nineteenth century. Until this period, under the Ottoman State's organizational system, the first banking activities began and continued with the activity of Galata money changers in Istanbul (Toprak 1982). Commercial banking activities such as regulating the country's money supply and credit volume, managing gold and foreign exchange reserves, making domestic and foreign payments, lines of credit to merchants and the state, and making payment transactions in foreign trade were carried out by a variety of organizations, including mints, monetary foundations, covered bazaars, and guilds until the banks attained an efficient status (Coşar 2009).

Following the pronouncement of the 1839 Reforms, the first paper money of the Ottoman Empire, “Kaime,” was printed in 1840 to cover budget deficits by exercising the privilege of seigniorage. Kaime is a type of government domestic debt security that offers a higher interest rate than money. The excessive supply of cash has decreased the value of money in order to support the ever-increasing budget and foreign trade deficits. There were several attempts to establish banks in order to finance the reforms, particularly upon recommendations of the foreign companies for the prevention of devaluation against other European currencies, ensuring exchange rate stability, reorganizing the monetary system, collecting state revenues, controlling public expenditures, offering loans to the public sector, issuing government securities, making principal and interest payments, and issuing banknotes on behalf of the state (Ortabağ 2018).

It is deemed that the first bank established in Turkish finance history, however, was İstanbul Bankası (Dersaadet Bank) in 1849, with 60% of its capital belonging to foreign merchants and 40% to the Ottoman government, which did not have the characteristics of a commercial or state bank, but only had the role of protecting the value of money and stabilizing the exchange rate (Ortabağ 2018; Al 2011). However, the said bank went bankrupt in 1852 due to speculations on local debt instruments known as kaime, illicit transactions, the inability to recover advances made to the government, the bank’s excessive borrowing, and the lack of a standard accounting system (Fertekligil, 2000).

It was borrowed from abroad for the first time in 1854, following the outbreak of the Crimean War in 1853, in addition to domestic borrowing instruments. “The Ottoman Bank,” based in London, was established in 1856 to serve as an intermediary in foreign borrowing, to give advances to the government through the discounting of domestic government debt securities, and to provide merchant loans (Canbaş and Doğukanlı 2007).

Due to the financial difficulties of the Ottoman State in the seventeenth and eighteenth centuries, such as excessive domestic and foreign borrowing, and excessive budget deficits, attempts to create some domestic banks, e.g., Bank of Turkey, did not take place. Meanwhile, the Ottoman Bank’s successful public offering of 8 million pounds of bonds on behalf of the Ottoman Government in 1862, as well as the withdrawal of discredited Kaime from circulation with the proceeds of the public offering and its use in accounting for domestic debts, increased the chances of establishing a national bank with broad statal privileges and authority.

The Ottoman government did not want to grant a national bank privilege to a bank dominated by a single country’s capital, and for a number of political reasons, The Ottoman Bank dissolved itself in 1863 and was renamed Imperial Ottoman Bank (Bank-ı Şahane-i Osman-i) under the British-French partnership. For a period of 30 years, the bank was given a monopoly on issuing banknotes, and it was entrusted with collecting revenues by acting as the state’s treasurer, making Treasury payments and discounting its bills, and mediating interest and principal payments on domestic and foreign liabilities (CBRT 2021).

The era of foreign banking initiated with this bank which was the first emission bank bearing the name of the state in the banking history of Turkey was the most

significant financial institution while it continued to operate in similar structure until 1924 and continued to serve until 2001 starting from that date while with the outset of the financial crisis it was assigned to Garanti Bankası. During the Ottoman period, there were very few banks established, and the financial system was not developed. In Ottoman society, Turks were generally involved in military services, management, and agriculture while commerce and interest-based transactions were left to non-Muslims; and failure to respond to the industrial revolution, which originated in England and extended around the world in this period, resulted in an economic structure based on self-enclosed and small-scale commercial and agricultural operations. As a result, the economy, banking, and financial intermediation activities were unable to flourish (Yıldırım 2014).

The most significant advancement in Turkish banking in the Ottoman Empire was the foundation of Local Funds in 1863 by the Governor of Nish, Ahmed Mithad Pasha, to address the funding requirements of agricultural producers who had to employ high-interest loans. Local Funds were available across the Ottoman Empire and were used efficiently for many years. In particular, two-thirds of the net profit created by agricultural crediting activities were used to build and maintain public necessities such as roads, bridges, and schools in the region where the Local Funds were used, and in this respect such Local Funds contributed to the development of the country. However, the degeneration in the functioning of the Local Funds observed in the following years whittled down their effectiveness, and the government, believing that the problems could be resolved by integrating the Local Funds to the central government, transformed the Local Funds into “Benefit Funds” in 1883.

However, it was concluded over time that it would be more reasonable to structure Benefit Funds as a bank, and in 1888, Ziraat Bank was established as a modern financial institution to replace Benefit Funds, while the operating Benefit Funds were transported into bank branches (Kaya and Kadanalı 2020; Ziraat Bankası 2021).

During this time, Ahmed Midhat Pasha formed the Istanbul Emniyet Sandığı (Security Fund) in 1868 as a national banking effort to address the credit requirements of traders and small artisans, as well as to collect and process people’s savings. Its management, however, was first taken over by Ziraat Bank in 1907, followed by a merger with Ziraat Bank in 1984. Ziraat Bank is Turkey’s largest national bank, which was founded during the Ottoman Empire, survived the Republican period, and continues to exist today. Until the collapse of Ottoman Empire, several banks with foreign capital were founded, and these banks were primarily involved in the operations of receipt and repayment of domestic and international loans for the Ottoman Treasury. For this reason, a concept of “loan banking” is also developed for Ottoman period banking (Tokgöz 1997).

Due to the Ottoman Empire’s inability to pay its obligations in 1875, The Ottoman Public Debts Administration was founded in 1881 with the Muharrem Decree to reorganize the Ottoman foreign loans, collect taxes, and pay creditors against domestic and international debts. A new age has begun (Akgüç 1992). After a large portion of the Ottoman Empire’s income sources went under the authority of an international organization, several foreign banks were established in the Ottoman Empire after 1881. Following this period, a significant inflow of foreign capital into the Ottoman

Empire did begin, and many companies were established in the field of trade and industry with foreign capital participation, particularly the excessive fluctuation of stock prices in the banking and finance sector from 1895 to the declaration of the second constitutional monarchy, and the loans extended by taking these securities as pledge. The financial system was in crisis, and the only notable development was the admission of German banks into the sector.

As a consequence of elevated uprisings, internal and external political turmoil, and fluctuations in the money and capital markets toward the end of the Ottoman Empire, the Second Constitutional Monarchy was proclaimed in 1908, and until 1914, when the World War I began, there were significant developments in the banking sector within the framework of the Union and Progress government's "national economy" view. Along with foreign banks, a few native banks were established. Konya İktisadi Milli Bankası, which came into operation in 1911 throughout this period, was Anatolia's first bank to promote the local economy and trade (Artun, 1983). However, when the Ottoman Bank, which was controlled by France and England during the World War I started in 1914, halted paying the government's foreign debt, the Ottoman finances were in need of German resources, and thus they moved closer to Germany and joined the war (CBRT 2021).

Despite the fact that several foreign banks were operational in the Ottoman Empire, and that the Ottoman Bank's capital was owned by foreigners, considerable privileges granted to this bank led to reactions. As a result of the increasing nationalist movement, the growth of national banking in the country, as well as the notion of establishing a national central bank that dominated the globe during this era, became highly debatable. With this in mind, the Ottoman National Dignity Bank (Osmanlı İtibar-ı Milli Bankası) was established in 1917, but due to the Ottoman Empire's defeat in World War I, it was unable to realize its objective of becoming a national bank and merged with İsbank in 1927.

Apart from a few foreign banks that entered the Ottoman banking sector outside of Istanbul between 1890 and 1915 with the goal of intermediating foreign trade, and a few small local banks established by local merchants to provide commercial loans in Anatolia in 1917–1918, there were no significant developments in the field of national banking during the Ottoman Empire period.

It cannot be asserted that there were significant developments in the field of national banking during the Ottoman Empire period, aside from some foreign bank entries to the Ottoman banking sector that were established outside of Istanbul between 1890 and 1915 with the aim of intermediating foreign trade, and some small local banks established by local merchants in order to provide commercial loans in Anatolia in 1917–1918. Banking activity was regarded throughout the Ottoman Empire as a structure that solely served to support the state's budget deficits and contribute to currency stability. Despite the fact that the Ottoman Empire spanned three continents and included people of all religions, languages, and ethnicities, the following factors contributed to the financial system's failure: The Ottomans' inability to adapt to the industrial revolution, the execution of banking activities such as money changers, money trade, interest-bearing loans and loan transactions, and military service, the application of low tax rates to foreigners and high tax rates to

locals, the inability to provide capital accumulation, and excessive public borrowing were all factors.

6.5.2 Turkish Banking System in Republican Era (1923–Onwards)

The development of Turkish banking during the Republican Era may be divided into two major periods: the period from 1923 until 1980, when liberalization began, and period of liberalization after 1980. Due to the closed mixed economy strategy, the state was significantly involved in the economy, finance, and banking activities throughout the first era when the financial system was about to develop through regulatory arrangements and controls over the interest and currency rates. The second stage is known as the modern banking period, during which the impacts of financial globalization and liberalization are experienced profoundly, the admission of foreign banks into the system is hastened, and technology is extensively utilized. However, according to the broad distinction, Turkish banking history will be explored in sections in this study (Coşkun et al. 2012).

6.5.2.1 Period of Establishment and National Banking (1923–1932)

When the Republic of Turkey was established in 1923, the country had a few military factories, railway line operated by foreign companies, small enterprises in big cities that meet people's basic needs like water, electricity, and gas, small peasant enterprises that holding low capital and traditional production technology to release them to the market, and a limited number companies raising and exporting items such as of hazelnuts, figs, dry grapes, and cotton evidencing that Turkey did not have a strong economic structure. Since economy was largely dependent on agriculture, it has been acknowledged that national banking should have been established in order to secure economic development, finance commerce and industry, protect the economy from foreign capital, and establish a national economy and market. To supplement the political independence obtained during the War of Independence with economic independence, efforts to establish a national central bank were conducted (Zarakolu 1973; Akgüç 1992).

During the same period, following the World War I, a movement evolved toward the establishment of central banks in order for countries to independently establish their own monetary policies and to give emissions through the senior age right. This issue was first addressed during the Izmir Economy Congress in 1923, which was attended by members from the country's agricultural, industry, and commerce sectors. It was decided in Congress that national banks should be established and developed for economic growth, industrialization, and development, and that the state should help propel in the field of banking, as in the cases of all areas, due

to the insufficient resources of the private sector, as well as the development of the national banks establishment of the central. On August 26, 1924, the first private bank of the Republican Era, İşbank (Türkiye İş Bankası), was established in accordance with the resolutions made at the Izmir First Economic Congress as recommended by Atatürk. This bank is still operating today as Turkey's largest privately held bank. Atatürk personally funded a share of the bank's nominal capital of 1 million TL, amounting to 250 thousand TL. Sınai ve Maadin Bankası (Industrial and Mining Bank), Turkey's first development bank, was founded in 1925 as a result of decisions reached in the Izmir Economy Congress. This bank was founded with the objective of offering loans to newly established industrial and mining enterprises by the private sector, establishing partnerships with the private sector, intermittently operating state-owned industrial enterprises and eventually transferring these institutions to the private sector, and providing financial and economic consultancy services to all segments.

In 1932, Industrial and Mining Bank, surrendered its factories to the Industry Office, which was then transferred to Industrial Credit Bank of Turkey (Türkiye Sanayi Kredi Bank) in order to issue industrial loans only. The industries in the hands of the Industry Office were transferred to this newly founded firm with the establishment of Sümerbank in 1933. Real Estate and Orphan Bank (Emlak ve Eytam Bankası) was created in 1927 to offer finance for construction and zoning operations, as well as housing loans, during this time period while this bank's name was subsequently amended as Real Estate and Credit Bank (Emlak ve Kredi Bankası) in 1946, and it has been engaged in Turkey's residential and commercial banking sectors for many years. In 1988, Wheat Bank (Buğday Bankası) and Turkish Express Bank (Türk Ekspres Bank) changed the name of the bank to Turkey Real Estate Bank (Türkiye Emlak Bankası), upon merger with Anatolian Banka (Anadolu Bankası) and Maritime Bank (Denizcilik Bankası) was transferred to Turkey Real Estate Bank in 1992. Again, within the framework of the Izmir Economy Congress resolutions, Ziraat Bank's financial structure was strengthened in 1924, and it was given the authority to carry out all banking activities in addition to agricultural banking (BAT 2008).

The establishment of the Central Bank was one of the most significant milestones of the Republican Era. The establishment of an independent central bank to safeguard the stability of the Turkish currency, control the money supply, and administer monetary policy was first considered during the 1923 Izmir Economy Congress. The draft bill on the Central Bank was passed by the Turkish Grand National Assembly on June 11, 1930, and published in the Official Gazette on June 30, 1930, under the name of Turkish Republic Central Bank Law numbered 1715 (BAT 2008).

The central bank started its operations on October 3, 1931, as a joint stock corporation, with an emphasis on its entirely distinct and autonomous position from other public institutions, after the tasks performed by several institutions and organizations were consolidated into one hand (CBRT 2021). The main purpose of the Central Bank, according to the Founding Law, is to assist the country's economic growth. The Bank has been awarded the authority to issue banknotes from a single source for this purpose. In 1923, Turkey had 35 banks operating, 22 of which were national

and 13 of which were foreign banks. Many local banks or foreign capital banks were founded and they were permitted to service the credit demands of merchants and industries between 1923 and 1932. In 1930, the number of national banks increased to 44 while the share of the nation in the total deposit rose to 80%. As can be seen, the Turkish banking system during this era comprises of research aimed at creating national banking in accordance with the resolutions discussed and adopted at the Izmir Economics Congress (Akbulak et al., 2004).

6.5.2.2 Period of Statism or Public Banking (1933–1944)

The 1930s was the time when the Central Bank maintained its independence, inflation stayed low, and an economic policy centered on import substitution was enacted. With the most significant economic crisis in world history, which originated in the USA in 1929 due to lack of demand, production plummeted, economies contracted, unemployment increased, and prices fell significantly. Such disadvantages had a negative impact on the economies of all developed and developing nations, as well as the Turkish economy and financial system. As a result, “statism” rose to prominence in economic life, and it was an era in which investment, production, and industrialization policies were implemented through public economic institutions. Statism is defined as the state’s direct intervention in every sector of the economy that requires huge sums of money. During this time, public banks specialized in certain fields were founded. Many specialized banks were established with state capital and undertook key roles as part of the First Five-Year Industrial Plan.

Sümerbank (1933) was established for the organization, development, and crediting of business and industry; Etibank (1935) for mine operation, energy generation, and distribution; Denizbank (1937) for the development and financing of the maritime sector; Belediyeler Bankası (İller Bank—(1933) for the promotion urban development and infrastructure, and Türkiye Halk Bankası (1938) for granting loans to artisans and craftsmen), together with banks established for specific purpose, such as Türk Ticaret Bankası (1937), to finance commerce. Many of these banks operated as both commercial banking and specialized banking (Yıldırım 2014). The 1930s were a period in Turkey when major rules in the sphere of banking and finance were enacted, and various actions were undertaken to promote domestic savings.

Although centered in North America and Europe, the great world economic crisis that erupted in 1929 had a detrimental impact on all countries, particularly the industrialized countries, as well as the Turkish economy. In the crisis-affected countries, unemployment soared, construction activities ceased, and prices fell, particularly for agricultural products, causing unemployment to rise, the economy to contract, and welfare levels to fall. The crisis continued during the 1930s and World War II, from 1939 to 1945 and the devastating repercussions of World War II had a negative impact on Turkey’s economy and financial industry, as in the case of rest of the world. Along with the disruptions posed by the World War II, the 1940s were the years when the negative effects of the World War II were realized and public financing began to be provided from the Central Bank’s resources. Under the impact of this tendency,

the Central Bank of Turkey pursued strategies targeted at closing the public sector's funding deficit throughout this era, rather than carrying out an independent monetary policy. As a result, the overall price level has climbed nearly thrice. With the effects of the Great Depression, Turkey had 62 banks functioning in 1931, which had dropped to 40 by 1945 (Akgüç 1992).

6.5.2.3 Period in Which Time Private Banking Operations Expanded (1945–1959)

With the end of World War II, the Bretton Woods decisions and Keynesian economic policies gained widespread support throughout the world, Turkey's internal and foreign economic structures started changing, and it was an era in which growth and rapid development targets were prioritized. The notion of economic statism was abandoned, and the industrialization strategy was pushed forward under the leadership of the private sector. During the World War II, the high inflation and speculative structure allowed for enormous wealth creation, particularly in the commercial sphere. Growing wealth accumulation has increased capital flow to the banking sector. The closed, protectionist economic policies that had been implemented in the Turkish economy since the 1930s were reversed during this time, and more liberal, outward-oriented policies that favored the private sector were implemented. Particular importance was attached to the market economy and private sector investments were encouraged, and investments such as energy, transportation, textiles, iron and steel, and so on that could not be produced by the private sector due to costs were financed with public funds.

Following 1950, as a result of changes in the political structure, an economic policy aimed at supporting open, liberal, and industrial entrepreneurs was adopted. Protectionist economic policies have taken a back seat to an economic strategy that encourages private property, fosters collaboration between the private sector and foreign capital, and aims to develop the capital market. This overall change in economic policies had a favorable impact on the development of the private sector banking sector. However, particularly throughout the 1950s, the Central Bank's resources were progressively utilized to fund such investments, economic growth, and development. The number of private banks has grown fast, as has the transition from single-branch banks to multi-branch banks, and from local banks to national banks. In 1944, Turkey had 43 banks and 405 branches; by 1959, the number of banks had increased to 60 and the number of branches had increased to 1759 (Akgüç 1992).

Industrialization, population growth and urbanization, and the expanding of the rural sector to the market all increased the need for credit in the economy. The need to fulfill the increasing loan demand fueled the desire of huge capital groupings and the state to establish banks during this time period. Among the newly established banks, the state founded Maritime Bank, Türkiye Vakıflar Bank, and Türkiye Öğretmenler Bank. As the most major private capital banks, Yapı ve Kredi Bank (1944), Garanti Bank (1946), Akbank (1948), Pamukbank (1955), and Türkiye Sanayi Bank (1950) started their operations.

Aside from the Türkiye Sınai ve Maadin Bankası, which was established in 1925 but did not last long, the Türkiye Sınai Kalkınma Bankası was the first bank to be established in our country. Commercial banks provided a large portion of the bank's start-up capital, while the Treasury provided support through long-term loans to the bank. Türkiye Sınai Kalkınma Bankası mainly financed the private manufacturing industry by way of the loans in Turkish lira and foreign currency, and it also lent money to vital economic development sectors such as mining, transportation, and energy (Akgüç 1992).

Since the government set the interest and commission rates that banks applied, and the Central Bank handled all foreign exchange transactions, interbank competition was limited to deposit collection during this time period. The competition to collect deposits has underlined the need of multi-branch retail banking (Yıldırım 2014).

During this time, three more significant developments took place: At first, in order to encourage foreign capital investment, the Law on Foreign Capital Incentives was passed in 1954, and the Central Bank Banknote printing house was established in Ankara in 1955, and banknotes have been manufactured in Turkey since 1957. Finally, the Banks Law numbered 7129 was enacted in 1958, and the Banks Association of Turkey was founded the same year to safeguard the rights and interests of the financial industry, improve competitiveness, prohibit unfair competition, and contribute to the development of the banking profession. The Banks Liability Fund, whose source is half a thousand of the savings and commercial deposits of the banks' end-of-year balance sheets, was introduced with the modification made to Banking Law numbered 7129, and the rules for progressive liquidation in banks were regulated. The Banks Liability Fund has been assigned to the Savings Deposit Insurance Fund administered by the Central Bank since 1983 (Asomedyia 2001). Again, the Banks Law numbered 7129 removed limits on the use of loans by state banks, allowing loan provision to resume.

Since 1953, the economic structure has eroded as a result of governments' overutilization of Central Bank resources. Inflation, trade imbalance, and foreign indebtedness all rose sharply. Because raw materials or semifinished products could not be imported owing to lack of foreign money, capacity utilization rates in the sector decreased, and devaluation became inevitable starting from 1958. The dollar/TL exchange rate was increased from 2.8 liras to 9 liras as part of the proclaimed Stabilization Program. However, because the excessive use of central bank resources exacerbated inflation, a new epoch has begun in which Turkish banking will operate in a high inflation environment for at least over the next 40 years. In the short term, the Turkish economy underwent a depression and recession in the late 1950s as a result of economic policy that resulted in excessive inflation and abuse of the Central Bank's resources, which led to the closure of several banks.

6.5.2.4 Period of Planned Economy (1960–1979)

As a result of the 1950s economic degradation, liberal economic policies were eliminated, and the mixed and planned economy practice based on import substitution,

which was closed to the outside and aimed to ensure domestic production of imported industrial goods, in which the state intervened in the economic field, was restored. The First Five-Year (1963–1967) Development Plan was devised in order to increase national savings, focus investments on the priorities necessary for societal benefit, and achieve economic, social, and cultural development through democratic methods.

The period is defined as the “planned period” because of Turkey’s development plans, which have been in place since 1963 and are updated every five years. Since Turkey was administered as a closed economy during this period, interest and currency rates, bank credit limits, and commission rates were established independently of foreign markets. During the planned time, the banking industry was largely under governmental control and influence, and the Turkish banking system’s resources were channeled to finance the investments outlined in the five-year development plans (Yıldırım 2014).

Foreign or Turkish banks were not allowed to be incorporated during this period, with the exception of five development banks and two private banks. Five development banks, namely T.C Turizm Bankası (1962), Sınai Yatırım ve Kredi Bankası (1963), Devlet Yatırım Bankası (1964), Türkiye Maden Bankası (1968), and Devlet Sanayi ve İşçi yatırım Bankası (1976), were established along with two privately owned commercial banks, namely Amerikan—Türk Dış Ticaret Bankası (1964) and Arap-Türk Bankası (1977) (BAT 2008).

T.C. Turizm Bankası was founded with public funds in 1962, and its status was changed in 1986 to that of a group of state-owned development and investment banks, before being transferred to the Türkiye Kalkınma Bankası A.Ş. with all of its assets and liabilities in 1989. Sınai Yatırım ve Kredi Bankası (Sınai Yatırım ve Kredi Bankası A.Ş.) is a development bank founded by six private commercial banks with the goal of funding the private sector’s investments in their development plans through medium- and long-term loans. Devlet Yatırım Bankası was established to fund the projects covered in the development plans, and this bank was reconstituted as Türkiye İhracat Kredi Bankası in 1987. Türkiye Maden Bankası was founded in 1968 but did not start operations until 1974, when it was dissolved. In 1976, Devlet Sanayi ve İşçi Yatırım Bankası was established as a governmental development bank to offer resources for industry financing and to provide services in the tourism sector with the transfer of the Turizm Bankası with all its assets and liabilities in 1987, while it was reorganized in 1999 as Türkiye Kalkınma Bankası to provide financial support for investment and entrepreneurship initiatives for private entities in the industry and tourism sectors and named Türkiye Kalkınma Bankası A.Ş. in 2018. During this period, two commercial banks were established: the Amerikan—Türk Dış Ticaret Bankası (1964), a joint venture between Bank of America and Türkiye İş Bankası, and Arap—Türk Bankası (1977) which constitute the first examples for international expansion (BAT 2008). During the Republican period, the Amerikan—Türk Dış Ticaret Bankası was the first bank to be established with the involvement of foreign capital (Akgüç 1992).

Arab-Turkish Bank, on the other hand, was founded with Libyan and Kuwaiti capital to lure Arab capital to Turkey, and it is a bank that specialized in commercial transactions between Turkey and the Middle East and North Africa. During

this time, the policy of employing a major share of bank resources for public borrowing or funding public investments commenced and lasted until the 2001 financial crisis. Interest rates, currency rates, and capital flows (the impossible trio) cannot be managed at the same time in the implementation of economic policy. Therefore, since interest rates and exchange rates are controlled as economic policy, that is to say, banks do not undertake interest rate and exchange rate risks and transfer a significant portion of the resources they collect to the public as loans, they have turned to more branch banking to increase their profitability, particularly in terms of deposits. During this time, as large banks expanded their branch network, particularly in large cities with substantial deposit potential, minor banks attempted to save costs by merging.

When the Turkish financial system transitioned to a planned economy in the 1960s, private sector investments remained inadequate due to insufficient savings and a lack of a program to increase savings. The funding of public investments using resources given by the public budget and domestic and international borrowing, as well as the central bank's continued provision of resources to the public through expansionary monetary policies, accelerated inflation. In addition to these factors, the inability of scarce resources to be allocated effectively enough to improve economic conditions, the finance industry, and development, as well as difficulties in collecting subsidies and loans, has resulted in an uncontrolled increase in money supply and inefficiency. Despite insufficient investments and output, the fast expansion of the money supply was the most fundamental factor of the seventies' quick surge in inflation rates.

A new phase in the history of the Central Bank started with the introduction of the new Central Bank Law numbered 1211 in 1970 in order to prevent such difficulties in the economic structure and to boost the efficiency of the central bank. Significant changes have been made to the Bank's status, organizational structure, and operations with the new Central Bank Law, and it has been stipulated therein that the Bank's share of the Treasury's capital cannot be less than 51% while the Bank's Joint Stock Company status is preserved.

The Bank's duties and powers in regulating money and credit transactions were expanded by the Law numbered 1211, as was the Bank's control over monetary policy instruments. The Bank was also authorized to conduct open market operations to regulate money supply and liquidity, as well as to provide medium-term loans with rediscount transactions to support investments and economic development and a credit-selection policy. Furthermore, the highest limit of the advance amount to be handed to the Treasury has been raised to 15% of the relevant year's budget expenditures (CBRT 2008).

In brief, during the planned period between 1960 and 1979, development and investment banking were encouraged, the establishment of private commercial banks was limited, the majority of private commercial banks were converted to holding banking, and holding banking was even supported by the state in the belief that it would accelerate private sector investments, and competition between banks exacerbated in branching activities due to low and even negative real interest and exchange rate risks. This was assumed to be the final phase of traditional, non-specialized,

self-enclosed holding banking, which primarily provided services for the financing requirements of group corporations since the Republic.

6.5.2.5 Transition into Market Economy, Financial Liberalization, and International Expansion (1980–1990)

Although rapid development occurred in reconstruction during the planned period, economic policies had to be re-identified due to skyrocketed inflation as a result of excessive use of central bank resources in financing investments and industrialization, production volume failed to support exportation due to production only meeting domestic market demands, deformations in the payment balance, and foreign currency shortage. Self-contained, import-substituted economic, and industrial policies were abandoned on January 24, 1980, with the adoption and implementation of a strategy for an internationally expanded, free market economy with financial liberalization and a liberal economy based on exportation, industrialization, and growth.

With the decisions being made on January 24, 1980, a fundamental revolution in the Turkish economy, financial structure, and banking system transpired, and the 1980s were years of significant developments in the Turkish economy and banking industry. Throughout this new age, the Turkish currency was devalued against other currencies, and the fixed exchange rate system was repealed in order to allow a healthy transition into a free-trade economy centered on exporting, with flexible (fluctuating) exchange rates. With the advent of the financial liberalization process, the central bank took significant measures to align monetary and exchange rate policies with the free market economy. It was decided to determine the appropriate interest rates on deposit accounts and loans in accordance with market conditions, and positive real interest policies were introduced. Price controls were abandoned in order to produce price within the framework of market mechanisms, and significant agreements were made in order to liberalize, extend, and reform financial markets in depth (BAT 2008, Şahin 2000).

On July 1, 1980, the first and most important arrangement for the development, expansion, and liberalization of the banking and financial system was established when interest rates on deposit accounts and loans were slashed. Interest rates on deposit accounts and loans increased rapidly as a result of the release of interest rates, the ability of banks to issue deposit certificates, and other initiatives to promote deposits (Parsız 2000). Banks had to compete aggressively against “bankers” who proliferated like rabbits and among themselves during this period because inflation was rampant, real interest rates were low, and alternative investment instruments were scarce.

During this time, businesses established with the aim of lending money were referred to as “bankers,” and their work was characterized as “brokerage” (Uluyol 2019). There were no precise conditions or capital requirements imposed on the banker. Although the interest rate applicable for deposit accounts at banks was capped at a period when the annual interest rate reached 30–40%, the bankers were paying

an interest rate of 10% per month since there were no interest-wise limits for the bankers. Depositors looking for a higher return than the inflation rate began depositing their savings with bankers. The bankers used their own certificates to promote the reduced deposit certificates they obtained from the banks to their clients, and they accepted deposits (monies) in an unregulated way that was not in accordance with the legislation of lending money and banking. The interest payable on cash placed with bankers was only payable on new deposit accounts for which money was lent at higher rates, while such collected sums were lavishly spent for private matters (Kale and Eken 2017).

Several banks hired bankers as intermediaries to sell deposit certificates in order to raise funds, while some holding companies founded their own brokerage businesses. The banks created their own banker businesses to carry out any operations that they were unable to carry out owing to regulatory constraints. Yatrm-Finansman was the commercial name of the corporation founded in mid-1980 with the participation of thirteen leading banks (Uluyol 2019).

The large amount of money thus collected enticed many people to enter the brokerage business, while the competition to collect funds with high-interest rates resulted in going into debt to pay for the interest of the money loaned in a while, and the race to offer interest that resulted in a crisis thus started. In the first case, in 1982, when inflation was at 30%, Hisarbank, which was about to go bankrupt, offered 80% interest on a one-year savings account. The race for interest eventually ended in a financial meltdown known as the “bankers’ crisis” in 1982 (Baykal 2007). As a result of the crisis, numerous banks and banker businesses went bankrupt, and the crisis cost around 2.5% of the country’s GDP. Following the crisis, the limitations on all types of deposit accounts were abolished, with the imposition of state guarantees on deposit accounts, and a reorganization program for the banking system was initiated (Coşkun 2012).

Due to problems in the banking and brokerage businesses, the free interest application was terminated in 1983, and free interest rates reintroduced in 1987. The banking system became vulnerable to financial risks as a result of the extrication of interest rates on deposits and loans, as well as exchange rates, permissions granted for the establishment of foreign banks, authorization granted to banks to make available foreign exchange positions, purchase and sale of foreign exchange, and allowing the opening of foreign exchange accounts. Furthermore, because competition was fierce, banks expanded their investments in technology and transferred all relevant financial applications from foreign markets to the country in an effort to provide a wide range of services. Through their subsidiaries and affiliates, the banks directly offered consumers’ loans, credit cards, foreign exchange deposit accounts, automatic teller machines, as well as financing methods such as leasing, factoring, forfeiting, and risk management applications such as forward, swap, futures, and options. During this time, Turkish banking flourished and internationalized.

The Law on Capital Markets was enacted in 1982 to safeguard the trustworthiness, transparency, and stability of capital markets, as well as to defend the rights and benefits of depositors, or investors, and the Capital Markets Board, Turkey’s first regulatory and supervisory organization, was founded. The Istanbul Stock Exchange

was founded in 1986 to facilitate the sale and purchase of money and capital stock instruments in a fair, reliable, and competitive environment within the framework of the aforementioned law. At first, it was rapidly developed as a result of people's easy access to the stock exchange as well as the ubiquitous branches of banks as the banks directly subscribed their membership to the stock exchange; however, when the banks were precluded from direct membership to the share markets of the Stock Exchange in 1997, the process of rapid development of the capital markets came to an end.

When the repercussions of the bankers' crisis were properly assessed, the Central Bank established the Savings Deposit Insurance Fund (SDIF) in 1983 to avert future liquidity crises and preserve depositors' benefits. Due to the 1994 economic crisis, SDIF's responsibilities were expanded, and SDIF was held accountable for strengthening the financial structure of banks and restructuring them when required, in addition to insuring savings deposits.

In 1985, the Banks Law numbered 3182 went into effect in order to organize the establishment, management, operational facts, assignment, merger and liquidation issues, as well as supervision to provide protection for deposit accounts and maintain the use of such accounts in accordance with the requirements of economic development. Beginning in early 1986, a uniform accounting plan was implemented to obtain the information required for producing a uniform balance sheet and table of income, as well as to verify and supervise such data for supervision and surveillance purposes, along with the financial analysis, risk analysis, efficiency analysis, and various analyses and interpretations.

After 1989, the age of "higher interest rates, more inflation" was ushered in economics. Funding a large amount of the rapid rising budget deficits through domestic borrowing has increased public demand for financial resources. Meanwhile, notwithstanding capital movement liberalization, inflationary policies based on increased domestic demand caused acute pressures on the balance of payments, which led to an increase in real interest rates. Expectations have worsened, and uncertainty has grown as a result of the inability to execute appropriate measures to address macroeconomic imbalances. The loss of macroeconomic discipline was mirrored in the activities and supervision of the financial sector. The Central Bank of the Republic of Turkey was empowered to manage the country's gold and foreign exchange reserves as a result of amendments made to the Central Bank Law during this time period. The Interbank Money Market was established in 1986 in order to more efficiently employ resources in the banking sector, to satisfy liquidity needs or to assess surplus cash, i.e., to alleviate liquidity concerns, and the Central Bank began to carry out open market operations in 1987. During this time, the central bank was a driving force in the establishment of the country's money and foreign exchange markets. The foreign exchange market was established in 1988, and the gold market in 1989. With the Resolution numbered 32 adopted in 1989, capital movements were liberalized, and financial institutions were allowed to deal in foreign currency (CBRT 2021).

Banks were allowed to collect cash from overseas through syndication or securitization following the liberalization of capital movements. Today, medium- and

long-term borrowing resources received from abroad have surpassed deposits as the most essential resource for banks (Ural 2003).

In addition to the financial liberalization and international expansion efforts of the Turkish banking system after 1980, it was the beginning of a period in which the interest-free or Islamic banking concept, which had emerged over time in the globe since 1960, began to flourish in Turkey as well. In Turkey, Islamic banking and finance practices known as participation banking also developed during these years. This type of banking, which operates on a profit-and-loss basis in Turkey, was originally incorporated into the Turkish financial system under the term “Special Finance House.” However, since 2006, private financial firms that have reservations about being classified as a “bank” in overseas transactions and markets have been designated as participation banks.

In summary, following the adoption of growth policies based on a free market economy in 1980, regulations were enacted to ensure liberalization in the banking and finance sector and to remove barriers to competition within this period. A new structure was established in the field of supervision and surveillance to protect depositors while barriers to make entries within the system were removed and interest rates were released in 1981, with capital market law was enacted in 1982. The Law of Capital Markets, adopted in 1982, established mechanisms for the development of capital market instruments, while foreign exchange trading debuted in 1984 and capital movements started in 1989, as part of the sectoral efforts for internationalization. As a consequence of research and legislation, the number of banks in the Turkish banking system climbed from 37 in 1980 to 64, and the asset size increased from 20.8 billion dollars to 58.2 billion dollars (BRSA 2002).

6.5.2.6 Period of Economic and Financial Crises (1991–2001)

Significant progress was achieved in the 1990s in terms of opening up the banking industry to the outside world and integrating it with the global financial system. The Turkish currency was deemed convertible in 1990, and a more liberal exchange rate system was implemented. People residing abroad are now allowed to open bank accounts in TL and foreign currencies, as well as trade stocks in Turkey, under this new regulation (BAT 2008).

The ratio of deposits collected in foreign currency deposit accounts to total deposits increased significantly throughout the 1990s. The phenomenon of “substitution of local currency with foreign currencies,” known as dollarization, has emerged in the economy as a result of persistent and excessive inflation. During this period, the banking sector experienced rapid growth as new local and foreign banks joined the financial system, rapid technological investments were made, significant steps toward the institutionalization of money and capital markets were taken, competition increased as a result of the liberalization of deposit and loan interest rates, and it was considerably easier for banks to supply resources from overseas due to the freedom provided in the foreign exchange regime. However, due to the rapidly growing public deficits and high public borrowing as a result of the ever-increasing budget deficits, a

significant portion of bank resources were allocated to public financing and the high-interest treasury bills and government bonds issued by the Turkish Treasury for this purpose. Thus, banks steered the real sector to public financing rather than offering loans and channeling resources to long-term investments to finance economic growth and development. In reality, while the loan/deposit ratio was 84% by early 1990, it had dropped to 50% by 2000. Furthermore, despite the increase in public deficits, the Central Bank met a large portion of the budget deficits, implying that the execution of expansionary monetary and fiscal policies contributed to the spiral of “high interest, high inflation.” Again, a significant expansion in the sector of retail banking, as well as an increase in the number of credit cards, had a significant impact on increasing the total demand throughout this time.

Although interest rates and capital flows were free during this period, exchange rates which were still kept under control resulted in a significant surge in short-term foreign portfolio investments. The banks’ open holdings expanded fast as the interest rate differential widened. The open position of bank due to wide gap between the interests and exchange rates raised the exchange rate risk in the banks, and as a result of the inability to implement the promised structural changes, this paved the way for the onset of the period of financial crises.

In early 1990, the Central Bank started implementing a monetary policy aimed at controlling the size of its balance sheet and the loans it provided to the Treasury, which is one of its domestic liabilities, in order to manage its own balance sheet size and so lower inflation. Sustaining high-interest rates and low exchange rates resulted in an increase in imports and a decrease in exports. As a matter of fact, although it was aimed to promote inflow of the foreign currency by keeping the exchange rates low which ever increased the foreign trade deficit. The Central Bank made efforts to implement its monetary policy by using the transactional instruments such as open market operations, rediscount policies, minimum reserves, and purchase and sale of foreign currencies. However, as a result of the Gulf Crisis in 1991 and the early general elections held that year, TL and foreign exchange liquidity from the markets declined dramatically, and this had a detrimental impact on the financial structures of the banks since it increased their financing costs.

Since the public sector’s high borrowing demand was continually expanding the budget deficit, inflation and the Treasury’s borrowing cost grew as a result of the economic policies pursued until the beginning of 1994. Because interest rates and capital movements were free and foreign exchange rates were low, banks converted the foreign currency they had provided from abroad via debenture into Turkish Lira and invested such amounts in high-interest public domestic securities during this period or preferred to finance individual loans. Foreign portfolio investors joined the financial markets to invest in government domestic debt instruments and stocks to take advantage of the “high-interest, low exchange rate” opportunity (BAT 2008).

By early 1994, the government attempted to cut interest rates in order to restrict the entry of hot money and boost exchange rates, and instead of making use of high-interest domestic borrowing, the government turned to Central Bank forward advances and foreign borrowing. While this condition restricted the utilization of

resources in the banks, it also expanded their open positions day by day. While structural measures and appropriate economic policies should have been implemented to eliminate macro-imbalances and reduce high-interest rates, attempting to reduce high-interest rates using incorrect methods (increasing sales of TL-denominated financial assets due to additional taxes levied on financial instruments, etc.) increased the orientation to foreign currency. As a result, Foreign Exchange Deposit Accounts in banks rose steadily, as did foreign trade imbalances, and Turkey's credit rating was subsequently downgraded.

The swift rise in exchange rates triggered the financial crisis that began in the banking sector on April 5, 1994. The Central Bank sold considerable amounts of foreign currency in efforts to stabilize foreign exchange values, but interest rates surged to record highs, the Turkish lira lost 200% of its value versus foreign currencies, and overnight interest rates increased to nearly 800%. 1994 was a year in which banks' open positions turned into losses, banks with weak financial structures went insolvent, and the banking system's assets decreased dramatically (Kandemir 2014).

To restore financial market stability, foreign exchange rates were released with the "April 5 Decisions," daily rates were established based on the foreign exchange sales rates of the ten banks with the highest foreign exchange transactions in the Interbank Foreign Exchange Market, the Central Bank sold foreign currency to the banks, and the banks closed their open positions. The Treasury's use of Central Bank resources was restricted, and all deposits were guaranteed. The activities of three banks (TYT Bank, Marmarabank, and Impexbank), which suffered considerable losses during this period and whose equity capital turned negative, preventing them from meeting their capital requirements.

The rapid economic recovery that proceeded after 1995 boosted the expansion of the financial system as in the case of other industries. Although high real-interests made the investment instruments in Turkish Lira attractive and currency substitution decelerated slightly, foreign exchange positions were reopened, domestic investor demand was shifted to short-term financial instruments, high-cost foreign borrowing was resumed, and the majority of demand deposits and term deposit in the banking sector were daily-denominated and exceptionally high-interest rate report while a portion of domestic deposits was diverted to offshore banks. In 1996, it was aimed that applications such as the public joint account, inflation-indexed borrowing, and foreign currency borrowing would help to fulfill the growing demand for public borrowing, without increasing interest rates.

Despite the Asian crisis, which emerged in 1997 as a result of liberalization of capital movements in Asia, fixed exchange rate policy, a slowdown in exports, an increase in the current account deficit, with a decrease in the quality of bank loans, all of which had a detrimental effect on all financial markets, foreign and domestic investors' expectations of Turkey improved, foreign exchange reserves increased, interest rates decreased, and investors started to favor deposit accounts once more. However, even this predicament did not limit banks' propensity to hold open positions; it rather encouraged banks to expand their open holdings (Kırbaşlı and Güzveli 2021).

Meanwhile, Russia declared a moratorium on non-payment of foreign loans in 1998, and despite the fact that the Russian economy dropped by 5.3% that year, it was able to restore its economic position due to an increase in oil prices. Despite the Asian and Russian crises, neither Turkey's economic structure nor its banking financial systems have changed considerably. Inflation, interest rates, the international trade deficit, the current account deficit, the budget deficit, and the public debt all increased. In the meanwhile, a large earthquake hit western Turkey in August 1999. The Marmara earthquake, which occurred in such a setting, exacerbated the financial woes. A new Banking Law was enacted in June 1999 to bring legal and institutional controls in the banking sector in line with international standards. The Banking Regulation and Supervision Agency (BRSA), a new supreme agency with administrative and financial autonomy, was established with the new Banking Law, and stricter standards were imposed for the founding and initiation of operations, and monitoring and supervision of banks' activities. In the same year, five deposit banks (Egebank, Esbank, Yaşarbank, İnterbank, and Yurtbank) were transferred to the Savings Deposit Insurance Fund (SDIF). The United Investment Bank, which was part of the group of investment and development banks, was closed down by revoking its banking license.

Due to chronic high inflation and concerns about debt sustainability, a new standby agreement with the IMF was established in December 1999, and a stabilization program in which currency rates were determined based on the targeted inflation was implemented. According to this program, exchange rates will be declared annually, monetary expansion will be limited with only foreign exchange purchases, governmental deficits will be lowered by strict fiscal discipline, and the primary surplus would be increased. Initially, favorable outcomes in the fields of growth, inflation, and public finance were produced as a result of the execution of the program. Interest rates decreased, inflation fell, and production and demand soared (Yıldırım 2014).

As a result of the Central Bank's decision to decrease short-term interest rates in order to curb inflation, and the assumption that there was no exchange rate risk due to the pre-announcement of the exchange rate, banks purchased government domestic debt securities by converting their foreign exchange resources into TL or borrowing in the short-run as they preferred to make easy profits. Banks did not hesitate to borrow more and more in the short term and invest in long-term assets, and face maturity and interest rate risks because they believed that they would not be exposed to foreign exchange rate risk. Banks reduced lending, which was formerly one of their primary activities, and evolved into organizations that aimed to finance the public. They shifted their financing focus to individual loans, which they believed were profitable. The perfect example to describe this scenario is Demirbank. Demirbank, which has been a part of the Turkish banking system since 1953, held 10% of the total public domestic debt stock in its securities portfolio, with short-term borrowing and open positions far exceeding the legal limits, despite the fact that time deposits accounted for 1% of its total resources.

Despite the fact that this system generated fragility on the banking sector, interest rates fell dramatically at the beginning of 2000, imports were cheaper, the international trade and current account deficit grew, and GDP surged as a result of the

exchange rate policy adopted. Despite positive structural reforms such as privatization, raising the retirement age, and improving the social security system, overvaluation of the real exchange rate, deterioration in confidence in the IMF program, risks borne by the banking system, and a loss of belief in the long-term viability of these risks all contributed to a loss of confidence in the economy by the end of 2000. Banks used foreign currency to settle open positions and boosted their TL demands to purchase foreign currency.

This raised the expectation of devaluation, and when speculative foreign currency demand was added to the increasing foreign exchange demand, the TL liquidity crunch dramatically boosted short-term interest rates and consequently the banks' financing costs. Foreign investors' capital fled as a result of this crisis, and Etibank was handed to SDIF in October 2000. As the economic program's implementation raised banks' exchange rate and liquidity concerns, many of the banks were afraid that they would no longer be able to manage these risks. As a result, interest rates have risen dramatically since November 2000, after several banks ceased their credit lines to Demirbank, which was experiencing severe liquidity constraints and refused to lend money.

However, many banks having government debt instruments in their portfolios desire had the intention to sell them, and that banks with open positions swiftly demanded foreign currency to cover their open holdings, thus removing market liquidity. As a result, interest rates climbed and the stock market fell significantly. Demirbank was handed to SDIF in December 2000, as the excessive increase in funding costs, decline in security prices, and liquidity constraints produced significant losses in the bank balance sheets. The Central Bank, in an attempt to preserve the exchange rate at the predicted level, sold approximately \$10 billion in foreign currency, while the government preferred to maintain the policy, which was accomplished with a re-agreement with the IMF. Despite the loss of trust in the banking sector, which was in a liquidity crunch and closed the year 2000 with massive security losses, and the economic program implemented, structural reforms were not implemented, and the present economic program was favored to be continued (Kale and Eken 2017).

By 2001, the economy and banking sector are taken with a grain of salt due to the current account deficit in the economic structure and the continuous growth of domestic demand, the increase in the share of consumer loans in total loans of banks in the banking system, the short-term and foreign currency-weighted resource structure, long-term and TL-based disbursements, and recent liquidity and interest risk.

This resulted in the outset of the Republic's greatest financial crisis in its history on February 19, 2001, and the program that was being implemented on February 21, 2001, was abandoned in the face of rising foreign exchange demand, and a floating exchange rate regime was implemented. Between 2001 and 2003, the value of TL decreased by almost 250%, 11 banks that failed not to fulfill the requirements for capital adequacy were transferred to SDIF, and the GDP shrunk by 7.4%. The degradation of the banking sector's asset and liability structure, as well as the fragile

structure, resulted in many institutions, including public banks, incurring large losses and depleting their capitals in 2001.

6.5.2.7 Period of Restructuring in Banking Sector (2002–2010)

In November 2000 and February 2001, the Turkish Banking Sector underwent one of the most severe financial crises in the history of the Republic. The banking industry has faced losses as a result of interest risks after November 2000, as well as both interest and currency rates after February 2001. The resulting crises increased interest rates, exchange rates, and inflation, and the difficulties in the financial sector not only halted the flow of resources to the real sector, but also had a negative impact on the repayment of the loans used by the real sector.

On May 3, 2001, a new standby agreement was signed with the IMF to restructure the economy and banking system, and the program for “Transition into a Sounder Economy” was launched. The aim of this program was to regenerate economic and financial stability, strengthen the financial and banking system, control inflation, and maintain sustainable growth. The fundamental actions to be taken for this specific purpose were defined as restructuring the banking sector to strengthen the financial structure of the public sector, implementing structural reforms, and constructing a sound, sustainable, and competitive financial system. The restructuring program designed to maintain a much healthier structure for the Turkish banking system was organized into four basic sections: restructuring public banks, banks covered by The Savings Deposit Insurance Fund (SDIF), banks with private capital, and improving the efficiency of surveillance and supervision (Banking Regulation and Supervision Agency (BRSA), 2002).

A joint management scheme was drawn up for the public banks within the restructuring process of the banking system and the duty losses of the public banks were all liquidated against the domestic government bonds to strengthen their financial capacity. The private banks strengthened their capital structure which they had lost substantially after 2001 crisis by way of capital increase while failing to do this, some of the banks merged or incorporated in SDIF. Out of the medium- to large-scale banks Pamukbank was assigned to SDIF followed by a merger with Halkbank. The partners paid for Şekerbank’s capital requirements in cash, while Vakfbank received a capital-like loan to strengthen its financial structure. The “Istanbul Approach,” or financial restructuring program, was adopted to strengthen the real sector and make non-performing loans receivable to the banking sector. Since banks realized the relevance and necessity of risk management more than ever before, significant measures were taken to minimize market, loan, and operational risks caused by fluctuations in exchange and interest rates in the banking system. The Public Surveillance and Supervision Agency (Banking Regulation and Supervision Agency) developed risk-based supervision understanding.

In 2005, a new banking regulation numbered 5411 was adopted to address application issues and enable consistency with generally accepted worldwide standards. With the new arrangements, BRSA was attained the authority to impose sanctions

if banks fail to meet the requirements for minimum equity and capital sufficiency rates stipulated in the legislation through licenses for the establishment and operation of banks, as well as powers of supervision and surveillance. At the end of the restructuring process that began in 2000, there were significant developments in the banking industry when indicators such as active quality of the industry, magnitude and variety of credits, level of liquidity, sufficiency of capital, risk management, and profitability were considered.

Because US banks provided loans to customers with poor creditworthiness at the time the banking system was restructured, house prices rose rapidly. Increased costs stimulated the issuance of additional credits and security against receivables from home credits. With the increase in interest rates and the suspension of mortgage expenses by late 2007, the repayments had become a challenge. The banks suffered significant losses not only as a result of the decrease in the value of the securities, but also as a result of the inability to collect the mortgaged amounts as the value of the issued securities for insuring such credits dropped and the housing credits were not properly paid. Credit-related financial products lost value, and this loss of value was exacerbated by leveraged transactions. Some financial institutions in the USA went bankrupt, while the rest of the world's economy were affected, resulting in a worldwide crisis. To overcome the economic stagnation and liquidity problem, central banks had to embark on an enormous monetary expansion.

The global crisis had a massive impact on Turkey, causing its economy to contract at a pace of 4.7%, exports to fall by 23%, imports to fall by 30%, and investments to drop. However, it did not turn out to be a banking crisis since the capital and financial structure of the Turkish banking system were sufficient and the leverage products were not included in the banks' balance sheets.

6.5.2.8 Digital Banking Period (2011–2020)

Digital banking, also known as banking without a branch, online banking, or electronic banking, may be defined as customers' access to financial transactions without the need for a branch or personnel. The benefits of digital banking include the elimination of branch and personnel fees, reductions in transaction fees, and convenience of access (Savaş et al. 2014). Access to financial services via a computer, telephone, television, or mobile application is referred to as digital banking. Users may easily access all financial transactions from their homes, offices, or anywhere with an Internet connection.

In the USA, digital banking was first offered as "banking services at home" in the state of New York in 1981 (Osho 2008). Clients had their own computers to connect to the bank's host computer via modem through telephone lines. The clients were able to monitor their bank accounts and make inter-account transactions in this manner (Horvitz 1996). In addition to banks with branches, the sector was introduced to banks that provide banking services over the Internet. The first bank to provide financial services through the Internet was "Security First Network Bank," which was founded in the USA in 1995. All transactions that might have been completed at a regular

bank were likewise completed at this bank. After completing their online membership processes, clients would create accounts, pay bills, apply for loans, conduct inter-account transfers, and develop a personal portfolio for themselves using passwords that were specifically assigned to them (Deitel et al. 2000:459).

The credit card was developed and first used in Turkey in 1970, followed by automatic teller machines (ATMs) in 1987, point-of-sale terminals (POS) in 1989, telephone banking in 1996, and Internet banking in 1997, and digital banks in 2012 (Onay ve Helvacıoğlu, 2007; Takan, 2002). Over a decade, digital banking reduced costs and significantly improved competitiveness, with digital banking progressing in the most crucial way to become the primary platform for the supply of financial services. With the contributions of pandemics, all financial services will be transformed in the near future to be supplied through a digital platform. In 2010, there were 16,4 million registered customers actively using digital banking services, and this number has increased to 68,4 million by March 2021.

6.5.2.9 Current Status of Banking Industry (2021–...)

In the last two decades, the Turkish economy, particularly its finance and banking sector, has piqued worldwide attention. Foreign investors are interested in Turkey because of its young demographic structure, growth led by private enterprise, reduction of the public deficit, decrease in inflation, improvement in labor quality, self-sufficient domestic markets, sound financial institutions, and growth potential generated by low penetration rates. During this time, the expansion of the financial sector in a solid way, as well as Istanbul's status as an international finance center, sparked interest in Turkish banking and financial systems.

The Turkish banking industry experienced an active expansion of EUR 674 billion as of late 2020. The GDP rate on assets is 105%, which is lower than the EU average. The credit-to-asset ratio is 57%, while the deposit-to-liability ratio is 57%. The potential for growth is preserved in this regard (Table 6.5).

The Turkish banking sector has grown very rapidly after 2002. After the 2001 financial crisis, the banking sector continued to recover until 2003, a restructuring program was implemented for banks, the number of banks, which was 79 in 2000, decreased to 49 at the end of 2010, after some banks were transferred to the SDIF and some banks merged, however, the total number of banks have reached 54 by the end of 2020. There are only three public banks since 2003. While the number of private deposit banks and development and investment banks has decreased, the number of foreign deposit banks has increased. Special financial institutions, operating according to Islamic principles were included in the scope of the Banking Law as Participation banks in 2005.

In the last 20 years, the number of bank branches and employees first decreased due to banks that went bankrupt or merged after the 2001 crisis and then increased rapidly after 2005. Number of branches and number of employees have declined again due to digital banking, technological improvements, development of online systems, and the advancements of alternative distribution channels. The number of

Table 6.5 Development and current situation of the Turkish Banking Sector

Period	2000	2005	2010	2015	2020
Number of banks	79	51	49	50	54
State-owned Dep. Banks	4	3	3	3	3
Private deposit banks	28	17	11	8	8
Foreign deposit banks	18	13	17	21	21
Develop. and Invst. Banks	18	13	13	13	14
SDIF banks	11	1	1	1	2
Participation banks	–	4	4	5	6
Total assets (Billion USD)	271	296	627	808	823
Total assets/GDP	101%	59%	91%	121%	121%
Liquid assets (Billion USD)	35	47	65	122	121
Securities (Billion USD)	19	107	191	113	138
Loans (Billion USD)	55	114	324	513	482
Deposits (Billion USD)	110	189	380	427	466
Non-deposits (Billion USD)	32	50	122	225	199
Shareholder's equity (Billion USD)	8	40	84	90	81
Number of branches	7.837	6.247	9.465	12.269	11.194
Number of employees	137.495	132.258	178.503	217.504	203.223
Number of ATMs	11.397	14.836	26.566	46.220	49.294
Number of credit cards	13.372.600	29.885.900	46.956.124	58.215.318	75.697.214
Number of POSs	489.213	1.130.408	2.176.000	2.158.328	1.686.009

Source BAT, BRSA, BKM

credit cards, which were first used in Turkey in the 1970s, has increased rapidly. The number of POS and ATM is also increasing regularly.

Number of banks operating in the banking sector was 54 as end of 2020. 34 of them were deposit banks, and 14 were development and investment banks. Of the deposit banks, three were state-owned banks, and eight were private banks. There were six participation banks in Turkey. Total assets increased to USD 823 billion. The share of assets of deposit banks was 87%, while the shares of development and investment banks and participation banks were 6% and 7%, respectively. The share of state-owned deposit banks was 38%, the share of private banks was 28%, and the share of foreign banks was 21%. Number of branches are 11.194, and the number of employees are 203.223.

Important advancements, steps, and milestones of the Turkish Banking Sector are summarized in Table 6.6.

Table 6.6 Development of Turkish Banking

Period	Substantial advancements, steps, and milestones
1071	Turks entered and settled in Anatolia
1840	The first applications related to banking and finance emerged
1840	The first paper money, “Kaime,” was issued in the Ottoman Empire
1849	Istanbul Bank (Bank-ı Dersaadet), considered the first bank in the history of Turkish finance, was established
1854	The Ottoman Empire borrowed from abroad for the first time
1856	The Ottoman Bank, with British capital, was established in London
1863	The Ottoman Bank dissolved itself and was reorganized as a state bank in the name Imperial Ottoman Bank (Bank-ı Şahane-i Osman-i) under the British-French partnership. This bank is the first issuance bank and is also considered to be the beginning of the foreign banks period in the Turkish banking system
1863	Homeland Local Funds, which is the foundation of Ziraat Bank, were established
1881	With the Muharrem Decree, Ottoman General Debt Administration (Düyun-u Umumiye) was established in order to restructure the Ottoman foreign debts, collect taxes and pay the creditors arising from domestic and foreign debts
1883	Hometown Local Funds have been converted into Benefit Funds
1888	Ziraat Bank was established as a modern financial institution to replace Benefit Funds
1911	Konya National Economic Bank, the first bank established to support the domestic economy and trade in Anatolia, started its activities
1917	With the idea of establishing a national central bank, the Ottoman National Dignity Bank (Osmanlı İtibar-ı Milli Bankası) was established in 1917
1923	When the Republic was founded, a total of 35 banks were operating in Turkey, 22 of which were national and 13 were foreign
1924	İsbank (Türkiye İş Bankası), the first private bank of the Republican Era, was established
1927	The Ottoman National Dignity Bank, which could not achieve its goal of becoming a national bank after the defeat of the Ottoman Empire in the World War I, was merged with İsbank of Turkey in 1927
1930	The Central Bank of the Republic of Turkey was established
1955	The Central Bank Banknote Printing House was established in Ankara
1957	Banknotes started to be printed in Turkey
1958	The Banks Association of Turkey and the Banks Liquidation Fund were established
1970	The first Credit Card was issued in Turkey
1980	With the decisions announced on January 24, 1980, a structural transformation was experienced in the Turkish economy, financial structure, and banking system, a free market economy based on exports was adopted, and a flexible (floating) exchange rate application was introduced
1980	On July 1, 1980, the interest rates applied to deposits and loans were released for the development, growth, and liberalization of the banking and financial system
1982	As a result of the financial collapse known as the “bankers’ crisis,” the activities of some banks were stopped and many banks and banking institutions went bankrupt

(continued)

Table 6.6 (continued)

Period	Substantial advancements, steps, and milestones
1983	A legal arrangement has been made regarding the establishment of Special Finance Institutions, which will operate in accordance with the principles of interest-free banking
1985	The first private finance institutions were Albaraka Türk Finance House and Faisal Finance House was established
1987	The first automatic teller machine (ATM) was put into service
1989	With the Decision No. 32 on the Protection of the Value of the Turkish Currency, capital movements were released and economic units were allowed to trade in foreign currency
1996	The first Internet Banking Branch was launched in Turkey
2001	After the 2001 crisis, which was the biggest financial crisis in the history of the Republic of Turkey, a standby agreement was signed with the IMF on May 3, 2001, and the “Transition to a Strong Economy Program” was put into practice, and the banking sector restructuring program was initiated for a solid, sustainable, and competitive financial system
2006	Special Finance Institutions were reorganized as “Participation Banks”

Source Formed by the Authors

6.6 Conclusion

Since 1980, when financial globalization and liberalization accelerated throughout the world, continuous and stable increases in investment and production, high economic growth, an increase in intranational trade volume, technological advancements, and international economic and financial developments have all had a positive impact on the development of Turkey’s financial institutions and markets. It is necessary for a solid, efficient, effective, and accurate financial system to achieve sustainable economic growth and the production of capital accumulation for this purpose, as well as the most rational use of resources.

Taking into consideration the Turkish Republic’s entire economic structure at the time of its establishment, as well as the then-global economic conjuncture, planned and self-contained economic policies based on import substitution were implemented. At the period, the interest rates on loans, credit limits, market inputs, and outputs were all under state control, and banks were heavily involved in funding the activities outlined in the development plans.

Since official policies did not permit the establishment of new private and foreign banks throughout the Turkish Banking history from 1960 to 2000, the banks had to function in an environment with restricted competition. Due to the absence of market risks induced by interest rates, exchange rates, and even negative interest rates, banks were forced to pursue growth programs based on deposit accounts. As a result, the banks showed growth in retail banking based on branch banking. Inadequate deposit accounts, as well as the use of central bank reserves to finance investments and current costs, increased the money supply and inflation. Inadequate output and exporting set the stage for exchange rate difficulties, which increased the

financial system's instability. Economic and financial crises came about as a result of actions to keep exchange rates under control, which, along with other negative conditions on macroeconomic balance, resulted in a rapid shrinkage in crises, with a significant portion of equities lost. Beginning in May 2001, a comprehensive restructuring initiative was launched. From 2002 to 2007, there were notable developments in the banking industry's financial structure and macroeconomic indicators.

In a period when the restructuring process of Turkish banking continued, banks suffered great losses due to the disruptions experienced in loans extended by US banks to consumers with low credibility due to the rise in interest rates and the decline in the prices of asset-backed securities issued through the collateralization of these loans. In many countries, especially the USA, some banks and financial institutions went bankrupt or fell into financial difficulties due to great losses. In order to overcome the economic stagnation and liquidity crisis created by this situation, an extraordinary monetary expansion process started by the Central banks. Although the Turkish economy contracted in this period, the lack of leveraged products in the balance sheets of Turkish banks and the strong capital adequacy and financial soundness of the banking system did not turn the banking system into a crisis.

Especially with the globalization process since the 1990s, banking activities have had to gain an international character. Since 2010, a rapid technological advancement and renewal has been observed in the Turkish banking system in parallel with the world banking. The rapid development of digital banking systems and alternative distribution channels contributed significantly to the integration of Turkish Banking with the international banking system. Banking Industry and the banks are the most important financial institutions in Turkey, to finance industry, trade, investments, foreign trade, and public spendings.

Therefore, while thorough provisions have been established for financially sound banking structures with effective supervision, the banking industry has been the most significant financial institutions in financing commerce, investments, international trade, and public deficits. The sound structure of the banking industry is critical for economic development. The Turkish banking system's active size is roughly 105% of GDP, which is approximately 90% of the banking financial system. Therefore, the banking industry is the most significant institution in the financial system, and it has the most potential for growth. When the capital, activity, balance quality, and profitability ratios of the Turkish banking system are considered, it is assumed that the banking sector will continue to develop steadily.

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Chapter 7

Finance School Graduates' Work Values in Their Working Lives: Empirical Research in Terms of Demographic Differences



Gulsevrim Yumuk Gunay 

Abstract Values begin to be acquired in the family, but then are shaped by school and social life, and continue to affect people's decisions in both their business and private life throughout their lives. Work values, on the other hand, are the practice of human values in working life, and actually consist of a kind of desired beliefs and behaviours. The study focused on the finance school graduates who came together to have a profession by leaving from different families and cultures, and started their working lives after three years of boarding high school education. The purpose of the study is to reveal whether the values of the finance school graduates which are shaped in both the family and the school make a difference depending on demographic characteristics and also which ones are prioritized in their working lives. According to the results of the study, the Rationalism and Professionalism values of the graduates mostly come to the forefront. Depending on demographic characteristics, it was observed that there were differences in the Professionalism values in terms of gender, age groups and educational level; in the Rationalism values in terms of gender and age groups; in the sense of Hypocrisy in terms of professions; in the Mystic values in terms of marital status and total working times. No differences were found in the Centralization values of the graduates in terms of demographic characteristics.

Keywords Finance school · Values · Work values

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7.1 Introduction

People act by maintaining a stance that become important to them in their relationships and decisions throughout their lives. This stance, which turns into the behaviour, is actually the result of beliefs, i.e. values, as a reflection of the principles and goals they have. These values we have in social or business life enable us to appear as a traditional, democratic, centralistic, rational, conservative or social one. On the other hand, we can say that these values which emerge as a reflection of our personality come up with the reflection of genetic and environmental factors as well as the general culture and subculture we belong to.

It has always been an issue of concern whether the work values that are the reflection of the individuals' accumulations and especially the indicator of how they are understood in their working lives differ according to marital status, age, educational level, profession and work experience. Although they have different demographic characteristics, the work values exhibited by the Finance School Graduates in their working lives are an issue worth studying in terms of determining their achievements of the "Finance School" which is the last process of education they received during a part of their lives and especially before their first working lives, and seeing the results of the "Finance School Culture".

Thus, firstly the literature reviews of the concepts of value and work values were performed. Then, based on the self-assessments of the Finance School Graduates, the "research questions" and their results were included in order to determine the differences in their working lives according to work values and demographic characteristics.

7.2 Literature

The concept of value is a subject that has been examined in management and psychology sciences for the last fifty years. The study which was performed by Eduard Spranger in 1928 and divided people into six types as theoretical, economic, aesthetic, social, political and religious was considered as the first study in the literature (Spranger 1928 as cited in Taşova 2019: 42). When analysed from an organizational point of view, it has been emphasized that values are also a source of motivation while they are an important determinant of behaviours and attitudes within the organization (Rokeach 1980: 156–157). Schwartz (1996: 2) defines values as "desired goals that serve by guiding in human life, change according to importance, and are beyond situations". Hofstede (2001: 5) who tries to reveal cross-cultural differences uses the definition of "a great tendency towards preferring certain situations to other ones" for values. Another definition for values is to "prefer a certain behaviour or stance to a personally or socially reverse or opposite behaviour or stance" (Robbins and Judge 2013: 145). The common features of all definitions for values in the literature are listed as follows. They are (1) concepts or beliefs, (2) desired goals and

behaviours, (3) go beyond certain situations, (4) guide in evaluating or choosing behaviours and events and (5) are listed according to their importance (Schwartz and Bilsky 1987: 551).

Work values, on the other hand, are seen as a subset of values (Taşova 2019: 53). Wollack et al. (1971: 331) define work values as a person's attitude towards her/his job. Ros et al. (1999: 64–68) emphasize that work values are a special explanation and reflection of human values. An employee's personal view, general and long-term feelings and beliefs about what s/he expects from the work and how s/he has to behave reveal the relevant person's work values (Özkalp 2004: 72).

Donald Super (1980: 130) used the expression “either a psychological state, relationship or material situation to which a person seeks to achieve” for work values. In fact, regardless of changing definitions, Zytowski (1994) stated in the vocational psychology literature that work values should mostly be described as reinforcers which increase job satisfaction.

The literature has demonstrated that work values also reveal one's understanding of work. Thus, during the activities that individuals, groups and institutions carry out to achieve a certain purpose, the reflection of the values and knowledge they have as an attitude expresses work values. These values, which emerge as an attitude, explain and can direct the methods, tools, processes, systems and actually mutual relations that people prefer while performing their work in their working lives (Aldemir et al. 2003: 7).

These values, which reveal the employees' understanding of work in their working lives, are the result of two basic processes. The first one of these two processes is the fact that knowledge and values are learned from experience and the other one is that knowledge and values are a process which is passed down from generation to generation as a reflection of the culture in which people live (Aldemir et al. 2003: 7). In fact, it is seen that the individual's family, the environment they grow up and their experience from the interaction in this environment as well as their culture are effective in the formation of work values and their reflection on the understanding of work.

When the literature is examined, it is understood that the approaches concerning work values differ culturally, religiously and sociologically (Taşova 2019: 54). However, Dose (1997: 221–225) showed a holistic perspective on work values and classified the theory and approaches in four ways. They can be classified as (1) Work values and vocational behaviour, (2) Values concerning work behaviour, (3) Significant of work and (4) Business ethics as a value system.

Empirical studies on work values have shown that work values are the precursors of job satisfaction (Kalleberg 1977: 124), organizational citizenship behaviour (Ali et al. 2020: 617), individual decision making (Judge and Bretz Jr 1991: 2) and professional interests (Berings et al. 2004) and are also associated with career choice (Zytowski 1994), organizational commitment (Kidron 1978) and job performance (Swenson and Herche 1994). On the other hand, there are many studies to investigate whether work values differ according to demographic factors, but most of the studies did not show any difference between gender (Sagie et al. 1996; Marini et al. 1996; Uyan 2002; Değirmencioğlu 2009), age (Sagie et al. 1996; Furnham

et al. 2005; Uyan 2002), educational level (Değirmencioğlu 2009; Kaleli 2019) and working years (Kalkan 2009). However, Özkan (2010) found a relationship between work values transformation and working years while Hansey and Leuty (2012: 34) revealed in their study that the differences between work values belonging to three generations (Silent Generation, Baby Boom and Generation X) were greater than their ages. Oltulu (2019: 37) has stated that “Social-Altruist Work Values”, the sub-dimension of work values, differ according to age groups. Kaleli (2019: 127–129), on the other hand, has found that there is a correlation between work values and five-factor personality traits and has stated that work values also vary with professions and generations.

7.3 Research

7.3.1 *Research Purpose and Importance*

The history of the Finance Schools goes back to the regulations after the declaration of constitutional monarchy in 1908. During this period, it was decided to establish a “Finance School” in order to increase the knowledge and experience of finance officers and the school was opened in 1909. However, it was aimed to enhance the cultural level of the students by teaching not only vocational courses but also law, economy, history and geography in the school. The school, which had to be closed during the years of the World War I, was reopened in 1924. In 1943, Vocational School of Finance achieved the status of an institution providing education at high school level under the name of “Finance School”. The institution providing education in Ankara maintained its activities in three provinces by opening a branch in Izmir in 1977 and in Istanbul in 1978. By creating equal opportunity for Turkey, Finance Schools had a school culture that provided many successful young people with different economic situations to have values to be an example to life and society in addition to their acquisition of knowledge, skills and professions.

Thus, the purpose of the study is to determine the work values created by the finance school culture they acquired from high school education although graduates have different family and regional culture, and to reveal the differences according to demographic characteristics. Considering the cultural effects of this well-established school on the work values of the graduates, it is thought that the study is also important in terms of understanding that the closure of Finance Schools is a great loss.

7.3.2 *Research Methodology*

The population of the study consists of 5001 (excluding those who died; Ankara: 2654, Izmir: 1873, Istanbul: 474) graduates according to the data obtained from the

Finance School Alumni Association. The minimum sample size was calculated as 357 with a 95% confidence interval and 5% margin of error over this number (5001). The link containing the questionnaire form was sent to a total of 2700 graduates via WhatsApp and Facebook groups created by the Finance Alumni Association. For the questionnaire study, 600 questionnaire forms were evaluated for analysis.

The questionnaire form consists of two parts. The first part of the form includes 6 questions to determine the demographic characteristics of the graduates who voluntarily participated in the research. The second part of the form includes the five-point Likert type "Work Values Scale" (Aldemir et al. 2003: 13). The scale consists of five dimensions and 58 values. These 58 values are known to be divided into dimensions as "Professionalism" (14), "Centralization" (9), "Sense of Hypocrisy" (14), "Rationalism" (15) and "Mystic" (6).

For the research, the studies in national and international literature were examined with the scanning method, and the hypotheses, which were created to answer the research questions based on these 5 factors (dimensions) determined by the work values literature, were tested.

Research Questions:

RQ₁: Are there differences in the *Professionalism* values of the Finance School Graduates in terms of Demographic Characteristics?

RQ₂: Are there differences in the *Centralization* values of the Finance School Graduates in terms of Demographic Characteristics?

RQ₃: Are there differences in the *Sense of Hypocrisy* values of the Finance School Graduates in terms of Demographic Characteristics?

RQ₄: Are there differences in the *Rationalism* values of the Finance School Graduates in terms of Demographic Characteristics?

RQ₅: Are there differences in the *Mystic* values of the Finance School Graduates in terms of Demographic Characteristics?

7.3.3 Analysis of Data

28.5% of the participants are women and 71.5% are men, 86.7% are married and 13.3% are single, 3.3% have high school education, 77.2% have undergraduate education and 19.5% have postgraduate education. 50% are between 44 and 54 years old, 22.5% are less than 44 years old, 22% are between 55 and 64 years old, 4% are between 65 and 74 years old and 1.5% are over 75 years old. The participants consist of 53.8% government officer, 21.5% IFA-CFA, 5.3% educator, 5% lawyer, 4.8% self-employed, 4.3% retired, 3.7% banker, 1% consultant and 0.5% military personnel. In addition, 42% have worked for 30–39 years, 38.5% for 20–29 years, 13.5% for 40–49 years, 4.7% for 10–19 years, 1% for more than 50 years and 0.3% for less than 9 years (Table 7.1).

Table 7.1 Factor analysis results

Value	Professionalism I	Hypocrisy II	Mystic III	Rationalism IV	Centralization V
Intuitivism	0.883				
Vision	0.877				
Cooperation	0.875				
Reconciliation	0.874				
Competence	0.873				
Prestige	0.870				
Being open to new ideas	0.861				
Doing one's job well	0.859				
Scepticism	0.857				
Voluntarism	0.852				
Responsibility	0.845				
Entrepreneurship	0.801				
Risk-taking	0.461				
Factionalism		0.874			
Self-interest		0.859			
Favouritism		0.838			
Intolerance		0.804			
Lavishness		0.787			
Exceeding one's authority		0.781			
Disloyalty		0.781			
Laziness		0.770			
Hypocrisy		0.730			
Ostentation		0.717			
Protectionism		0.669			
Rigidity		0.626			
Materialism		0.460			
Religion			0.868		
Fatalism			0.837		
Conventionalism			0.802		
Affectivity			0.702		
Austerity			0.570		
Family ties			0.558		
Friendship				0.831	
Scientificness				0.821	

(continued)

Table 7.1 (continued)

Value	Professionalism I	Hypocrisy II	Mystic III	Rationalism IV	Centralization V
Individual rights and freedoms				0.816	
Being fair				0.808	
Humility				0.804	
Rationalism				0.802	
Trust				0.802	
Paying attention to details				0.800	
Information sharing				0.797	
Discipline				0.796	
Industriousness				0.795	
Honesty				0.791	
Assertiveness				0.788	
Success				0.767	
Living today				0.708	
Dependency					– 0.780
Rank and authority					– 0.742
Centralization					– 0.706
Submissiveness					– 0.696
Repressiveness					– 0.569
Alpha	0.973	0.930	0.861	0.977	0.771

Total variance explained = 69.123%

KMO = 0.965

BTS = 32,333.219, $df = 1326$, $p = 0.000$

Considering the KMO (0.965) and BTS (32,333; $p = 0.000$) values as a result of the analysis, it was seen that the data set and the correlation matrix were suitable for factor analysis. The data set with the explained variance of 69.123% was collected under 5 factors as in the original article. The first factor is Professionalism (13 items), the second one is Sense of Hypocrisy (13 items), the third one is Mystic (6 items), the fourth one is Rationalism (15 items) and the fifth one is Centralization (5 items). A total of six items of the work values scale were excluded from the analysis due to their shifting to different dimensions or being included in two dimensions. Principal components analysis was used as a factor model in the analysis. Oblique method was used as a rotation method in order to clearly distinguish between factor dimensions and values with factor loads of 0.40 and above were taken into consideration based on the original article from which the scale was taken (Aldemir et al. 2003: 19).

7.4 Findings

Table 7.2 shows in detail on which factors the work values of the graduates are concentrated. Therefore, it is seen that graduates have the most (90.96%) Rationalism values (Strongly Agree + Agree + Somewhat Agree), followed by the Professionalism values (89.35%). Mystic values, which include religion, fatalism, austerity, family ties and affectivity, take place in the third place (67.11%) on the graduates’ work values in their working lives. While almost half of the population (47.73%) put the Centralization aspect at forefront, it is observed that the Sense of Hypocrisy which contains negative elements has the lowest (11.45%) work value.

The Kolmogorov–Smirnov test showed that our data was normally distributed, and parametric tests were used to answer the research questions. According to the socio-demographic characteristics of the participants, answers were sought for five research questions using the T-Test (gender and marital status) and Anova (age, educational level, professions and total working time) statistical methods of the sub-dimensions of work values (*Professionalism, Centralization, Sense of Hypocrisy, Rationalism and Mystic*).

7.4.1 Research Question One

The analysis results of the first research question and associated six hypotheses are given below.

RQ₁: Are there differences in the *Professionalism* values of the Finance School Graduates in terms of Demographic Characteristics?

H₁: There are differences in the *Professionalism* values of the Finance School Graduates in terms of Gender.

Table 7.2 Finance school graduates’ work values

	Professionalism		Centralization		Sense of hypocrisy		Rationalism		Mystic	
	%	Cum	%	Cum	%	Cum	%	Cum	%	Cum
Strongly agree	41.9	41.9	4.40	4.40	1.22	1.22	50.45	50.45	13.50	13.50
Agree	39.12	81.02	13.03	17.43	2.40	3.62	33.22	83.67	24.14	37.64
Somewhat agree	8.33	89.35	30.30	47.73	7.83	11.45	7.29	90.96	29.47	67.11
Disagree	5.44	94.79	31.37	79.10	28.33	39.78	5.17	96.13	20.14	87.25
Strongly disagree	5.21	100	20.9	100	60.22	100	3.87	100	12.75	100

Shows the ratios of business values that Finance School Graduates think they have

H₂: There are differences in the *Professionalism* values of the Finance School Graduates in terms of *Marital Status*.

H₃: There are differences in the *Professionalism* values of the Finance School Graduates in terms of *Age Groups*.

H₄: There are differences in the *Professionalism* values of the Finance School Graduates in terms of *Educational Level*.

H₅: There are differences in the *Professionalism* values of the Finance School Graduates in terms of *Professions*.

H₆: There are differences in the *Professionalism* values of the Finance School Graduates in terms of Total Working Time (Table 7.3).

There is a statistically significant difference in the professionalism values of the graduates in terms of gender ($t = 2.065$; $p = 0.040$). Accordingly, the hypothesis “H₁: There are differences in the *Professionalism* values of the Finance School Graduates in terms of Gender” was **accepted**. Female graduates have higher professionalism values than male ones.

There is no statistically significant difference in the professionalism values of the graduates in terms of marital status. Therefore, the hypothesis “H₂: There are differences in the *Professionalism* values of the Finance School Graduates in terms of *Marital Status*” was **rejected** (Table 7.4).

There is a statistically significant difference in the professionalism values of the graduates in terms of age groups ($t = 5.534$; $p = 0.000$). Accordingly, the hypothesis “H₃: There are differences in the *Professionalism* values of the Finance School Graduates in terms of *Age Groups*” was **accepted**. According to the Games-Howell test, one of the Post-Hoc tests performed, this difference is observed between the groups between under the age of 44 and the ages of 55–64, and between the 45–54 age range and the 55–64 age range. Both comparisons also show that those between the ages of 55–64 have more professional work values.

There is a statistically significant difference in the professionalism values of the graduates in terms of educational level ($t = 5.439$; $p = 0.005$). Accordingly, the hypothesis “H₄: There are differences in the *Professionalism* values of the Finance School Graduates in terms of *Educational Level*” was **accepted**. The Games-Howell Post Hoc test results show that this difference is between undergraduate and postgraduate groups, and the latter group has higher professional work values.

Table 7.3 T-test for comparison of professionalism value in terms of gender and marital status

		N	Avg	St. Deviation	t	p
Gender	Female	171	4.1844	0.79427	2.065	0.040
	Male	429	4.0256	0.97669		
Marital status	Married	520	4.0713	0.93979	0.029	0.977
	Single	80	4.0683	0.87312		

$p < 0.05$

Table 7.4 Anova test for comparison of professionalism value in terms of age groups, educational level, professions and total working time

Demographic characteristics		<i>N</i>	Avg	St. Deviation	<i>F</i>	<i>p</i>
Age groups	Below 44	135	4.1550	0.68164	5.534	0.000
	45–54	300	4.1882	0.82636		
	55–64	132	3.8124	1.15911		
	65–74	24	3.7115	1.35821		
	Above 75	9	6.6496	1.37556		
Educational level	High school	20	3.5731	1.33012	5.439	0.005
	Undergraduate	463	4.0455	0.95177		
	Postgraduate	117	4.2564	0.93048		
Professions	Government officer	323	4.0105	0.97860	1.276	0.253
	Banker	22	4.5804	0.33211		
	IFA-CFA ¹	129	4.0990	0.99769		
	Consultant	6	4.0128	0.71405		
	Educator ²	32	4.2620	0.58838		
	Self-employed	29	3.9841	0.88792		
	Military officer	3	4.0769	0.00000		
	Lawyer ³	30	4.1718	0.76808		
	Retired	26	4.0089	0.87742		
Total working time	Less than 9 years	2	4.1538	0.97907	3.432	0.005
	10–19 years	28	3.8654	0.74686		
	20–29 years	231	4.2155	0.72656		
	30–39 years	252	4.0653	0.98472		
	40–49 years	81	3.7464	1.20535		
	50 years and more	6	4.0513	1.18338		

$p < 0.05$

There is no statistically significant difference in the professionalism values of the graduates in terms of professions. Therefore, the hypothesis “H₅: There are differences in the *Professionalism* values of the Finance School Graduates in terms of *Professions*” was **rejected**.

Although there seems to be a statistically significant difference in the professionalism values of the graduates in terms of total working times, the relevant Games-Howell Post Hoc test could not determine between which groups this difference was. Therefore, it was considered that the differences in the frequency distributions

¹ Independent Accountant and Financial Advisor, Certified Financial Advisor.

² Teacher, Academician.

³ Lawyer, Judge, Prosecutor.

of the groups may cause it and the hypothesis “H₆: There are differences in the Professionalism values of the Finance School Graduates in terms of Total Working Time” was **rejected**.

7.4.2 Research Question Two

The analysis results of the second research question and associated six hypotheses are given below.

RQ₂: Are there differences in the Centralization values of the Finance School Graduates in terms of Demographic Characteristics?

H₁: There are differences in the Centralization values of the Finance School Graduates in terms of Gender.

H₂: There are differences in the Centralization values of the Finance School Graduates in terms of Marital Status.

H₃: There are differences in the Centralization values of the Finance School Graduates in terms of Age Groups.

H₄: There are differences in the Centralization values of the Finance School Graduates in terms of Educational Level.

H₅: There are differences in the Centralization values of the Finance School Graduates in terms of Professions.

H₆: There are differences in the Centralization values of the Finance School Graduates in terms of Total Working Time (Tables 7.5 and 7.6).

The centralization values of the graduates do not make a significant difference according to any demographic factor. Therefore, the associated six hypotheses were **rejected**. Then, there is no difference in the Centralization values of the Finance School Graduates in terms of demographic characteristics.

Table 7.5 T-test for comparison of centralization value in terms of gender and marital status

		N	Avg	St. Deviation	t	p
Gender	Female	171	2.4164	0.68614	- 1.236	0.217
	Male	429	2.5147	0.76237		
Marital status	Married	520	2.5085	0.74187	1.935	0.056
	Single	80	2.3450	0.73328		

$p < 0.05$

Table 7.6 Anova test for comparison of centralization value in terms of age groups, educational level, professions and total working time

Demographic characteristics		<i>N</i>	Avg	St. Deviation	<i>F</i>	<i>p</i>
Age groups	Below 44	135	2.4756	0.70133	0.058	0.994
	45–54	300	2.4920	0.70966		
	55–64	132	2.4848	0.77720		
	65–74	24	2.5250	1.0336		
	Above 75	9	2.4000	0.74221		
Educational level	High school	20	2.5200	0.87636	0.052	0.949
	Undergraduate	463	2.4894	0.74138		
	Postgraduate	117	2.4701	0.72745		
Professions	Government officer	323	2.5121	0.71554	1.577	0.128
	Banker	22	2.3273	0.73172		
	IFA-CFA ⁴	129	2.4884	0.79565		
	Consultant	6	2.2000	0.66933		
	Educator ⁵	32	2.3125	0.66805		
	Self-employed	29	2.4690	0.80228		
	Military officer	3	3.4000	0.00000		
	Lawyer ⁶	30	2.3067	0.12005		
	Retired	26	2.7000	0.17231		
Total working time	Less than 9 years	2	2.3000	0.98995	1.059	0.382
	10–19 years	28	2.6286	0.79389		
	20–29 years	231	2.4130	0.67708		
	30–39 years	252	2.5405	0.76128		
	40–49 years	81	2.4691	0.81496		
	50 years and more	6	2.7000	1.00200		

$p < 0.05$

7.4.3 Research Question Three

The analysis results of the third research question and associated six hypotheses are given below.

RQ₃: Are there differences in the *Sense of Hypocrisy* of the Finance School Graduates in terms of Demographic Characteristics?

⁴ Independent Accountant and Financial Advisor, Certified Financial Advisor.

⁵ Teacher, Academician.

⁶ Lawyer, Judge, Prosecutor.

Table 7.7 T-test for comparison of sense of hypocrisy in terms of gender and marital status

		<i>N</i>	Avg	St. Deviation	<i>t</i>	<i>p</i>
Gender	Female	171	1.5056	0.53339	− 1.522	0.129
	Male	429	1.5826	0.61869		
Marital status	Married	520	1.5649	0.61815	0.585	0.559
	Single	80	1.5327	0.42886		

$p < 0.05$

H₁: There are differences in the *Sense of Hypocrisy* of the Finance School Graduates in terms of Gender.

H₂: There are differences in the *Sense of Hypocrisy* of the Finance School Graduates in terms of Marital Status.

H₃: There are differences in the *Sense of Hypocrisy* of the Finance School Graduates in terms of Age Groups.

H₄: There are differences in the *Sense of Hypocrisy* of the Finance School Graduates in terms of Educational Level.

H₅: There are differences in the *Sense of Hypocrisy* of the Finance School Graduates in terms of Professions.

H₆: There are differences in the *Sense of Hypocrisy* of the Finance School Graduates in terms of Total Working Time (Table 7.7).

There is no statistically significant difference in the Sense of hypocrisy of the graduates in terms of gender and marital status. Therefore, the hypotheses “H₁: There are differences in the *Sense of Hypocrisy* of the Finance School Graduates in terms of Gender” and “H₂: There are differences in the *Sense of Hypocrisy* of the Finance School Graduates in terms of Marital Status” were **rejected** (Table 7.8).

There is a statistically difference in the Sense of hypocrisy of the graduates only in terms of professions ($t = 2.025$; $p = 0.042$). Therefore, only the hypothesis “H₅: There are differences in the *Sense of Hypocrisy* of the Finance School Graduates in terms of Professions” was accepted. The paired comparisons show that the Sense of Hypocrisy of the military officers is higher than that of other professions excluding consultants.

7.4.4 Research Question Four

The analysis results of the fourth research question and associated six hypotheses are given below.

RQ₄: Are there differences in the *Rationalism* values of the Finance School Graduates in terms of Demographic Characteristics?

Table 7.8 Anova test for comparison of sense of hypocrisy in terms of age groups, educational level, professions and total working time

Demographic characteristics		<i>N</i>	Avg	St. Deviation	<i>F</i>	<i>p</i>
Age groups	Below 44	135	1.5179	0.51978	0.603	0.661
	45–54	300	1.5523	0.59128		
	55–64	132	1.6037	0.67660		
	65–74	24	1.6798	0.66855		
	Above 75	9	1.5299	0.36578		
Educational level	High school	20	1.7654	0.67314	1.350	0.260
	Undergraduate	465	1.5473	0.60122		
	Postgraduate	117	1.5786	0.55979		
Professions	Government officer	323	1.5568	0.62901	2.025	0.042
	Banker	22	1.3706	0.46315		
	IFA-CFA ⁷	129	1.5325	0.51535		
	Consultant	6	1.6282	0.53164		
	Educator ⁸	32	1.3750	0.29421		
	Self-employed	29	1.6844	0.57393		
	Military officer	3	2.2308	0.00000		
	Lawyer ⁹	30	1.6410	0.54142		
	Retired	26	1.8136	0.88356		
Total working time	Less than 9 years	2	1.5769	0.81589	0.547	0.740
	10–19 years	28	1.6648	0.50124		
	20–29 years	231	1.5221	0.54271		
	30–39 years	252	1.5763	0.67307		
	40–49 years	81	1.5698	0.53054		
	50 years and more	6	1.7692	0.32271		

$p < 0.05$

H₁: There are differences in the *Rationalism* values of the Finance School Graduates in terms of Gender.

H₂: There are differences in the *Rationalism* values of the Finance School Graduates in terms of Marital Status.

H₃: There are differences in the *Rationalism* values of the Finance School Graduates in terms of Age Groups.

⁷ Independent Accountant and Financial Advisor, Certified Financial Advisor.

⁸ Teacher, Academician.

⁹ Lawyer, Judge, Prosecutor.

Table 7.9 T-test for comparison of rationalism value in terms of gender and marital status

		<i>N</i>	Avg	St. Deviation	<i>t</i>	<i>p</i>
Gender	Female	171	4.3571	0.78737	2.704	0.007
	Male	429	4.1546	0.92249		
Marital status	Married	520	4.2044	0.89435	− 0.573	0.568
	Single	80	4.2642	0.86601		

$p < 0.05$

H₄: There are differences in the Rationalism values of the Finance School Graduates in terms of Educational Level.

H₅: There are differences in the Rationalism values of the Finance School Graduates in terms of Professions.

H₆: There are differences in the Rationalism values of the Finance School Graduates in terms of Total Working Time (Table 7.9).

There is a statistically significant difference in the Rationalism values of the graduates in terms of gender ($t = 2.704$; $p = 0.007$). Accordingly, the hypothesis “H₁: There are differences in the Rationalism values of the Finance School Graduates in terms of Gender” was **accepted**. Female graduates have higher Rationalism values than male ones.

There is no statistically significant difference in the Rationalism values of the graduates in terms of marital status. Therefore, the hypothesis “H₂: There are differences in the Rationalism values of the Finance School Graduates in terms of Marital Status” was **rejected** (Table 7.10).

There is a statistically difference in the Rationalism values of the graduates in terms of gender ($t = 7.316$; $p = 0.000$). Therefore, the hypothesis “H₃: There are differences in the Rationalism values of the Finance School Graduates in terms of Age Groups” was accepted. The paired comparisons show that the Rationalism values of the 45–54 age group are higher than the rational Understanding of Work values of the 55–64 age group. Although there seems to be a statistically significant difference in Rationalism values of the graduates in terms of total working times, the relevant Games-Howell Post Hoc test could not determine between which groups this difference was. Therefore, it was considered that the differences in the frequency distributions of the groups may cause it and the hypothesis “H₆: There are differences in the Rationalism values of the Finance School Graduates in terms of Total Working Time” was **rejected**.

7.4.5 Research Question Five

The analysis results of the fifth research question and associated six hypotheses are given below.

Table 7.10 Anova test for comparison of rationalism value in terms of age groups, educational level, professions and total working time

Demographic characteristics		<i>N</i>	Avg	St. Deviation	<i>F</i>	<i>p</i>
Age groups	Below 44	135	4.2183	0.72736	7.316	0.000
	45–54	300	4.3616	0.69664		
	55–64	132	4.0025	1.15990		
	65–74	24	3.6417	1.38715		
	Above 75	9	3.7481	1.40862		
Educational level	High school	20	3.8700	1.27348	2.932	0.054
	Undergraduate	463	4.1932	0.90414		
	Postgraduate	117	4.3464	0.72826		
Professions	Government officer	323	4.1775	0.92885	1.172	0.314
	Banker	22	4.5545	0.34999		
	IFA-CFA ¹⁰	129	4.1364	1.01451		
	Consultant	6	4.4000	0.58727		
	Educator ¹¹	32	4.5188	0.46858		
	Self-employed	29	4.2138	0.74565		
	Military officer	3	3.9333	0.00000		
	Lawyer ¹²	30	4.3000	0.74376		
	Retired	26	4.2410	0.91430		
Total working time	Less than 9 years	2	4.2667	1.03709	2.706	0.020
	10–19 years	28	4.0714	0.87769		
	20–29 years	231	4.2638	0.74569		
	30–39 years	252	4.2817	0.85655		
	40–49 years	81	3.8947	1.23711		
	50 years and more	6	4.2444	1.24127		

$p < 0.05$

RQ₅: Are there differences in the *Mystic* values of the Finance School Graduates in terms of Demographic Characteristics?

H₁: There are differences in the *Mystic* values of the Finance School Graduates in terms of Gender.

H₂: There are differences in the *Mystic* values of the Finance School Graduates in terms of Marital Status.

¹⁰ Independent Accountant and Financial Advisor, Certified Financial Advisor.

¹¹ Teacher, Academician.

¹² Lawyer, Judge, Prosecutor.

H₃: There are differences in the Mystic values of the Finance School Graduates in terms of Age Groups.

H₄: There are differences in the Mystic values of the Finance School Graduates in terms of Educational Level.

H₅: There are differences in the Mystic values of the Finance School Graduates in terms of Professions.

H₆: There are differences in the Mystic values of the Finance School Graduates in terms of Total Working Time (Table 7.11).

There is no statistically significant difference in the Mystic values of the graduates in terms of gender. Therefore, the hypothesis “H₁: There are differences in the Mystic values of the Finance School Graduates in terms of Gender” was **rejected**.

There is a statistically significant difference in the Mystic values of the graduates in terms of marital status ($t = 2.119$; $p = 0.036$). Therefore, the hypothesis “H₂: There are differences in the Mystic values of the Finance School Graduates in terms of Marital Status” was accepted. It is seen that the mystic values of married graduates are more than the mystical origin values of single graduates (Table 7.12).

Although there seems to be a statistically significant difference in the Mystic values of the graduates in terms of total age groups, the relevant Games-Howell Post Hoc test could not determine between which groups this difference was. Therefore, it was considered that the differences in the frequency distributions of the groups may cause it and the hypothesis “H₃: There are differences in the Mystic values of the Finance School Graduates in terms of Age Groups” was **rejected**. It was seen that there were no differences in the Mystic values of the graduates in terms of educational level and professions and the hypotheses “H₄: There are differences in the Mystic values of the Finance School Graduates in terms of Educational Level” and “H₅: There are differences in the Mystic values of the Finance School Graduates in terms of Professions” were **rejected**. There is a significant difference in terms of total working times ($t = 2.820$; $p = 0.016$). It is seen that the Mystic values of those who work for 20–29 years are higher than the Mystical Origin values of those who work for 40–49 years.

Table 7.11 T-test for comparison of mystic value in terms of gender and marital status

		<i>N</i>	Avg	St. Deviation	<i>t</i>	<i>p</i>
Gender	Female	171	3.0789	0.79177	0.453	0.651
	Male	429	3.0455	0.87738		
Marital status	Married	520	3.0801	0.87012	2.119	0.036
	Single	80	2.8917	0.71850		

$p < 0.05$

Table 7.12 Anova test for comparison of mystic value in terms of age groups, educational level, professions and total working time

Demographic characteristics		<i>N</i>	Avg	St. Deviation	<i>F</i>	<i>p</i>
Age groups	Below 44	135	3.1802	0.90398	4.209	0.002
	45–54	300	3.1083	0.77483		
	55–64	132	2.9167	0.91993		
	65–74	24	2.6181	0.93313		
	Above 75	9	2.5926	0.73177		
Educational level	High school	20	2.9250	0.97554	0.391	0.677
	Undergraduate	463	3.0497	0.87627		
	Postgraduate	117	3.6988	0.73570		
Professions	Government officer	323	3.1120	0.88977	1.786	0.077
	Banker	22	3.0227	0.89575		
	IFA-CFA ¹³	129	2.8230	0.80465		
	Consultant	6	2.9444	1.14827		
	Educator ¹⁴	32	3.1667	0.63075		
	Self-employed	29	3.0747	0.81234		
	Military officer	3	3.0000	0.00000		
	Lawyer ¹⁵	30	3.1389	0.69905		
	Retired	26	3.3013	0.88697		
Total working time	Less than 9 years	2	2.0000	1.41421	2.820	0.016
	10–19 years	28	3.1786	0.92065		
	20–29 years	231	3.1371	0.83114		
	30–39 years	252	3.0642	0.82631		
	40–49 years	81	2.7942	0.92168		
	50 years and more	6	2.8056	0.77110		

$p < 0.05$

7.5 Conclusion and Recommendations

Work values that affect the preferences, behaviours and achievements of individuals in their working lives are influenced by demographic characteristics as well as family, school and regional cultural characteristics. Therefore, it is an important concept to be taken into account in working life. According to the data of 600 participants in the study, it is seen that the work values of the Finance school graduates in their working lives are formed within the framework of Rationalism,

¹³ Independent Accountant and Financial Advisor, Certified Financial Advisor.

¹⁴ Teacher, Academician.

¹⁵ Lawyer, Judge, Prosecutor.

Professionalism, Mystic, Centralization and Sense of Hypocrisy respectively. Five research questions were created within the framework of demographic characteristics by considering the types of work values of the graduates. Each research question was tested with six hypotheses that were created separately, and it was observed that only the Centralization values did not make a difference.

From the research questions, the answer for the question, "RQ₁: Are there differences in the *Professionalism* values of the Finance School Graduates in terms of Demographic Characteristics?", is that differences are observed in terms of gender, age groups and educational level. Analyses have showed that female graduates have higher professionalism values than men, so their values such as responsibility, risk taking, doing one's job well, entrepreneurship and cooperation are more intense than men's ones. Some studies in the literature (Avcı 2011: 13) have demonstrated that women have higher work values, while others (Çevik Tekin and Akgemci 2016: 40) have showed that there is no difference, especially in the professionalism dimension. In terms of age groups, the study has showed the graduates between the ages of 55–64 who are mature and close to retirement are more professional in working life. Many studies in the past have revealed that age groups differ according to generations and values such as prestige (Gürsoy et al. 2008: 457) and responsibility (Özer et al. 2013: 138–139), which are seen as elements of professionalism, are higher in the baby boomer generation (56–74 years old). In terms of educational level, they have also indicated that the graduates become more professional and each new knowledge makes them more experts, as the level of education increases. Thus, we can say that the literature has showed the professionalism values (vision, being open to new ideas, etc.) (when considered as accepting new technologies and ideas) become easier as the level of education increases (Li et al. 2008: 878 as cited in Chai and Mo 1997).

The answer of the second research question, "RQ₂: Are there differences in the *Centralization* values of the Finance School Graduates in terms of Demographic Characteristics?", is that any difference is not observed. That is, values such as rank and authority, dependency, repressiveness and submissiveness do not change according to demographic characteristics. However, many studies in the literature have showed that factors such as status, rank and authority, loyalty, etc. are actually different in terms of marital status (Çoban 2011: 73) and generation gap/age (Özer et al. 2013: 138).

The hypotheses for the third one, "RQ₃: Are there differences in the *Sense of Hypocrisy* values of the Finance School Graduates in terms of Demographic Characteristics?", indicate that the difference is observed in terms of professions. It shows that military discipline is stricter, more protective, more intolerant and more ostentatious than consultancy which is freer and more independent. For the Sense of Hypocrisy that involves mostly materialism, ostentation, lavishness and self-interest, the literature has also demonstrated that there is a difference in terms of gender (Elizur 2004: 209), age (Cherrington et al. 1979: 621) and experience (Jurgensen 1978 as cited in Kubat 2007: 25).

The answer of the fourth question, "RQ₄: Are there differences in the *Rationalism* values of the Finance School Graduates in terms of Demographic Characteristics?", is that there are differences in terms of gender and age groups. It is seen that women vs.

men and 45–54 age group versus 55–64 age group have more information sharing, are more scientific, more successful, more hardworking, more honest, more disciplined and fairer. The literature has also showed that women have more friendly relationships than men (Neil and Snizek 1987: 261), and that young people care more about the trust factor than the older ones (Cherrington et al. 1979: 621).

The answer of our last question, “RQ₅: Are there differences in the *Mystical Origin* values of the Finance School Graduates in terms of Demographic Characteristics?”, can be that the difference is observed in terms of marital status and age groups. While married people are more traditional, more abstemious and have tighter family ties compared to singles, those in the 20–29 age group are seen to be more affective, more fatalistic and have stronger religious values than those in the 40–49 age group. The literature (Cherrington et al. 1979: 621) has also showed that older people care more about the moral aspect of work than younger people.

As a result, the Finance School graduates are observed to have the most rationalism values such as scientificness, individual rights and freedoms, success, fairness and industriousness, etc. and then the professionalism values such as competition, risk-taking, intuitivism, entrepreneurship and cooperation, etc. in their working lives. On the other hand, it is observed that work values differ according to some demographic characteristics within the scope of the sub-dimensions (excluding centralization). According to all these results, we can say that the presence of the Finance School graduates who have the Professionalism and Rationalism values in their working lives can be effective in the formation of a society based on science and technology. Therefore, it is useful to know that the finance schools which were closed and the ever-decreasing number of graduates are important for working life and creating a developed society.

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Chapter 8

What is Priority for Organization: Environmental, Social and Governance or Sustainable Corporate Governance: Literature Review



Ali Rehman, Yuvaraj Ganesan, and Hasnah Haron

Abstract Environment, social and governance (ESG) and sustainable corporate governance (SCG) are two popular terms that are floated around the corporate sphere. ESG and SCG are the major governance factors; however, they cannot be considered similar in addressing the environmental, social and governance aspects of a business. It is obvious that corporate governance alone cannot satisfy stakeholders satisfaction and inclusion of ESG and SCG is required. ESG represents a more stakeholder-centric approach to doing business, whereas SCG creates long-term stakeholder value by implementing a sustainable business strategy. This chapter identified literature in these areas and presented a detailed analysis of the global scenario. With the application of stakeholders theory, this chapter highlighted the importance of both governance factors and identified that SCG is the principal trait of corporate governance and ESG can be the part of SCG. This chapter identified the advantages, disadvantages and risks associated with the probable non-implementation of ESG and SCG. This study will be beneficial to regulators, corporate leaders and professional bodies in setting up the standards and amending their codes and policies. This study will enhance the existing body of knowledge and can be converted into a complete empirical study.

Keywords Environment social and governance · Sustainable corporate governance · Risk · Advantages of ESG and SCG · Disadvantages of ESG and SCG

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8.1 Introduction

There could be many potential reasons for organizations to adopt or apply codes of corporate governance into their businesses, but this concept emerged once the organizations started facing fraud and related activities involving their executive management and board of directors (Gunz and Thorne 2019; Paletta and Alimehmeti 2018). Codes developed by many countries and authorities defined several purposes for these codes; however, they all are consistent in identifying the reasons, namely (a) maximize long-term success for organization (b) building strong national economy (c) protection of stakeholders and shareholders (SEC 2016; CMA 2016). Despite the fact that the codes were developed, implemented and heavily controlled but frauds are still occur and with more intensity than before (Rehman 2021).

With the increasing rate of fraud, stakeholders and particularly shareholders demanded their protection which was surely not provided by the codes of corporate governance and innovation was necessitated. A few of the recent frauds which jolted the corporate world include the Malaysian 1MDB fraud, NMC Health Care fraud, the collapse of Abraaj group, Volkswagen carbon emission fraud, Wells Fargo fraud and Formosa Plastics fraud (Hotten 2015; Rehman 2021; Flitter 2020; Fernández 2019). It is worth noting that all these organizations were in full compliance with the codes of corporate governance and even a few of them also got the award for environmental protection and sustainability projects (Volkswagen 2014; Fargo 2016). Nature of all these frauds can be categorized as environmental fraud, social fraud, economic fraud, political fraud, territorial goals fraud and corporate governance fraud.

Above mentioned are the few examples of corporate governance failure. Reasons for these failures can be categorized as fraud, inefficient internal audit function, weak board of directors, unqualified board members, corruption, unethical leadership and short-term vision of organization (Danha 2019; Basterretxea et al. 2022). Probable mitigation against these failures and required innovation in the corporate governance can be termed as sustainable corporate governance (SCG) and integration of environment, social and governance (ESG) in SCG.

Few scholars and practitioners use SCG and ESG terminologies interchangeably; however, there is difference between them and is necessary for the organizational success. SCG is the result of sustainable development goals developed by United Nations (UN) in year 2015. There are seventeen sustainable goals developed by UN (English and Carlsen 2019). These seventeen areas are interrelated and strive for the sustainability of society which includes organizations as well. These sustainable goals are focused on the long-term strategies of countries and emphasizing on improving the quality of lives, protect ecosystem and preserves natural resources for future generations (UNESCO 2015). For the successful implementation of these goals every country requires corporations/organizations, profitable companies, future-oriented leaders and cash-rich organization. SCG ensures that the organizations are not looking for the short-term profitability, strive for becoming self-reliant and help society to grow as well (Rehman 2021).

Business continuity is dependent on SCG. According to a recent survey, 66% of organizations recognize that SCG is essential; however, 82% of their board members are not providing proper controls and consideration to SCG (Rehman 2021). Several countries do not include/cover SCG in their codes for corporate governance, and it is not a part of all business processes. Market and regulatory failures both contribute to problems caused by the non-implementation of SCG. The board of directors and executive management are supposed to act in the interests of the company as a whole (Hugh and Clouse 2017), but instead they focus on short-term profit-taking, which pleases the shareholders. Additionally, the board's compensation and the executive management's bonuses are based on short-term profitability rather than sustainable growth (Rosa et al. 2019). Failures of this nature are caused by deficiencies in corporate governance (Commission 2020a; b) and SCG is the only mitigation factor that can prevent such failures and force companies to think long term.

Till date of this chapter, there are no clear set criteria available for the SCG. In the absence of these defined guidelines business sustainability is becoming uncertain and it is difficult to assure that an organization's work should be promoted as sustainable or downgraded to merely greenwash. There are several instances available where organizations utilize exaggerated claims to position themselves as sustainable. Furthermore, sustainability has been misunderstood due to a lack of defined measures. Organizations are uncertain about sustainability's meaning and what aspects they should concentrate on because of its constant redefinition. In such a case, suddenly sustainability is about addressing climate change, poverty reduction and gender equality (Courtneil 2021).

Another aspect of achieving sustainability is ESG which is one of the governance factors and helps in realizing SCG. ESG encourage organizations to develop policies and regulations based on environmental impact evaluations and long-term socialhuman component. ESG also emphasizes on having long-term goals instead of short-term profitability initiatives (Râmniceanu 2022). ESG is evolved from business sustainability. Main difference between ESG and SCG is that ESG is having defined and set rules which are formulated by standard setting bodies such as International Financial Reporting Standards (IFRS) Foundation Trustees and International Sustainability Standards Board (ISSB). These standards identify that how an investment product considers ESG issues in its objectives, investment strategy and stewardship activities (Courtneil 2021; ISSB 2021). Another difference is that ESG focuses on the environmental impact, social impact and governance impact which can be for current period or for shorter periods of time, whereas, SCG ensures long-term sustainability and growth.

In current business environment, ESG is one of the main factors encouraging lending companies/financial institutions to provide loans or grant loan extensions. ESG encourages financial institutions to make responsible investments. In accordance with the recent report issued by United States Sustainable Investment Foundation (US SIF) it is stated that there is 42% growth in the asset management for ESG strategic companies and investment grew from USD 12 trillion to USD 17 trillion (USSIF 2020). ESG highlights several risks which can be categorized into following categories, and these risks are different from risk identified by SCG.

It is clear from Table 8.1 that ESG environmental impact is more focused towards external factors whereas organizational risk is covered from the governance perspectives only. It is worth mentioning that control environment which is available within organization cannot be covered under governance risk and is required to be treated under the environment risk. Committee of Sponsoring Organizations (COSO) developed risk framework which clearly mentions the control environment risk. Control environment can be defined as importance given by board and executive management towards internal controls (COSO 2022). Furthermore, there are several business sectors which are not impacting the external environment such as educational sector, telecommunication sector and software developers. Organizations which are not impacting environment will always be achieving highest grades for environment disclosures regardless of their poor control environment. In order to complete the disclosures for ESG, inclusion of control environment is necessary. This disclosure will assist shareholders and regulators to identify the sustainability of organization and it will also enforce the highest ethical standards.

SCG and ESG are the two main governance factors and both are necessary for the organizational sustainability. This chapter will highlight that there is difference between SCG and ESG and both factors cannot be utilized simultaneously. This chapter will highlight the control environment factor to be included under ESG for it to be considered as complete and concise. This chapter will also identify the theories related to SCG and ESG and will enhance existing body of knowledge. To the best of the knowledge of researchers, there is no study conducted which compares the SCG and ESG and highlights the difference between these two governance factors; furthermore, there is no study available which considers control environment under ESG. This chapter will be useful and beneficial to regulators and organizations towards amending and incorporating SCG and ESG into the codes of corporate governance and organizational policies. This chapter will also be beneficial to professional bodies and international organizations such as United Nations and IFRS foundation.

Table 8.1 Risks of ESG

Environmental risk	Social risk	Governance risk
Climate change	Inequalities	Board remuneration
Water security	Diversity and inclusion	Executive management remuneration
Waste	Employee relationship	Board diversity and structure
Pollution	Health and safety	Donations and political lobbying
Deforestation	Working conditions	Bribery and corruption
Loss of biodiversity	Discrimination	Policies and standards

Source Râmniceanu (2022)

8.2 Literature Review

This section will cover the literature related to SCG, ESG and their related theory. This section will also highlight the history, background of SCG and ESG and potential risk associated with the non-compliance of SCG and ESG.

8.2.1 *Historical Background of Sustainable Corporate Governance and ESG*

This section will define and highlight the historical background of SCG and ESG in detail.

8.2.1.1 History of Sustainable Corporate Governance

SCG is the improved term for corporate governance where organizations are asked to perform in a way that is sustainable to the organization and its shareholders. As a result of the Brundtland Report of 1987, sustainable development has become a core component of management systems enabling them to enhance the long-term value of their organization (Çalıyurt and Yüksel 2016). Sustainable development was defined in the Brundtland Report as “development that meets the needs of the present without compromising the ability of future generations” (UN 1987). This definition provides the long-term vision for organizations and enforces organizations to mitigate or develop mitigating actions for high levels of uncertainties (Mondini 2019).

Sustainability has been introduced into legislative frameworks through the Brundtland report. This report provided the basis for the development of sustainable goals and can be considered as the fundamental and essential concept of today's SDG (Mondini 2019). However, social reporting started during the 1970s as an embedded part of financial reporting. Social reporting provided information related to the economic, environment and social aspects of the organizations (Pritchard and Çalıyurt 2021). These aspects can also be considered as dimensions for SCG. These dimensions were further extended by adding two more aspects namely political and territorial dimensions. In the year 2019 two additional dimensions were added, namely corporate governance and the nature of the product (Zborkova and Dvorakova 2011).

Corporate sustainability can be achieved by integrating all seven dimensions of sustainable development. However, several scholars believe that the economic dimension provides the strongest financial foundation and also prevents organizations from collapsing due to financial issues. Through organizations' governance practices and economic development, companies can achieve corporate governance sustainability (Rehman and Hashim 2021).

8.2.1.2 History of ESG

The ESG idea was born from socially responsible investments (SRI) that can be traced back to the nineteenth century, when social factors and restrictions were considered when making investment decisions, especially by faith-based organizations. Due to historical occurrences like the Vietnam War and contemporary social issues like women's rights, the environment and civil rights, these concerns gained traction and became more frequently considered by politically engaged people when making investment decisions. A few decades later, SRI initiatives focused on divesting from companies with ties to apartheid South Africa and the arms trade (e.g., Sudan). This situation inspired the formation of organizations like London's Ethical Investment Research Services Ltd., which aims to equip religious institutions and non-governmental organizations with the independent research information they need to make ethical investment decisions (Eccles et al. 2019).

In the year 2004 when the term ESG was first mentioned in a United Nations Global Compact report titled *Who Cares Wins: Connecting Financial Markets to a Changing World*. The report's primary focus is to create policies and propose a better way to integrate ESG concerns into securities brokerage services, asset management and associated research functions. The report was supported by financial institutions that included asset managers, asset owners, large banks and other stakeholders. Further, in the year 2005, the United Nations Environment Programme Finance Initiative published a report called a legal framework for incorporating ESG issues into institutional investment. This report highlighted the fiduciary duty to use ESG information when making investment decisions and gave key evidence on why ESG issues are important from a financial point of view. These two reports became the basis to launch of the United Nations Principles for Responsible Investment in 2006, which encouraged global financial institutions and others to pledge to incorporate ESG in their investment decisions (Eccles et al. 2019; Lim et al. 2022). Over the past decade, the assets under management that take ESG factors into account are substantial and enlarging, and the number of signatories to the Principles for Responsible Investment, which are backed by the United Nations, has increased fivefold (Huang 2021).

In today's world, an increasing number of businesses are participating in ESG reporting and working towards making an impact on ESG issues through a variety of other initiatives that are closely related to one another. Some of these initiatives include the Global Reporting Initiative (GRI), The Universal Purpose of a Company in the Fourth Industrial Revolution as outlined in the World Economic Forum's (WEF) Davos Manifesto 2020, the Carbon Disclosure Project (CDP) and the Sustainability Accounting Standards Board (SASB) (Lim et al. 2022). The ESG is currently gaining popularity in developing nations after years of active use in Europe, America and other developed nations. Furthermore, several accomplishments, such as the creation of the ESG assessment system, the ESG disclosure requirements and the ESG index system, have supported the growth and maturity of the environmental, social and governance components as well as ESG as a whole (Li et al. 2021).

8.2.2 Corporate Governance

Before dwelling further into SCG and ESG it is better to discuss corporate governance as it is the foundation for any organization and without the presence of corporate governance public listed organizations cannot operate (Rehman and Hashim 2020). Introduction and proper implementation of corporate governance are the results of the fraudulent activities conducted by organizations. Another reason for corporate governance enforcement is to provide satisfaction and security to shareholders, especially minority shareholders.

Corporate governance is the set of policies and rules which organizations are required to follow (Aluchna and Kuszewski 2021; Idowu and Kaliyurt 2014). Regulators such as the capital market authority (CMA) or securities exchange commission (SEC) of countries are required to ensure compliance with these codes (CMA 2016; SEC 2016). The purpose of codes of corporate governance is to provide protection for investors' rights and interests. Codes cover the behaviour of the organization and set standards for board and related committees, executive management, internal auditors and external auditors (Rehman and Hashim 2020).

Several countries introduced codes of corporate governance in the year 2002 and made several amendments to these codes. It is worth mentioning that codes are necessary to be followed; however, there is no appropriate assurance authority available who can provide assurance for the proper implementation of the codes. External auditors are providing opinions which are more towards verification of the compliance sheets provided by the organizations, and they are not verifying the details. The provided opinion is more towards saving their legal rights than providing satisfaction to shareholders (Rehman 2021). Internal auditors are considered as third line of defence and are required to provide the details of compliances with rules and regulations (Brasseur 2020); however, frauds that are conducted by board and executive management are difficult to be identified as they are policymakers and have complete influence over system and people including internal auditors specially those auditors who are outsourced (Coram et al. 2008). These conditions necessitated additional practicalities to corporate governance which can be considered as sustainable and ensure that organizations think long-term for the sustainability of organization and provide long-term benefits to shareholders.

8.2.3 Sustainable Corporate Governance

Sustainable corporate governance (SCG) is the result of failures in existing corporate governance and also to facilitate the achievement of UN sustainability development goals.

8.2.3.1 United Nations Sustainable Development Goals

With 17 goals, 169 targets and 232 indicators, the 2030 agenda for sustainable development represents the most comprehensive approach to sustainable development to date. As a result, sustainability was modelled with a focus on global economic, social and environmental development (Bergman et al. 2018). Table 8.2 determines the goals, brief description and targets and impact on organizations towards SCG and ESG.

The impact mentioned in Table 8.2 is extracted from the details provided by UNESCO. It is evident that from 17 goals three are related to the SCG, and six are related to ESG which are directly associated with the organizations. The remaining goals are the responsibility of the government and international unions or groups.

It is recognized by UNESCO that goals 8, 9 and 17 cannot be achieved unless organizations are involved and work for the achievement of SCG. For this reason, several awareness sessions were conducted and many reforms were made (Chamber 2022). For the ESG-related goals, similar efforts are exerted by UNESCO and it is identified as the responsibility of the organizations in particular and societies at large.

8.2.3.2 Integration of Sustainability into Corporate Governance

It is the responsibility of organizations to curtail down fraud, provide satisfaction to shareholders and assist in achieving UN sustainable goals. For this reason, integration of sustainability into corporate governance is very necessary. Sustainability in wider terms refers to the building of society by creating a balance between economics, social and environmental attributes (Zborkova and Dvorakova 2011; Çalıyurt 2020). Integration of these three attributes is very necessary for long-term sustainable growth while considering economic attributes as the driving force. The economic attribute of sustainability delivers financial strength and assists in diminishing circumstances which can lead an organization towards business closure/winding up of business because of financial reasons (Küçükgül et al. 2022; Krechovská and Prochazkova 2014). There are other attributes also necessary for sustainable growth namely community, occupational groups, government, culture and physiology (Prakati 2019). With the combination of these additional attributes, it can be asserted that to achieve sustainability there is a requirement of eight attributes.

Sustainability encourages sustainable business development and corporate sustainability refers to organizations performing corporate activities which create sustainable business development. Organizations can develop sustainable business through their governance policies and practices, supporting the local population in the shape of job creation and profit distributions in the shape of dividends, pension payments and other similar support to society. Organizations should develop policies and procedures which should circulate around the sustainable long-term vision and objectivity of the company. For organizations to integrate sustainability into corporate governance focus is to be provided for the following aspects mentioned in Table 8.3.

Table 8.2 United Nations sustainable development goals, brief description and targets

Goals	Domains of sustainable development goals	Brief description and targets	Impacting organizations for	
			SCG	ESG
1	No poverty	By 2030, eradicate extreme poverty for all people everywhere, currently measured as people living on less than \$1.25 a day	No	Yes
2	Zero hunger	By 2030, end hunger and ensure access by all people, in particular the poor and people in vulnerable situations, including infants, to safe, nutritious and sufficient food all year round	No	No
3	Good health and well-being	By 2030, reduce the global maternal mortality ratio to less than 70 per 100,000 live births	No	No
4	Quality education	By 2030, ensure that all girls and boys complete free, equitable and quality primary and secondary education leading to relevant and effective learning outcomes	No	Yes
5	Gender equality	End all forms of discrimination against all women and girls everywhere	No	No
6	Clean water and sanitation	By 2030, achieve universal and equitable access to safe and affordable drinking water for all	No	No
7	Affordable and clean energy	By 2030, ensure universal access to affordable, reliable and modern energy services	No	Yes
8	Decent work and economic growth	Sustain per capita economic growth in accordance with national circumstances and, in particular, at least 7% gross domestic product growth per annum in the least developed countries	Yes	No

(continued)

Table 8.2 (continued)

Goals	Domains of sustainable development goals	Brief description and targets	Impacting organizations for	
			SCG	ESG
9	Industry, innovation and infrastructure	Develop quality, reliable, sustainable and resilient infrastructure, including regional and transborder infrastructure, to support economic development and human well-being, with a focus on affordable and equitable access for all	Yes	No
10	Reduce inequalities	By 2030, progressively achieve and sustain income growth of the bottom 40% of the population at a rate higher than the national average	No	Yes
11	Sustainable cities and communities	By 2030, ensure access for all to adequate, safe and affordable housing and basic services and upgrade slums	No	No
12	Responsible consumption and production	Implement the 10-Year Framework of Programmes on Sustainable Consumption and Production Patterns, all countries taking action, with developed countries taking the lead, taking into account the development and capabilities of developing countries	No	Yes
13	Climate action	Strengthen resilience and adaptive capacity to climate-related hazards and natural disasters in all countries	No	Yes
14	Life below water	By 2025, prevent and significantly reduce marine pollution of all kinds, in particular from land-based activities, including marine debris and nutrient pollution	No	No

(continued)

Table 8.2 (continued)

Goals	Domains of sustainable development goals	Brief description and targets	Impacting organizations for	
			SCG	ESG
15	Life on land	By 2020, ensure the conservation, restoration and sustainable use of terrestrial and inland freshwater ecosystems and their services, in particular forests, wetlands, mountains and drylands, in line with obligations under international agreements	No	No
16	Peace, justice and strong institution	Significantly reduce all forms of violence and related death rates everywhere	No	No
17	Partnership for the goals	Strengthen domestic resource mobilization, including through international support to developing countries, to improve domestic capacity for tax and other revenue collection	Yes	No

Source UNESCO (2015)

Table 8.3 Necessary aspects of integration sustainability into corporate governance

Aspects of integration	Description
Overall business processes	Sustainability should be embedded into all organizational policies and processes
Performance management	Organizational KPIs should be developed in a way that encourages sustainability
Business performance metrics	Identify industry-specific sustainability goals and incorporate them as organizational objectives

Source Krechovská and Prochazkova (2014)

There are few professional bodies who are working towards integrating sustainability into corporate governance; however, results are still not evident. In a recent review conducted on Singapore listed companies, it was revealed that 74% of companies which are demonstrating the sustainability disclosures are still not linking their board's and executive management's remuneration to the sustainability achievement and sustainability is still considered as obscure and trivial (Loh 2021).

8.2.3.3 Corporate Governance Sustainability

Sustainable corporate governance (SCG) is described as corporate governance which is sustainable. European Union (EU) as “Sustainability in corporate governance encompasses encouraging businesses to consider environmental (including climate, biodiversity), social, human and economic impact in their business decisions and to focus on long-term sustainable value creation rather than short-term financial value” (Commission 2020a; b). SCG enforces that all the policies which are related to organizations are focused on the long-term vision, socially responsible and should not be for the shorter period of gains (Rehman 2021; Starks 2021). Current pandemic highlighted this issue more further (Naeem et al. 2022) as many companies shut down their operations completely and many governments fall in to the never-ending debt traps (Rehman 2021). There are many factors which formulates the SCG and builds the framework for its possible implementation. These factors are discussed below.

Corporate Social Responsibility

Corporate social responsibility (CSR) is normally referred to as the organizational duties towards society at large and for employees in particular. As the name suggests it is the responsibility of the company to be socially active to support its stakeholders. CSR creates social responsibility for human rights, fair labour practices, environment, operating practices, customer perspective and community involvement and development (Sarac et al. 2021; Courtneil 2021).

CSR encourages the support and protection of human rights, ensuring that there are no abuses of the working environment and there is no forced labour (Courtneil 2021). In the current business environment, CSR is majorly viewed as the note disclosure in the financial statements where organizations highlight how much they budgeted for CSR and their intended plan. The majority of the organizations still consider CSR as charity to be provided to some orphanage, to fund someone’s education and to support some political parties (Greendorfer 2018). However, once the CSR is merged into the SCG, these practices can be avoided as the organizations will be forced to develop long-term policies with enduring and stable impacts.

CSR promotes equality among employees and eliminates discrimination. It also takes responsibility for the positive environmental impact of the organization. There are several examples available where organizations are providing CSR but still impacting society with toxic waste and pollution such as Formosa Plastics company. CSR alone cannot mitigate this risk and integration of SCG is necessary. CSR also encourages honest business practices including anti-fraud measures and whistleblower mechanisms. CSR intends to focus on the organizational supply chain and enforces the responsibilities to the third parties’ operations even if they are not directly linked with the organization.

Green Economy

Growing public concern about environmental issues and the sustainability of economic development led to the development of green economies practices in the late twentieth century. A seminal report published by the United Nations Environment Programme (UNEP) in 2011 defines a green economy as “one which improves human well-being and social equity while reducing environmental risks and ecological scarcity”. Green economy is motivated by two major factors namely (a) organizational motivation and (b) obtain enhanced public image (Purwandani and Michaud 2021; United Nations 2011).

Green economy can be linked to the SCG as there are several potential frauds occurring which are labelled as green washing. Green washing refers to the frauds which are created to avoid or misguide the shareholders towards SCG (Netto et al. 2020). Organizations which are highly impacting the environment such as energy and power sectors are receiving immense pressure from stakeholders for the production of sustainable commodities and clean energy. Green business is gaining awareness among investors and organizations are forced to adopt green practices (Antunes et al. 2015; Porter and Kramer 2006; Vollero et al. 2016). With the integration of green economy into the SCG, frauds can be eliminated and organizations will develop policies which have real impact on long-term basis.

Sustainable Strategy

Sustainable strategy is an environmental, social and economic sustainability strategy prioritizes actions that will drive performance and drive long-term sustainability. Businesses incorporate sustainable development into their short-, medium- and long-term strategic plans. It involves defining a set of sustainability statements, programmes, plans, actions and goals that outline how a business will compete in a particular market or markets sustainably (Courtnell 2021).

For organizations to achieve SCG they are required to develop strategies which are sustainable. There are several ways to achieve this goal; however, the organization intent and board's willingness are required. Laws and regulations should be made emphasizing on the sustainable strategies so that businesses can adopt and implement. Sustainable strategies should be drafted in a manner which enables ease of operations for current period and generates the sustainability for the future (Ukko et al. 2019).

Sustainable Plan and Programme

An organization's sustainability strategy includes a sustainability programme. This programmes provides actionable roadmap highlighting the related measures and activities that contribute to the sustainability story and drive results. A well-defined organizational structure, well-defined initiatives and specific implementation plans are included in this programme. Sustainability programmes must address sustainable

strategy as a continuum in order to be effective. It is not a static programme, and it requires constant adjustments and changes as and when necessary to remain sustainable. To coordinate multiple projects and plans, a sustainability programme relies on a broad set of sustainability objectives and goals (English and Carlsen 2019).

Sustainability plans are designed in advance to fulfil a given goal from a sustainability programme. Sustainability strategies set a broad range of goals and actions. An actionable sustainability plan is then created based on these sustainability programmes. In order to achieve a primary sustainability strategy, a sustainability programme will include more than one sustainable plan (Courtneil 2021).

Sustainability Framework

Frameworks are developed to assess the performance. Once the SCG strategies, programmes and plans are developed the last factor is to assess the SCG via framework. This framework is built to support the decision-making process and translates into the scientific/technical progression. This progression defines where organization is and what are the potential gaps in achievement of its SCG goals.

A framework-based assessment of sustainability is one of the most complex appraisal methodologies. In addition to multidisciplinary aspects, this also involves cultural and value-based aspects. Sustainability frameworks are typically built to support policy development and decision-making. The assessment of sustainability is becoming more common in product, policy and institutional appraisals. In order to provide a new perspective on planning and decision-making for sustainable development and SCG achievement, sustainability assessments are introduced (Sala et al. 2015).

For the development of any framework, it is necessary to have attributes/principles, levels of achievement and criteria (Rehman and Hashim 2018). For SCG the probable attributes are guiding vision, essential considerations, scope, SCG indicators, transparency, effective communication, monitoring and reporting (Sala et al. 2015). Assessment can be made via “what if” scenarios, identifying current situation and recognizing potential gaps via perceived performance measurement.

8.2.4 Environmental, Social and Governance

Environmental, social and governance (ESG) have been discussed long ago but currently have become the golden words for businesses and many governments. Although the ESG emerged long ago, there is still no single accepted definition for ESG (Abhayawansa and Mooneapen 2021; Aldowaisi et al. 2022; Li et al. 2021; Lim et al. 2022). According to Lim et al. (2022), the ESG has been conceptualized in four distinct ways such as (i) a framework, ideology, or paradigm that has three components: environment, society and governance, (ii) a concept of corporate social

responsibility (CSR), which incorporates “business actions and policies that evaluate, monitor and administer an organization’s accountabilities for and implications on society and the environment, (iii) a type of social impact assessment that considers the social and environmental value generated by any organization’s actions or operations, (iv) a form of sustainable finance and investment. Meanwhile, Aldowaish et al. (2022) highlighted two positions of ESG in the current literature, the first perspective is known as a socially responsible investment (SRI), and it examines ESG from the viewpoint of investments and the second perspective, which has developed from sustainable development (SD), examines ESG from the viewpoint of business operations. Hence, the common understanding of the ESG in three dimensions, as shown in Table 8.4, which define the environmental, social or governance issues that could positively or negatively affect the financial performance or solvency of an organization, a nation or an individual (Aldowaish et al. 2022; Gao et al. 2021; Li et al. 2021).

Table 8.4 The ESG frameworks

Dimension	Description
Environmental (E)	<ul style="list-style-type: none"> • GHG emissions • Energy consumption and efficiency • Air pollutants • Water usage and recycling • Waste production and management (water, solid, hazardous) • Impact and dependence on biodiversity • Impact and dependence on ecosystems • Innovation in environmentally friendly products and services
Social (S)	<ul style="list-style-type: none"> • Workforce freedom of association • Child labour • Forced and compulsory labour • Workplace health and safety • Customer health and safety • Discrimination, diversity and equal • Opportunity • Poverty and community impact • Supply chain management • Training and education • Customer privacy • Community impacts
Governance (G)	<ul style="list-style-type: none"> • Codes of conduct and business principles • Accountability • Transparency and disclosure • Executive pay • Board diversity and structure • Bribery and corruption • Stakeholder engagement • Shareholder rights

Source Li et al. (2021)

Currently, the entity, individual and nation have intensified growth in adopting the ESG. For example, there are more firms directly or indirectly involved in ESG reporting and aiming to make ESG impacts through numerous closely connected programmes like the Sustainability Accounting Standards Board (SASB), the Global Reporting Initiative (GRI), Carbon Disclosure Project (CDP), the Davos Manifesto 2020 the World Economic Forum's (Lim et al. 2022). Further, ESG investing has grown significantly over the last decade, and the COVID-19 epidemic has accelerated this trend. By bringing together the financial and ESG aspects, issues and opportunities, ESG integration gives even regular investors a chance to do some good (or at least less harm) to society and the earth through their investments (Abhayawansa and Mooneeapen 2021). Meanwhile, the countries using relevant authorities to implement the regulations and standards, such as the European Union and many developed countries, have made ESG reports mandatory for companies to disclose. Although ESG practices are still in their infancy in developing nations such as Malaysia, regulators encourage companies, mainly listed companies, to disclose ESG reports. Therefore, it can presume that emerging nations will gradually advance the ESG mandatory disclosure principle of listed firms in the future, following the lead of European and American nations (Gao et al. 2021).

The different perspectives on the benefits of ESG are also discussed widely. Some of the group views that the company is responsible for enhancing the shareholder wealth as the implementation of ESG involves a higher cost than the benefits driven by the practice of ESG. Another group believes that companies are accountable to the stakeholders rather than solely to the shareholder. This group argued that companies should not focus only on increasing shareholders' wealth but must emphasize and incorporate the social and environmental elements in their business operation (Dogru et al. 2022).

The benefits arrived from the practices of the ESG outweigh the costs (Brooks and Oikonomou 2018; Daugaard 2019; Dogru et al. 2022). Examples of the benefits are financial rewards through such effects as improved firm performance and valuation, return opportunities and reduced costs, meanwhile in terms of non-financial like enhancement of transparency, enhanced brand value, improving reputation and legitimacy, risk mitigation, increased customer loyalty and employee motivation, better business practices and control processes and augmented competitive advantage (Abdul Rahman and Alsayegh 2021; Brooks and Oikonomou 2018; Gao et al. 2021; Starks 2021). Furthermore, the systematic review paper by Lim et al. (2022) highlighted three advantages: (i) ESG reporting mitigates information asymmetries between the organization and its investors and among investors. (ii) ESG provides tangible capital market benefits such as improved liquidity, higher stock return, lower cost of capital (debt and equity), improved corporate decision-making, more favourable investor preference, higher asset price or organization value and reduced organizational risks. (iii) The ESG adoption can also result in increased psychological well-being because it supports national economic and social welfare indices like health, non-material consumption, adequate material welfare and income equality.

At present, there is plenty of ESG research. However, unfortunately, most studies are related to developed countries from the regions such as Europe, Australia, the

USA and Canada, even though ESG challenges are significantly far more enormous in emerging nations like Latin America, Africa and Asia (Gao et al. 2021; Li et al. 2021; Lim et al. 2022). There is ample room for contributions from various disciplines and fields in ESG research because most studies are published in accounting and finance, general sustainability, or both fields (Gao et al. 2021; Lim et al. 2022). Furthermore, ESG research focuses primarily on one facet of ESG elements, and literature on environmental and social factors is limited (Li et al. 2021). Therefore, there are encouraged to have more ESG research in emerging nations, SMEs firms and focus on ESG in multidisciplinary fields such as culture, religion, audit quality, internal control, total quality management, political ideology and others (Abhayawansa and Mooneeapen 2021; Gao et al. 2021; Khan 2022; Li et al. 2021; Lim et al. 2022). Meanwhile, ESG research has been formulated from many theoretical lenses such as agency theory, resources dependence theory, legitimacy theory, transaction cost theory, upper echelons theory, natural resources-based theory, social identity theory, signalling theory, place attachment theory, system justification theory and so on (Abdul Rahman and Alsayegh 2021; Li et al. 2021). However, the more prevailing theories in ESG study are stakeholder theories (Dogru et al. 2022; Khan 2022; Li et al. 2021).

There is still hope that ESG will soon be widely used in various disciplines, even if some research has already set the groundwork for this development trend. ESG will become increasingly important in the future, as organizations that place a high value on ESG development will be better positioned to take advantage of growth prospects, while companies that do not adopt ESG can be exposed to more significant risks. Further, the ESG practices are the steppingstone for the nation to achieve the Sustainable Development Goals (SDGs).

8.3 Difference Between Sustainable Corporate Governance and Environmental, Social and Governance

SCG and ESG are governance factors and both are necessary for the achievement of mature corporate governance. SCG defines the long-term vision and goals for organizations, whereas ESG ensures that organizations are supporting not only the enhanced profits and shareholders but also positively impacting environment and society at large. There are no standards or compliance available for SCG, whereas ESG is supported by standards and world leaders' support. There are many financial institutions which are enforcing the ESG for the lending of loan or to support any future investment (Monteiro et al. 2021).

There are sustainable goals developed by UN and adopted by many countries. These goals emphasize the organizations to have sustainable corporate governance which can enhance social aspects of society and might be positively impact the environment. ESG on the other hand enforces the laws which is not encouraging for organizations to have long-term vision for corporate governance but to have positive

impact on environment and social well-being of society. The governance factor for the ESG is also prone towards the governance related to the social aspect of organization with emphasis on environmental impact.

SCG provides the information which gives satisfaction to shareholders that their organization is on the right path (Reichman 2022); whereas ESG ensures that organization is achieving one of the objectives and not thriving for the achievement of its vision and mission (Monteiro et al. 2021). It wouldn't be prudent to say that without SCG implementation of ESG would be difficult and unmanageable. One of the recent example is the Volkswagen fraud where they were impacting the environment due to the poor governance (Crossman 2021). There could be many other examples where organizations impact the environment and social aspects but it is due to poor governance and short-term strategy.

ESG-based organizational policies are not clear (Halbritter and Dorfleitner 2015). They are missing many aspects such as transparency in financial reporting, satisfaction and protection of shareholders, encouragement of foreign investment, mitigation of risks related to conflicts of interest, illegal and unethical organizational practices (Khan et al. 2016). Furthermore, ESG is focusing more on the externalities of organization and not focusing on the internal environment of organization. Control environment is first and foremost necessary for any organization and this aspect is completely missing in the ESG policies.

SCG ensures that organizations adopt socially responsible policies which enhances the long-term vision of organizations (Starks 2021). Recent pandemic highlighted the issue of SCG. Organizations which were on track of SCG and implemented it properly were able to survive and recovered their losses and were also able to continue their business. Many scholars believes that ESG is necessary to ensure the continuation of organizational business (Krishnamoorthy 2021); however, it is the SCG which can provide satisfaction and protection to shareholders.

Among many differences, there is one common features, that is, SCG and ESG both are not available in the codes of corporate governance developed by many countries. Much efforts are required from countries, regulators and organizations to implement the SCG and ESG policies. These policies should be drafted for the protection of shareholders, thus focusing on mitigating the fraud risk, enhancing value of company and supporting the society.

8.4 Associated Theory

There could be several theories associated with SCG and ESG; however, the theory which can best define the relationship between SCG and ESG for sustainability is stakeholder theory. This theory is developed to answer the stakeholders' concerns related to value creation, trade, ethics of capitalism and board mindset/tone at the top.

Stakeholder theory suggests the relationship between an organization and a group of individuals or other organizations that can affect or are affected by the concerns

mentioned in the preceding paragraph. From the perspective of stakeholder, stakeholder theory defines the set of relationships among organization and various stakeholders. These relationships are about how organizational managers (board and executive management), community, financiers, employees, suppliers and customers create value and develop trade. Stakeholder theory suggests that understanding of these relationship helps to understand and manage the business. Furthermore, in case of conflict of interest, the business should redefine its value creation not only for one particular group of stakeholders but for all of its stakeholders such as in order to please the financiers the value for the customers or employees should not be ignored. It is moral duty of the organizational managers to enhance business in capitalist system and thrive its stakeholder's relationship without creating harm to other stakeholders and avoid any moral failures (Flak and Rose 2005).

From the ethical point of view, stakeholder theory encompasses accepting the following notions (Parmar et al. 2010):

- Stakeholders are organizations or individuals having legal, authentic and legitimate interest or concern in procedural and/or fundamental aspects of organizational activities. Stakeholders are recognized based on their interests in the organization and not on the interest of organization in these stakeholders.
- Stakeholders interest are of essential value. Each group of stakeholders defines their own consideration, and it may or may not be linked with the consideration of other group.

Stakeholder theory encourages the policymakers to ensure that organization is adding value to its customers, treating employees as assets, have fair dealing with suppliers, supporting the community and generating long-term value. These policies are introduced to support the shareholders' investment, to attract other investors, grow and innovate and deliver future success to organization, community and country.

SCG and ESG compel the organization to develop policies that are for the long term and impact all the stakeholders associated with the organization. These policies are drafted for all stakeholders and to ensure that organizations are positively impacting the economics, social, environmental, community, occupational groups, government, culture and physiology. SCG and ESG cannot be defined for one particular group but rather influence the whole society. SCG ensures the corporate governance of organizations which can also include ESG.

8.5 Conclusion

Corporate governance is necessary for the survival of organization. However, due to the several corporate failures stakeholders requires more protection and demanded sustainability in the organizational operations. SCG and ESG are the governance factors which are introduced to enhance the organizational value, provide protection to stakeholders and satisfaction to shareholders. SCG ensures that organizations are working towards long-term goals and are not focusing on the short-term profitability,

thus mitigating the risk of fraud and malpractices. ESG inclusion ensures that organizations are not only focused for the profitability or sustainability of organizations but also are concerned for the environment and society as whole.

Stakeholder theory identifies that an organization's relationship with individuals or other organizations that can affect or are affected by its stakeholders' concerns. According to stakeholder theory, organizations and various stakeholders have a set of relationships. Managers, community members, financiers, employees, suppliers and customers develop these relationships to create value and develop trade. According to stakeholder theory, understanding these relationships is crucial to understanding and managing a business. As a result of SCG and ESG, organizations are compelled to develop policies that will impact all stakeholders in the long run. Creating these policies ensures that organizations are positively impacting all stakeholders, including economics, social, environmental, community, occupational groups, government, culture and physiology. SCG and ESG affect the entire society and cannot be defined for one particular group.

This chapter highlighted the potentials of SCG and ESG and identified that SCG is necessary for the organizational survival, whereas ESG can be included in the organizational operational as the support of SCG but not as a main constituent of SCG. SCG defines the organizational sustainability which is required by the shareholders and reflected in the mission and vision of organization. Corporate governance defines the rules and regulations for organizations, unless these rules are not sustainable than it would be difficult for organization to survive and would not be able to deliver the ESG characteristics.

This chapter could be converted into the empirical study and can be beneficial to regulators, policymakers, standard setting bodies and organizations. This chapter provides the importance of SCG and ESG and highlighted that SCG is the main factor of corporate governance and ESG can be part of the SCG for the attainment of sustainability.

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Part IV
History of Economics

Chapter 9

Entrepreneurship Models and Partnership Structures in the Classical Age of the Ottoman Empire



Yasin Akkuş

Abstract The concept of entrepreneurship is mostly discussed in business and economics studies after the industrial revolution. However, since Cantillon, who first defined entrepreneurship, lived before the industrial revolution and during the enlightenment, the history of entrepreneurship can be traced back to the Middle Ages and even before. A similar situation occurred for the concept of entrepreneurship in the Ottoman Empire, and entrepreneurial activities before the Tanzimat period were either ignored or not given enough importance. However, Muslim and Turkish entrepreneurs have dominated both domestic and foreign trade in and around Anatolia since the Seljuk period. Among the proofs of this situation, documents such as tax records of the period, mühimme notebooks, şer'iyye registers, and kadi registers can be counted. In this study, the entrepreneurship models preferred by mostly Muslim Turks in the Classical Age of the Ottoman Empire and the partnership structures they have established are discussed within the framework of the mentioned resources.

Keywords Entrepreneurship · Ottoman Empire · Classical age · Partnership

9.1 Introduction

Many studies on entrepreneurship also refer to the historical development of the concept of entrepreneurship. It is stated that the concept of entrepreneurship was first defined by Richard Cantillon, who lived in the early eighteenth century. In the nineteenth and twentieth centuries, thinkers such as Jean Baptise Say and Schumpeter brought new perspectives to the concept of entrepreneurship. There seems to be no discussion in the literature about the historical development of the concept of

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entrepreneurship (Soysekerçi 2014: 7–8). However, when entrepreneurship is considered in a certain historical period or in the historical process of a country, studies that are anachronistic in the literature come before us. The aforementioned studies discuss and evaluate the historical period with today's entrepreneurship paradigm. However, it is considered that it would be more correct to address the issue with the entrepreneurship paradigm of the historical period studied.

Studies in Turkish literature deal with the historical development of the concept of entrepreneurship in parallel with foreign literature. However, very few studies address entrepreneurship in the Ottoman Empire. It is seen that most of the studies dealing with entrepreneurship before the proclamation of the Republic fell into the above-mentioned anachronism and either ignored or ignored the entrepreneurial activities in the previous periods. One of the most common mistakes is looking at the entire pre-Republican period with the mass production-oriented entrepreneurship approach of the industrial revolution. With such a perspective, it is seen that there was no entrepreneurial activity in the Ottoman Empire, except for a few examples in the nineteenth century. However, when viewed from a similar point of view, in the eighteenth century, when Cantillon defined entrepreneurship, there was no entrepreneurial activity in the world, and an erroneous conclusion can be reached. Based on all this, it turns out that it is wrong to consider the history of entrepreneurship from the perspectives of our present or recent past (Candan 2011: 154–162).

It is observed that another mistake encountered in the handling of entrepreneurship in the Ottoman Empire was made over the religions and races of the entrepreneurs. It is seen that the racial and religious cluster that appeared in some sectors in the last period of the Ottoman Empire has been extended to all sectors and all periods (Çakırer 2016: 13–15). With this wrong point, it is claimed that non-Muslims made entrepreneurship in the Ottoman Empire, and Muslim Turks did not engage in entrepreneurial activities.

This study aims to eliminate the above-mentioned misconceptions through the entrepreneurship models and partnership structures preferred by mostly Muslim Turks in the Classical Age of the Ottoman Empire.

9.2 Entrepreneurship in the Classical Age of the Ottoman Empire

In order to explain entrepreneurship in the Ottoman Empire, a definition covering the period is first needed. As mentioned earlier, it is thought that it would be wrong to define entrepreneurship before the industrial revolution with today's understanding of entrepreneurship. In this context, the views of Cantillon, who lived before the industrial revolution and defined entrepreneurship first, will be focused on (Demirel ve Akbıyık 2009: 6–7).

In order to understand entrepreneurship in Anatolia, especially in the Classical Age, it is useful to start from the Seljuk Empire period, when it was the heir of

the Ottoman Empire. It is seen that the basic entrepreneurial structures developed starting from this period and were transferred by the Ottomans.

9.2.1 Definition of Entrepreneurship in the Classical Age

Cantillon entrepreneurs in the eighteenth century were defined as structures in the markets of centrally located villages and towns, with prices forming in line with supply and demand. Again, he defines the structures that export the products produced in the villages as “entrepreneurs and traders.” Cantillon states that city entrepreneurs are operating in various business lines such as bakery and butchery by constructing or renting buildings (Cantillon 2010: 30–36). Cantillon, in his work “*Essai Sur La Nature Du Commerce En Général* (An Essay on Economic Theory),” sometimes uses “entrepreneur and/or trader,” sometimes “entrepreneur and/or craftsman,” and sometimes just “entrepreneur.” Based on these expressions, it would not be wrong to say that the definition of entrepreneurship in the eighteenth century included a wide range of artisans, small manufacturers, and traders. It is seen that the main feature emphasized while defining entrepreneurship is “risk.” According to Cantillon, entrepreneurs are people who set up and organize businesses in various sectors, sometimes even risking bankruptcy, in order to make a profit (Cantillon 2010: 73–74).

9.2.2 Entrepreneurship in Anatolia Before the Classical Age

Entrepreneurial activities carried out in Anatolia before the Classical Age can be revealed with limited documents until today. However, the main sources that reveal the entrepreneurs and entrepreneurial structures of the period with a social phenomenon are travelogues and chronicles. At the beginning of these sources is a travelogue written by Ibn Battuta. Ibn Battuta talks about entrepreneurs called “*ahi* (or *ahi*)” during his trip to Anatolia. Ahis are engaged in various artisanal activities, build religious buildings with the profits they earn, and welcome all guests, especially passengers. It is reported that the ahis living in almost every city (or even their village) in Anatolia had serious arguments for hosting the guests coming from the travel. Based on this, it will not be wrong to say that the ahis who opened a place of businesses by taking risks during the period have achieved a level of profit that can comfortably afford the building and aid activities (Battuta 2000: 403–405).

In addition, it is seen that there are entrepreneurs who earn high income in Anatolia. An example is the K y ko  lu family, whose members Ibn Battuta met at different times and places. It is reported that this family, who resides in Alanya and is stated to be from Muslim Turks, established a trade network that spanned almost the entire Mediterranean. It is even stated that the family gave loans to the sultans of the period (Battuta 2000: 402, 445).

Based on all this, it is determined that entrepreneurial activities were widespread in Anatolia and its immediate surroundings during the time of Orhan Bey, which is considered to be within the period of the establishment of the Ottoman Empire. In addition, it can be concluded that these activities are mostly carried out by Muslim and Turkish entrepreneurs, ranging from craftsmanship to intercontinental trade.

9.2.3 Entrepreneurship in Anatolia in the Classical Age

In the Classical Age of the Ottoman Empire, cotton weaving looms, considered the period's industry, played an important role in Anatolia and its surroundings. It is reported that the weaving looms in the Ottoman Empire were not inferior to India, which was the period's number one cotton producer and exporter. It is also seen that Turkish masters imitate some Indian goods and offer them to the domestic and foreign markets. It is stated that Turkish cotton fabrics were in a dominant position in the domestic market in the seventeenth and eighteenth centuries and constituted an important export item to Europe and even Central America. It is even reported that the techniques used in the clustered fabric dyehouses in Edirne were intended to be copied by the French and Dutch in the eighteenth century (İnalçık 1996: 264, 272–273).

Many products needed in the domestic market, such as woolen fabric samples, are manufactured and sold by entrepreneurs in Anatolia. There is no information that the mines were imported in the Classical Age. The Ottoman leather manufacturers are in a better position than the European and surrounding leather manufacturers. While products such as leather are exported in excess in the domestic market, exporting metals such as copper without meeting the domestic market needs is prohibited. Based on all these, it is seen that Anatolian and Rumelian entrepreneurs in the Classical Age were at a level to meet the domestic market needs, especially in basic products (Akkuş ve Menteş 2018: 169–186). In light of the information about the ahi-order tradition inherited from the Seljuks, it is reported that Muslim Turkish entrepreneurs largely meet the domestic market needs.

9.2.4 International Trade Conducted by Muslim Turks in the Classical Age

It is reported that Muslim Turkish entrepreneurs who were Ottoman subjects in the sixteenth century had a close commercial relationship with India and its surroundings. According to Western travelers, four hundred Ottoman Turkish entrepreneurs were constantly trading in Gujarat in the sixteenth century (İnalçık 1996: 266–267). It is reported that a similar situation is observed in the Balkans. It is stated that Muslim Turkish entrepreneurs played an active role in the field of woolen fabric in the Balkans

and especially in Dubrovnik, where trade took place intensively in the sixteenth century. Similarly, it is seen that Anatolian and Rumelian Turks were dominant in the trade in and around the Black Sea in the Classical Age (İnalçık 2000: 319–320). It is stated that wholesalers are foreigners in Cairo, which is among the important trade points in the Mediterranean. It is reported that most of these entrepreneurs, who are not from Cairo but are Muslims, are Anatolian and Rumelian Turks, known as “*Rumis*” (Faroghi 2006: 644–645).

Another proof that some of the active entrepreneurs who directed the trade between Europe and Anatolia in the Classical Age were Muslim Turks is the “*Fondaco dai Turchi*” in Venice. This structure, which is reported to have been built in the eighteenth century and resembles the caravanserais in Ottoman society, was reserved for the accommodation of Muslim traders. This structure, which was reserved by the Republic of Venice for the accommodation of Turkish entrepreneurial communities, started to be used by Muslims belonging to other nations when they belonged to a similar religion and thought they would feel comfortable. It is reported that similar “*fondacos*” were allocated to the Turks starting from the sixteenth century. Based on this, it is seen that Anatolian and Rumelian Turks and hasa merchants are engaged in intensive commercial activities with Venice and, therefore, Europe (Turan 1968: 247–275).

As a result, from the sixteenth century to the middle of the eighteenth century, Muslim Turkish merchants established their own networks in the internal market of the Ottoman Empire and on the land and sea routes under the empire’s control. Even in the eighteenth century, it is reported that there were wealthy Ottoman entrepreneurs who made great initiatives against the British entrepreneurs in Aleppo (Faroghi 2006: 654–655). Based on all this, it is very difficult to argue that entrepreneurship was absent or weak in the Classical Age of the Ottoman Empire. On the contrary, it is seen that there were Muslim Turkish (Anatolian and Rumelian) entrepreneurs who competed with and sometimes surpassed European, Indian, and Russian entrepreneurs in and around the Ottoman Empire. These entrepreneurs are spread over various trade centers and are relatively high in number and capital.

9.2.5 Entrepreneurship in Public Officials and Soldiers in the Ottoman Empire

While describing the entrepreneurial activities in the Ottoman Empire, it is claimed that entrepreneurship was mostly made by non-Muslims. As a basis for this, it is suggested that Muslim Turks prefer the military and civil service more (Candan 2011: 161–162). Derviş Mehmet Pasha, who lived in the seventeenth century and served as the grand vizier, is one of the most prominent examples showing the opposite. Dervish Mehmet Pasha started his entrepreneurial activities in many sectors during his governorship periods in Damascus and Baghdad and achieved a considerable fortune. It is reported that Derviş Mehmet Pasha had extensive agricultural

investments in Iraq and had representatives in trade centers such as India, Basra, and Aleppo. A similar example is Rustem Pasha, who was the vizier of Suleiman the Magnificent. It is reported that Rustem Pasha is a successful entrepreneur. So much so that statesmen's being entrepreneurs or entrepreneurs being a statesman was criticized by scholars both before and during the period. Before the Classical Age, Ibn Khaldun and Koçi Bey in the seventeenth century talked about the harms of statesmen's entrepreneurial activities to the country Mustafa Ali, who also lived in the seventeenth century, in his book called "Kitab-ı Müsteab" and expresses the drawbacks of entrepreneurs being classified as statesmen (Faroghi 2006: 672–673). Based on this information, it is clear that during the Classical Age of the Ottoman Empire, statesmen turned to entrepreneurship, while entrepreneurs turned to politics. The criticism of many scholars on this subject can be counted among the greatest evidence.

There is information that the military class carried out entrepreneurial activities in the Classical Age of the Ottoman Empire. In an order published in the sixteenth century, it is stated that various military classes were engaged in activities such as tradesmen and traders, which was prohibited (Doğan 2014: 138–143). Despite all the prohibitions, especially the janissaries are engaged in military entrepreneurial activities, and by using their privileges, they are out of the control of the kadi and the muhtesi. Other entrepreneurs have constantly sued janissaries who do not comply with the narhs, open a workplace where they want, and offer poor-quality products to the market. However, these cases were often interspersed with the privileged behavior of the military class. In this regard, many complaints from the provincial administration were also conveyed to Istanbul. In addition, there are opposite situations, such as the participation of entrepreneurs in the janissary corps (Çiftçi 2010: 37–41). In the practice seen in Cairo, various entrepreneurs pay a high price to register with the guild of janissaries and benefit from the privileges brought by the military class.

9.3 Entrepreneurship Modeling and Business Partnerships in the Classical Age of the Ottoman Empire

In the Classical Age, interest-bearing commercial loans were considered prohibited in almost the entire Islamic world, especially in the Ottoman Empire. Alternative ways have also been found from time to time to overcome obstacles to issuing interest-bearing loans. However, in an environment where interest is considered illegitimate and forbidden, partnership structures have been developed in which the investment risk is shared at various rates. Main elements of these are *mudaraba*, *mufavada* (*mufavaza*) and *inan*. New partnership structures have been created by bringing innovations to the listed partnerships over time (Pamuk 2003: 90–91).

9.3.1 *An Overview of the Types of Companies and Companies in Islamic Law*

The direct prohibition of interest-bearing loans and similar investment instruments in the religion of Islam has resulted in all sects focusing on company partnerships in detail. Perhaps the most powerful reason for the importance given to the issue of companies and types of companies is the disputes that occur between partners. The authority (usually kadis) to settle the dispute needs religious and sectarian jurisprudence. For this purpose, the fiqh scholars, who adopted the Hanafi, Hanbali, Shafii, and Maliki traditions, put forward sometimes similar and sometimes different provisions regarding company partnerships. It also seems that the denominations listed above group the types of companies differently (Kaan 2016: 21–22).

It is known that the dominant sect in the Ottoman Empire was Hanafi. However, other sects may request that the opinions of the scholars of their own sects be taken into dispute. At this point, while examining the types of companies in the Ottoman Empire, evaluations will be made mostly from the perspective of the Hanafi tradition (Erçin 2015: 18–19).

Companies in the Hanafi sect are divided into groups called “property company,” “contracting company,” and “ibaha company.” In addition to these three main types, an intermediate form, *amel-mal* (labor capital) companies, is also considered as a separate group. *Property* company arises from the inseparable mixing of objects (properties) for various reasons. Among these reasons, situations such as inheritance and purchase can be counted. An example can be given to a partnership company established due to inheritance as *izdırari* (mandatory) and an *ihitiyari* (voluntary) company established due to acquisition. In the contracting company, the partners have a contract stating that they are partners on capital and profit. Contracting companies are divided into two groups in terms of equal or unequal capital and profit. Of these two types, while there is the capital with absolute equality in *mufavada*, there is no equality in the type of *inan*. Whether it is equality or not, contracting companies can be established by focusing on their capital, labor, and reputation. A contracting company founded on capital is called a *commodity company*. If it is founded on labor, it is called a *deeds company*. If it is founded on reputation, it is called a *vücu* company. The *Ibaha* company is a partnership established in general goods that are accepted as belonging to all humanity. It is noted that such a partnership is unsuitable, and these goods belong to the acquirer, not the partners. On the other hand, there are *mudaraba* (*mukarada*), *muzaraa*, and *musakat* sub-company types in *amel-mal* (labor capital) companies. In *mudarebede*, one side reveals its labor, one side reveals its goods, and the profit is divided. In *müzaraa*, one party puts the land, and the other party puts forth its labor, and the resulting product is divided in determining proportions. In the *musakat*, one party gives its fruit-bearing garden while the other party takes care of the garden with its labor. The resulting fruits are divided into certain proportions (Kaan 2016: 21–44).

9.3.2 Preferred Partnership Structures in Entrepreneurship in the Ottoman Empire

As mentioned before, according to the definition of entrepreneurship in the Classical Age, there were many Muslim Turkish entrepreneurs who appealed to the domestic and foreign markets of the Ottoman Empire. It is not possible to know the number and distribution of these in light of the unearthed sources. As in the rest of the world in the Classical Age, not all entrepreneurial activities can be recorded in the Ottoman Empire. It is seen that entrepreneurial activities in the Ottoman Empire and the partnership structures preferred by these entrepreneurs can be understood from limited archive records (customs records, kadi books, i.e., shari'iyya records, ammunition books) (Şenyurt 2013: 201–214). For example, in a Shaykh al-Islam fatwa, it is stated that partners who set up a commodity company (commodity company) to trade fruit by putting capital must bear the losses in proportion to their capital (*Osmanlı Arşivinde Şeyhülislam Fetvaları* 2015: 47). Again, many economic records are found in partnership cases and sharia records (Duman 2007: 155–156).

In the examinations made on the basis of archive records (mainly the şer'iyye registers), it is seen that some types of companies are widely preferred in some professions. For example, ship masters and investors establish mostly *mudaraba* companies. It is reported that artisans, such as tailors, prefer more *amel* companies. In commercial activities, it is reported that other goods companies, especially the İnan company, are preferred (Gedikli 2018: 112).

In the Ottoman Empire, and even in all Islamic states established since the seventh and eighth centuries, *mudaraba* is the most preferred partnership of entrepreneurs. The entrepreneur who reveals his commercial, geographical knowledge, and labor and the investor who reveals his capital agree on profit according to the *mudaraba* method. It is seen that this profit is generally divided into $\frac{3}{4}$ for the investor and $\frac{1}{4}$ for the entrepreneur. The determination of these rates, which were agreed from the beginning of the partnership, was left to the entrepreneur and the investor, and no other coercion was made other than custom. In the event of a negative result of the activity, the loss is divided between the investor and the entrepreneur at the rates determined from the beginning. At this point, the biggest possible loss for the investor is due to the amount of capital invested. The loss of the entrepreneur is labor and time that have not turned into profit. The *mudaraba* system generally offers a wide range of freedoms to the entrepreneur. The investor can limit these freedoms if he wants to. But in the Classical Age, when communication was quite limited, it was more reasonable for the investor to free the entrepreneur. Since the entrepreneur can collect capital from many investors in *mudaraba*, in a sense, it is possible for the entrepreneur's probable earnings to be received by the investors in the form of shares. However, it cannot be said that this structure is a joint-stock company, as seen in Europe (Çizakça 2006: 681–683).

In the Classical Age, it is seen that some of the entrepreneurs in Anatolia and Rumelia preferred several types of companies together. It is even seen that some entrepreneurs take on the role of both entrepreneur and investor together. Abdülğani

Bey, who was a Liva-i Homs chief and a great merchant, can be given as an example. It is seen that Abdülgani Brain conducts entrepreneurship and investment together. The aforementioned gentleman establishes a large trade network and carries out the soft goods trade with his proxies in many cities, especially in Istanbul. This information is obtained from the sharia record on the distribution of the estate of Abdülgani Bey, who died in the war, among the heirs. As it can be understood from this record, Abdülgani Bey was making a large amount of trade with the *mudaraba* method. In the same period, another pilgrimage, Seydi b. Haji Hasan's wealth, is over one million akçe, and it is reported that a quarter of this wealth was obtained through different initiatives such as *mudaraba* and *mukataa* tax farming (Ergenç 1982: 116).

Apart from the partnerships listed above and mostly established between individuals, there are also partnerships established between institutions and entrepreneurs. It is reported that entrepreneurs who are looking for capital to conduct a commercial activity using their knowledge and labor are sometimes funded by money foundations. Although the emphasis is mainly on interest-bearing loans provided by money foundations, it is seen that these foundations provide capital to entrepreneurs by making company partnerships (Gedikli 2018: 121–122). The merchant named Hacı Abdi b. Sinan can be shown as an example of this situation. The aforementioned trader was complained to the kadı for using the foundation's money for a period ranging from 4–5 months to 1 year. The main reason for the complaint is the claim that the money foundation is deprived of any possible interest due to the capital used by the merchant (Ergenç 1982: 114–115).

The types of partnerships also differ depending on the entrepreneur and those who provide labor. There are also structures that resemble partnerships rather than wage-earning employee–employer relations. The most striking example that can be given to these is the *mukataba* agreement between the entrepreneur and his slave. Generally speaking, *mukataba* appears as an agreement stating that if the slave provides a certain amount of money, product, or labor in a certain period of time, he will be free entrepreneurs, on the other hand, demand *mukataba* practice more as labor or product. There are many *mukataba* agreements made by the entrepreneurs who have fabric and silk weaving looms in Bursa. As a result of these agreements, it is seen that the slaves first gained their freedom and then, supported by their former owners, they owned their own looms. From this point of view, it is seen that the *mukataba* method is a way that provides the transition from slavery to entrepreneurship (Sahillioğlu 1983: 221–229).

9.4 Discussion and Conclusion

In the Classical Age of the Ottoman Empire, it is seen that entrepreneurs benefited from interest and interest-free structures to provide capital. When interest-bearing loans provided by money foundations or loan sharks are excluded, it is seen that the remaining capital provision systems are based on a partnership. These partnerships, which are made by revealing goods, labor, knowledge, reputation, and even freedom,

foresee profit and loss sharing between the two parties at varying rates. It is seen that these partnership structures set an example for European traders in the Classical Age and later on and were even developed and adopted by the entrepreneurs and investors of the twenty-first century (Gedikli 2018: 64–72).

The company structure, which was established by labor-capital cooperation, known as *mudaraba* or *mukarada* in the Islamic tradition, was frequently preferred by Muslim Turkish entrepreneurs in the Ottoman Empire. It is even claimed that the system known as “*commenda*” in Europe since the tenth century was learned from Muslims. Today, we see a similar structure to the *mudaraba* structure between entrepreneurs/start-ups and venture capital. The relationship that was previously established as labor capital today appears as patent capital, business idea/business model capital (Döndüren 2008: 10–11).

In light of the documents created in the Classical Age and the data in these documents, entrepreneurship in the Ottoman Empire is slowly beginning to be understood. Based on this information, it turns out that the idea that there was no entrepreneurial class in the Ottoman Empire or that it was predominantly in the hands of non-Muslims was wrong. It is seen that Muslim Turkish traders, who were in a dominant position in the domestic market and the Black Sea in the Classical Age, competed with European traders in the Mediterranean until the end of the eighteenth century. However, due to the capitulations, foreign traders gained important privileges, especially in the Mediterranean, over time and surpassed Muslim Turkish traders (Mantran 1987: 163–164).

As a result, it is thought that entrepreneurship in the Classical Age of the Ottoman Empire and the partnership structures preferred by entrepreneurs can shed light on the present. It is seen that there are structures that can be adapted to the present in the creation of financing resources other than interest-bearing loans for the financing of business ideas of entrepreneurs and start-ups. It is thought that the development of models suitable for the national and regional entrepreneurship culture will contribute more to the entrepreneurship climate instead of the financing models that are taken from other cultures and tried to be adapted.

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Chapter 10

Historical Development of Business Economics: Bulgarian Case



Nikolay Sterev and Pencho Penchev

Abstract The understanding of the economic development always is based on the knowledge how the economic elements have been appearing through the human society lifecycle. Thus, the contemporary worldwide economy is result of everything that had happened in the society before. Therefore, the understanding historical development of the contemporary business economics could give a slight view of what is the next evolutionary step of its development: Industry 5.0 And something more, despite different business law basics as well as different social and politic systems, the business economics has been built to have an exact path of its growth and maturity as the enterprise: the cell of contemporary business economic, is constructed to be stable social and economic structure. The only difference is the time! So, we use Bulgarian history of business economics as a special case to answer of three questions:

- 1) What is current state of the business theory?
- 2) How did it become like this?
- 3) What is the next evolutionary step of development the theory and practice of business economics?

The structure of the chapter that follows the given answers is: Introduction: presentation of the main business law that makes the enterprise a stable micro-structure of the business economics; (1) History of business economics: summarizes main keystones of development of the enterprises and business economics starting from the ancient times through middle ages and nowadays; (2) Lifecycle of Bulgarian business economics: starting from the national liberation in nineteenth century, the history of establishment of the major Bulgarian business is presented. We divided the history development on three stages that cover main three social and political changes in Bulgarian that boosted the change of business economics from Industry

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1.0 to Industry 3.5; (3) The Industry development on focus: we cover the main pit stops of the Bulgarian business economics based on the world one as well as we discover that should be the next step of it worldwide and national (resp. Bulgarian) development; Conclusions: summary of our findings is presented.

Keywords Business economics • History of business economics • Enterprise • From Industry 1.0 to Industry 5.0 • Bulgarian business history

10.1 Introduction

Understanding history of business economics could help to make visions about the future enterprise development. Although the economy /resp. trade/ is as old as the modern human society, it has been ruled by different laws from ancient times till nowadays. Thus, the business economics reflects the societal and political changes hand by hand with the evolution of technologies. In these terms, it is very important to answer of three questions: (1) What is current state of the business theory? (2) How did it become like this? And (3) What is the next evolutionary step of development the theory and practice of business economics? The answers will reveal the ground base of the contemporary economic system: enterprise. As the enterprise is the cell of contemporary economic, it is constructed to be stable social and economic structure. Its base is the profit and business economics development shows how it has become more and more effective from the very beginning till nowadays. As the business opportunity grows up, then the entrepreneurial economics started to enlarge the businesses. The same business economics cycle put in the ground of enterprise in past is valid today:

Added value/Business profit/ = sells /prise/ - inputs /costs/ (Formula 1)

So, the enterprises have been pushed up to increase sells /prices/ and/or to reduce inputs /cost/. In that point of view, we found that the evolution of the business economics follows just one rule of substitution:

If an input /costs/ becomes expensive than it is exchanged with cheaper one.

This knowledge is put on the business economics researches from the beginning of twentieth century till nowadays in political economics, entrepreneurial economics, theory for growth and development, etc. But, business economics has found of a “hidden” break—society. So, as the society has been “born” the business economics, then it has the power to demolish it!

In addition, business is not equally spread or developed all over the world, so it is interesting how one developing country, for example: Bulgaria, has performed changes in within the business economics society. Although political and societal changes, the economic rules look like universal and regional economics, beside their social and political fluctuations, follow one and the same business economics river.

10.2 Establishment of Contemporary Business Economic

The history of business from ancient Europe to the modern trade law.

Analyzing the development of business economics and its foundations brings out the thesis that the business economics changes always are predicted. We just need to understand the main milestones of its growth—like a human being: from the birth to the death. As the business economics is artificial social structure, it has been “made” in human image and likeness. So, it has its establishment in sixteenth-eighteenth century, its teen-age onrush in nineteenth and beginning of twentieth century, its youth fast growth in twentieth century, and the beginning of maturity in the beginning of twenty-first century.

Additionally, the knowledge of business economics’ theories development could help to the explanation of so-called industrial revolutions.

But how does it take time in brief.

The business economics has been appeared as a theoretical concept that research the functions and organization of any single enterprise in the beginning of twentieth century. Nevertheless, the social and economic institution “enterprise” has been established centuries before.

The ground of the contemporary enterprise is the household economics. As the Aristotle defines the economics (oikonomie/oikos) as an art of the economic activity of the household (see: *E. Szanto. Die wirtschaftslehre Ristoteles; Handwörterbuch der Staatswissenschaften I. Band 1909*), the main activities of the household (oikos) are set as: productivity activities and consumption activities. In that meaning, the main principle of household economics is to get needed purchasing goods in most effective way (see. Formula 1).

In the next centuries, the basics of economic theory are focused on the household and how to get more agriculture production within the limitation of household land. Following that, we could find enough reasons for the ancient wars for new land exploration, including exploration the North America in eighteenth and nineteenth centuries.

The first attempts for shift from household economy to the business economy could be found in fifteenth and sixteenth centuries in Venice. Looking to keep the trade knowledge of the Venetian Trade Union, the efficiency of the trade is explained with the personality of the trader /resp. household head/ and its accounting and managerial skill (*Benetto Cotragli, 1573, “Deila Merkatura et del Mercante Parfeto”*).

Few handbooks for self-education of young traders (*Jaqaes Savary, 1675, „Le parfait negociant”, Cantillon, 1755, Essai sur la nature du commerce en general, Paris*) have appeared in seventeenth century. And the maturity of the trade science is defined in eighteenth and begging of nineteenth century when we found finalizing the trade knowledge as the best practice of the household economy (*G. G. Ladovici, Vollständiges Kaafmannslexicon, 1752—1756; J. H. Jang, Das gemeinnützige Lehr bach der Handelswissenschaften, Leipzig 1785, J. M. Leachs, Das System des Handels, 1806—1822*) (see. Seyffert, Betriebswirtschaftslehre, ihre Geschichte 1928).

The establishment of the “social structure” of the single enterprise as an attempt to diverse the household economics form business economics is found in the late nineteenth century. It is found that the very first definition of business enterprise is given by A. Lindwurm (*Handelsbetriebslehre und die Entwicklung des Welthandels* 1869) where he defines the entrepreneurial profit of the economic-trade activity (see. Formula 1). It covers the function not just the agriculture households, but trade companies and craftsman households (*Courcell Seneul, „Manuel des affaires, ou trait e theorique pratique des entreprises industrielle, commerciales et agricoles, Paris 1856*). In the UK, Alfred Marshall defines “modern principles” of the Economics of Industry as institutionalize as enterprise as well as entrepreneurs in the competition market economy (Marshall, A., 1961, *Principles of Economics*, 9th edition, London: Macmillan).

The final understanding of business economics has been found in the beginning of twentieth century as the business economics science covers not just the single enterprise but a bundle of enterprises the compete each other's on the market. Thus, the enterprise is not isolated social and economic structure, but it is a part of the bigger economic structure as regional on national (politic) economics. In this meaning, the role of the business entrepreneur and its profit purchase differs from the household or societal needs (*E Schmalenbach—Selbstkostenrechnung 1923, Nicklisch Wirtschaftliche Betriebslehre 1922, J. Stephenson The principles of business economics; J. H. Jones, Economics of private enterprise; L. A. Rufener, Principles of economics, 1935*).

The next step of business economics development is found in diversity of rationality research for management and organization of the single enterprise. The business economics understanding nowadays is based on the fundamental books of: H. Devenport, *Economics of Enterprise*. 1924; R. W. Taylor, *Principles of Sciantific Menagement*, 1911; S. Oliver, *The Philosophie of Menagement*, 1923; H. Fayol, *Administration industrielle et generale* 1925, and others.

Nevertheless, the role of the enterprise's founder—the entrepreneur becomes important with the development of social sciences in the mid-1950s. Looking back to the business owner after a century of institutional understanding of business economics is based on analysis of factors causing industrial revolution (Wilson 1955; McKendrick 1959; Schumpeter 1947) (see. Geoffrey Jones and R. Daniel Wadhvani, *Entrepreneurship and Business History: Renewing the Research Agenda*, 2006, <https://www.hbs.edu/ris/Publication%20Files/07-007.pdf>).

The previous period ended in the mid-1960s when the role of professional entrepreneurs—managers takes the core place of the economic researches. At that time “bigger means good”. There are a lot of “good business” practices within the economy and organization of business that explain the success of corporations. Chandler, Alfred D., Amatori, Franco and Hikono, Takashi (1997), *Big Business and the Wealth of Nations*. (Cambridge; New York: Cambridge University Press). Chandler, Alfred D. (1990), *Scale and Scope: The Dynamics of Industrial Capitalism* (See. *The Belknap Press of Harvard University Press*). The business economics volume increase is explained by Chandler as result of scaling and scoping the production: the core mechanisms of “competitive managerial capitalism /competitive market

economy – a.n./” (in USA) as well as of “cooperative managerial capitalism/social market economy – a.n.” (in Germany) and “personal capitalism” (in Britain) (Richard B. Du Boff, 2015, *Scale and Scope. The Dynamics of Industrial Capitalism* by Alfred D. Chandler, Jr., Pages 61–64).

Next step of business economics development is found within the economic history development in 1990s—the era of innovative enterprises. As the scale process within the “competitive managerial capitalism” found its peak, once again the role of the entrepreneur becomes more significant at the business economics theories. Based on the Porter’s competition models (Porter M.E., 1990, *The Competitive Advantage of Nations*, Drucker, P. F., 1985, *Innovation and Entrepreneurship; Practice and Principles*, New York: Harper and Row.), the economic development is possible on the innovative added value development: the role of external and internal entrepreneurs. Something more, the process of development “entrepreneurs” is found within the European strategic documents (Lisbon Strategy, https://www.europarl.europa.eu/meetdocs/2009_2014/documents/empl/dv/lisbonstrategybn_/lisbonstrategybn_en.pdf).

The rebirth of the entrepreneurs is defined as results of Corporate Downsizing that “triggered cries of betrayal and lack of social conscience on the part of the large corporations”. In these terms, the social aspects (not just at social market economy countries) of business economy have revealed in the beginning of 2000s. As Lazonic (2003) stated: the innovative enterprises effectively use the collective character of innovation and transformation process. (See. Gartner, W. B., 1989, “‘Who is an Entrepreneur?’ is the Wrong Question”, *Entrepreneurship Theory and Practice* 13, 47–68; Audretsch, D. B. and A. R. Thurik, 1999, ‘Capitalism and Democracy in the 21st Century: From the Managed to the Entrepreneurial Economy’, *Journal of Evolutionary Economics*; Sander Wennekers and Roy Thurik, *Linking Entrepreneurship and Economic Growth*, *Small Business Economics* 13: 27–55, 1999).

Summarizing the evolution of the business economics foundations, we could point main stages as follows /Fig. 10.1:

- **Wealth viewpoint:** This is a **classical viewpoint** that was given by Adam Smith: the main purpose of all economic activities is to gain **maximum wealth as possible**.



Fig. 10.1 Development of theories on business economics (Source Based on Pratibha Bagga 2016, Business Economics, NMIMS Global Access)

- **Welfare viewpoint:** It is a **neo-classical viewpoint** that was given by Alfred Marshall: “Economics is a study of man in the ordinary business of life. It enquires how he gets his income and how he uses it. Thus, it is on the one side, the study of wealth and on the other and more important side, a part of the study of man”.
- **Scarcity viewpoint:** It is a **pre-Keynesian thought** that was given by Lionel Robins (1932): “Economics is a science which studies human behavior as a relationship between ends and scarce means which have alternative uses”.
- **Growth viewpoint:** This is the **modern perspective** of economics mainly given by Paul Samuelson (2006): “Economics is a study of how men and society choose with or without the use of money, to employ scarce productive uses resource which could have alternative uses, to produce various commodities over time and distribute them for consumption, now and in the future among the various people and groups of society”.
- **Entrepreneurial viewpoint:** This is the latest perspective of economics development given by Glancey and McQuaid (2000): “Entrepreneurial Economics is concerned with the role of entrepreneurs, and the nature and scope of entrepreneurship in the economy” that linked number of entrepreneurs to the economic development.

10.3 Lifecycle of Bulgarian Enterprises/Companies/

The Bulgarian business /industrial/ economics practice does not differ from the main leading worldwide theories. Nevertheless, the political and social conditions in Bulgaria from sixteenth to the twenty-first century define rather different histories of Bulgarian business economics.

According to the literature preview, it could be divided on four periods.

a. Bulgarian business economic form past to common trades

The appearance of the first Bulgarian commercial companies /by ownership/ can tentatively be dated to the second half of the sixteenth and in the seventeenth centuries. It is the result of the activity of commercial companies from Dubrovnik on the Bulgarian lands. Thus, in 1567, Bulgarians from Razgrad formed a company together with two people from Dubrovnik for the export of ox hides to Dubrovnik. All the initial capitals for the purchase of skins for the joint venture belong to the Bulgarians, and their Dubrovnik partners participate in the division of transport costs. Their role is important for the sale of the goods in Dubrovnik and for its further export to Italy. The profit is divided equally between the partners. The company existed for about a year, and after the successful implementation of the export operation, it was liquidated in 1568 (Spisarevska 1998: 237–243). Other similar companies are also registered, which were involved in the commercial activity of Dubrovnik in the Balkans in the second half of the sixteenth century.

In the seventeenth and eighteenth centuries, Dubrovnik’s Balkan trade gradually declined. A Balkan trade colony was also formed in the Ukrainian city of

Nezhin. All Orthodox merchants—Greeks, Bulgarians and Serbs—get the general name “Greeks” there. The Bulgarian “non-Greeks” created commercial companies to organize their activities. The earliest information about such dates back to the first half of the eighteenth century. Close relatives (father, brothers, sons, etc.) are most often involved in their establishment, and most of them are short-term and are organized to carry out specific transactions (Mitev 1996: 76–77). The economic ties between Central Europe and the Ottoman provinces on the Balkans became more and more intense. In the seventeenth and eighteenth centuries, Bulgarian trading companies were established in the cities of Brasov and Sibiu /modern Romania/. Their researchers point to the presence of two types of commercial companies: those established to carry out a single commercial transaction and companies with a longer duration and a more complicated structure (Panova 1980: 89–91).

In the eighteenth to the beginning of the nineteenth century, 23 trading companies of Bulgarians were established, which traded along the Danube—Transylvania—Austria route (Rusev 2015: 304–306). The main goods exported from the Bulgarian provinces of the Ottoman Empire were wool and cotton, while the imports consisted of luxury goods and coins. It is remarkable that toward the end of the eighteenth century, the companies involved in the trade exchange with Austria acquired the characteristics of limited liability companies. This is taken as a sign of the increased material capabilities of Bulgarian merchants (Panova 1996: 217–218).

At the end of the eighteenth century, the first larger Bulgarian companies with their headquarters in Bulgarian lands appeared. The founder of one of them is the entrepreneur Hristo Rachkov from Gabrovo. He organized a wide commercial network for the purchase and export of Bulgarian products north of the Danube. Local merchants from Kazanlak, Tarnovo, Dryanovo, Lovech, Sliven, Sevlievo, Ruse, etc., as well as Gabrovo merchants who are settled in Russia, in Romania /Bucharest/, etc., are attracted to this network. It is news that Hristo Rachkov exports not only traditional products such as flour, pastrami, pastrami, skins, etc., but also products such as silk and rose oil. These works are relatively new in the production structure of the Bulgarian economy and began to find a place in the export lists from the Bulgarian lands in the second half of the eighteenth century (Tsonchev 1929: 596–629).

An important innovation for the Bulgarian business practice, which should be noted, is that Rachkov does not act as an independent trader, but organizes his production and commercial activities primarily on a partnership basis. Partnership relations are regulated by commercial contracts. The most commonly practiced form of association is called “*na ortak*”. Specialists identify this type of association with a general partnership, where the partners are jointly engaged in an activity with labor and capital participation (Rusev 2015: 311).

In the first half of the nineteenth century, a period of tangible modernization began in the Ottoman Empire. It also affects the legal basis for the establishment and functioning of various companies. The most important in this regard is the entry into force in 1850 of the Ottoman Commercial Law, which was borrowed almost literally from the French “Code de Commerce” of 1807. It regulated a number of novelties for the economic practice of the empire such as commercial companies, interest (Rusev 2015: 341).

During the years until the Liberation of Bulgaria, the commercial and legal matter of the empire was supplemented by other normative acts. The economic progress in the Bulgarian lands from the middle of the nineteenth century is illustrated by the establishment of numerous successful companies with a different profile of activity. In 1849, the first large company dealing with banking operations was established in Sliven. Shareholders in the company are wealthy local merchants, and with minor interruptions, the company has been operating successfully for almost 20 years. Its liquidation is due to the competition it has experienced since the creation of the General Funds, which grant loans at lower interest rates (Rusev 1996: 211–219).

Most of the successful companies are commercial and deal with the export of agricultural, livestock, and handicraft products from the Bulgarian lands. Close relatives continue to participate in many of the companies, and the most successful of them realize enviable profits. Thus, the available documentation shows that for the period from 1855 to 1875, the average annual profit of the Sliven company “R. V. Mirkovic and company” is 28.83% (Rusev 1996: 63–65). Printing, banking, and industrial companies were formed. Not all are successful. In 1862, a subscription was launched for the sale of shares in the Bulgarian Commercial Steamship Company “Providenia”. The company intended to engage in maritime trade and purchased a steamship from England on credit, but due to the lack of experience in this business, the venture ended without success (Bochev 1998: 270–280). Similar is the fate of the joint-stock company planned by Ivan Bogorov to open a cotton textile factory in Plovdiv.

b. Bulgarian business economic from scratch in nineteenth century to contemporary corporations

After the restoration of the independent Bulgarian state in 1878, the conditions in which Bulgarian enterprises were created and operated changed compared to the period when the Bulgarian lands were part of the Ottoman Empire. Laws are passed in the Bulgarian parliament guaranteeing the inviolability of private property, a relatively modern system of public finance is being built, industry is encouraged, government contracts and concessions guarantee a secure market for the insufficiently strengthened Bulgarian companies, etc.

Of particular importance is the adoption of the Commercial Law in 1897. It is based on provisions from the Hungarian and Romanian Commercial Law. The law regulates the possibility of creating two types of companies: collective and joint-stock. The establishment of joint-stock companies in the country is relatively limited and is not devoid of speculative actions. Thus, toward the end of the First World War (1914–1918), the capital Sofia was gripped by speculative fever. Stoyan Bochev, a contemporary of the events, wrote that “there were lucky and unscrupulous people who founded companies to sell shares. We ourselves observed in 1917 and 1918 subscriptions where the public scrambled ... to hurt themselves to subscribe for shares. It was a special state of mind that relied on large incomes through new enterprises and on ... a difference in the share price” (Bochev 1998: 338–339). Only in 1924 a special law of limited liability companies was passed (Andreev 1993: 133–134).

The Bulgarian government is trying to speed up the industrialization of the country by adopting encouraging legislation. For the period from 1894 to 1928, four laws for the promotion of local industry were voted and entered into force in the country. With them, industrial entrepreneurs are given tax breaks, reductions in import duties, reliefs in railway tariffs, etc. After the onset of the Great Depression in 1929, stimulus legislation in favor of industry took a back seat. Some sectors of the local industry are declared saturated and the opening of new enterprises is restricted there, and the remaining industry in the country is protected mostly in the form of customs protectionism (Parvanova 2021: 296–302; Dimitrov 2014: 185–204).

The incentive legislation creates “greenhouse” conditions for the Bulgarian industry. Local industrial enterprises find it difficult to compete in international markets. However, it should be noted that the most emblematic industrial enterprises such as sugar factories, mills, breweries appear and function thanks to state encouragement. The same applies to the cement production enterprises—“Zlatna Panega” and “Granitoid”, the two largest mining enterprises—the state-owned “Mini Pernik” and the private (with French investments) mine “Plakalnitsa” and others.

One of the dynamic industrial sectors before the First World War was the woolen textile industry. After 1878, modern factories were founded in Gabrovo, Sliven, Kazanlak, Tryavna, etc., but by the end of the nineteenth century, this sector was in a state of decline. From approximately 1902 until the outbreak of the First Balkan War (1912–1913), the Bulgarian woolen textile industry recovered and demonstrated growth. During this period, it emerged as a modern and relatively well-organized business with a return on invested capital for the first decade of the twentieth century of over 11%. Information about the management of the main woolen textile enterprises during these years is relatively limited, but in general, then the management of the enterprises passed into the hands of the so-called second generation entrepreneurs—usually sons and other close relatives of the founders, but with a specialized university economic or technical education, with wider knowledge of their modern methods of production and management (Ivanov 2021: 115–116, 187–189).

After the First World War, several tobacco companies became a significant economic factor. One of them is the Plovdiv “Kutsooglu Brothers and Sons”. From 1919 to 1923, representatives of this company purchased annually about 5 million kilograms of leaf tobacco, which were placed on the German market. Due to the poor tobacco harvest, in 1924 the company moved to Turkey, from where it also bought and exported about 5–6 million kilograms of tobacco per year. The Turkish state facilitates the company’s activities, because through it the Turkish tobacco market in Europe is restored. An important role in tobacco exports is played by the joint-stock company “Orienttabako”, founded by Krum Chaprashikov. The Italian bank “Commerciale” also participates in it with its own capital. Druzhestvoti buys tobacco from the region of Dupnitsa, Gorna Jumaya, Haskovo, etc., but also from Turkey. Their exports are mainly aimed at Poland. However, the company is registered in Switzerland (Lugano) in order to avoid heavy taxation in Bulgaria, which hinders the development of Bulgarian companies (Palaveev 2013: 57–59).

In the newly established Bulgarian state, there are specifics that slow down the emergence and development of modern companies. The Bulgarian intelligentsia has

limited experience and knowledge of the functioning of international markets, of the organizational structure and technical features of various industrial enterprises. The local Bulgarian market is limited both from the point of view of available capital and from the point of view of the demand for industrial works. The administration in the Bulgarian state is growing too fast. It offers young people secure and well-paid work, and private business, which is associated with risks, turns out to be unattractive (Geshov 1886: 118–133; Načovič 1902: 147–196).

The rapid increase of the state apparatus puts business development in a dependent position and becomes a source of corruption. It affects the first more significant business initiatives in the country. An early case of direct corruption was revealed by Konstantin Irecek. In 1881, the Frenchman Hippolyte Bergier obtained the first industrial concession in the country for the construction of a distillery near Sofia. The total capital of the enterprise is the not small amount for Bulgaria of 1 million gold francs. Of these, 250,000 was brought in by the Bulgarian Ivan Hadjienov and the rest by French investors. A quarter of the enterprise's capital was distributed as bribes to ministers (Ireček 1899: 360).

Some of the large Bulgarian joint-stock companies established at the end of the nineteenth century have a close relationship with the then existing political parties. The executives in the companies are relatives of leading figures in political life or sometimes directly participate in it as deputies, ministers, etc. Girdap—the first private bank founded in Bulgaria after 1878—was in close political and business relations with the influential pro-Western People's Liberal Party. Prominent figures from this political force are directly involved in its management. Perhaps, the most telling example of such close ties between business and politics is the Bulgarian Commercial Bank established in January 1895 in Ruse. Its founders are close to the then ruling People's Party. Party protections play a positive role in the initial raising of capital, but they create suspicions of corruption in society (Ivanov 2010: 27–37; Avramov 2007: 149–151).

Bulgarian companies and entrepreneurs during the period of the so-called first Bulgarian capitalism (1878–1944) worked in conditions of a specific business culture. In the *Journal of the Bulgarian Economic Society* (1899) Iv. Tsonev published a list of the most typical abuses that occur when setting up joint-stock companies in the country. In the statutes of the companies, it is stipulated that the members of their boards receive, in addition to a salary, a certain percentage of their profit. Accounting fraud is common, which allows a falsely positive picture of the state of the joint-stock company to be presented, and thus, the trustees distribute large sums of money among themselves. In case of positive results of the activities of the joint-stock company, the price of its shares increases, which gives the opportunity to those familiar with the true state to sell their shares at a significant profit. In practice, the Management Boards drain the joint-stock companies by concentrating the “profits” in their hands and leaving the losses for the ordinary shareholders (Tsonev 1899: 186–190).

Some of the savings companies function in a similar way. Unlike joint-stock companies, these companies, at least officially, set a noble goal—mutual support of members and limiting the influence of moneylenders. Good intentions do not equal good results. In the more remote parts of Bulgaria, where the level of literacy is

lower and the population is dependent on the local leaders, the boards of the savings societies misuse their funds for their own benefit and commit various frauds. The draining of their funds led to the bankruptcy of some of them—in Belovo, Stanimuka (now Asenovgrad), the village of Chervena Voda, etc. (Karadzhov 1899: 166).

According to the provisions of the Law on Agricultural Funds of 1893, the establishment of rural funds in the municipalities of the country is foreseen, on the model of the German Raiffeisen funds. A few years after the entry into force of this normative act, the manager of the cash registers Manushov stated that the establishment of such cash registers was impossible. The reason, according to him, is directly related to the problem of honesty—“absolutely not a single decent person can be found in the villages to head the association” (Načović 1902: 214).

Another aspect of similar practices in the economic culture of free Bulgaria is revealed by the observations of foreigners who are quite well acquainted with the details of the functioning of the economic system. The first observation was made by the representative in Bulgaria of the holders of bonds from the Bulgarian government loans, Georges Bousquet. In December 1910, he wrote to the French chargé d'affaires in Sofia: “...everyone who has dealt with transactions in Bulgaria is forced to admit that the idea of a contract and the power of formal conventions has entered the mentality too superficially” (Bulgarian national bank 1999, item II: 527).

Two decades later, in 1930, the French minister plenipotentiary in Sofia, A. Cambon, reported to the foreign minister of his country about the intention of the Bulgarian government to put tax receipts into circulation. Cambon notes that the country's peasants have no intention of paying off their tax arrears. According to him, the concept of legality among Bulgarians is too superficial (Balgarska narodna banka 2004, item IV: 308). The two opinions of foreign observers can also be reduced to the not particularly sincere acceptance and honest observance of assumed obligations by various economic entities.

c. Bulgarian business economic from agribusiness to the high technologies.

On September 9, 1944, after a coup in Bulgaria, a government of the Patriotic Front coalition was formed, headed by K. Georgiev. Within the next few years, a left-wing one-party dictatorship was established in the country.

The monopoly on power was acquired by the Bulgarian Communist Party. Political change leads to a radical transformation of economic structures. The USSR served as a model for the changes. Private property and market mechanisms are abolished or severely limited. Strategic economic decisions become the work of the higher party bodies. Through central planning, the party-state allocates resources and directs economic development according to its own vision of building an industrial society. Within the framework of the centrally planned economy, with the practical absence of private property and market, classical entrepreneurship has been liquidated in Bulgaria for a long period. However, conditions for certain manifestations of entrepreneurship are preserved.

It is extremely important to understand the attitude of the socialist regime toward entrepreneurship to outline the basic principles of its ideology. The most important element of the official ideology consists in the belief that socialism is a superior

socio-economic system to capitalism, and as such it is called upon to save humanity from poverty, inequality, and other social ills. This belief is combined with the view that capitalism (the market economy) has passed the stage where it contributed to the progress of society and is showing many signs of decay and decline. The application of this general idea to economics states that socialism eliminates the errors caused by the anarchy of the market by abolishing private ownership of the means of production, which allows for rational planning.

It should make it possible to eliminate crises of overproduction, to eliminate unemployment, to cut unnecessary advertising costs, to eliminate competition that leads to the bankruptcy of many producers, to the duplication of administrative costs, etc. The official ideology further preaches that since under socialism workers are not exploited by owners but work for themselves, they will work more conscientiously and enthusiastically, which in turn will reduce the cost of control over the workers themselves. In this sense, the enthusiasm and conscience of the workers should replace some of the functions performed by the entrepreneurs. Last but not least, it should be noted that socialism is presented as a purer, nobler, and more ethical system that ensures social justice (Ostrovityanov et al. 1954).

The nationalization of the main branches of the economy is of key importance for the consolidation of the Stalinist economic model. The offensive against private property in various forms began as early as the autumn of 1944. The property of those convicted by the People's Court (created to try the rulers guilty of involving Bulgaria in the Second World War on the side of Hitler's Germany) was confiscated or property for which believed to have been acquired by speculative activity.

In 1946, the insurance business was nationalized, and the following year, a state monopoly on foreign trade was established. The state share in the economy is expanding through the creation of large state enterprises such as "State Saltworks", "State Forests". The logical end of this process was the adoption of laws on the nationalization of industrial enterprises, mines, and banks in December 1947. In the following two years, about 7000 enterprises, most of them small, were nationalized. With the practical realization of the nationalization of private entrepreneurship in all the main sectors of the economy outside of agriculture, it has come to an end.

Deep changes took place in agriculture, private land ownership was limited, and at first, a process of creation of collective farms began slowly. In 1948, collectivization in agriculture became mass. Laws actually nationalize a large agricultural equipment, and private leases are abolished. The most important means that force the villagers to enter the TKZS (*Trudovo Kooperativn Zemedelsko Stopanstvo*—an agricultural unit of a Soviet type) is the system of compulsory state supplies. With it, a large part of the production of private farms is seized by the state and paid at negligible prices. By force, many rural households are deprived of even their means of subsistence. Some are forced to buy grain, milk, etc., to pass on government supplies. The so-called kulaks or wealthy peasants are under particular pressure. As a result of the enormous state pressure in the fall of 1950, collectivization accelerated. By the end of 1951, it covered 52% of rural households and just over 60% of cultivated land. Forced collectivization was temporarily halted on Stalin's express advice. From 1956 to 1959, the second wave of collectivization took place. After its completion, 95% of

rural households enter the TKZS. Collectivization and the introduction of machinery did not improve efficiency in agricultural production. In 1953, when harvesting with combines, 10% of the wheat was scattered.

Since the end of the 1950s, industry has been increasingly important in determining the shape of the Bulgarian economy. By 1960, the volume of industrial production in the country had increased six times compared to 1948. Solid production capacities were put into operation in the fields of metallurgy, electricity production, mechanical engineering, and the chemical industry. However, industrial enterprises are built without the availability of sufficient local materials for processing and without taking into account insufficient energy sources. The general industrial production often is not coordinated appropriately with Bulgarian and CIS-countries markets, no in-depth studies are made on the possible revenues and expenses. A typical example of the ways in which it is carried out and of the shortcomings of socialist industrialization is the “Kremikovtsi” Metallurgical Combine. Even before it was put into operation, reasoned opinions were expressed that the local ore in the area was insufficient, that expensive imports from the USSR would be necessary, that the number of workers would be too large, etc. All these mean that the production of the combine is emerging as too expensive. Since the technical equipment for the combine is from the Soviet Union, the enterprise was built because a possible refusal would be perceived as an unscrupulous position. As a result, from the very beginning, the combine accumulated losses, which were covered by state subsidies. State subsidies are also directed to many other loss-making industries. In the centrally planned economy of the socialist type, it is considered unthinkable to allow bankruptcies (Penchev 2019).

At the beginning of the 1960s, the rates of economic growth in socialist Bulgaria visibly slowed down. A number of organizational problems of enterprises in the various sectors of the economy also become apparent. Both Bulgarian party leaders and economists report the existence of serious shortcomings of the adopted economic model—lack of material interest among workers to produce more and better-quality production, deficits, stagnant production, a large amount of unfinished construction, accumulation of large stocks in enterprises, non-compliance with contractual obligations, poor efficiency of new investments, lack of connection between pay and work results, etc., under (see for example: Davidov 1956; Bonev 1968: 94–95; Petrov 1969: 129). This necessitates an attempt to introduce market reforms. Their main meaning is to give individual enterprises greater autonomy and to make workers and management responsible for profits or losses. After the suppression of the Prague Spring in 1968, the enthusiasm for market reforms in the Bulgarian economy gradually subsided.

From about the mid-1980s, a second attempt was made at market reforms to force socialist enterprises to be more efficient, less bureaucratized, etc. The end of the reformed “enthusiasm” in the conditions of the socialist regime was the decree for the introduction of company organization and especially the famous Decree N56 of January 1989. In it, with many conditions, the creation of private companies of citizens and companies with foreign participation was permitted. The state ensures that “Prices of goods and services are established in accordance with international

market prices and domestic supply and demand". Even at the textual level, the decree seems radical: the word market and its derivatives are mentioned 9 times.

The reforms are half-hearted and belated and fail to even mitigate the effects of the crisis. To a certain extent, they facilitate the outflow of capital from state-owned companies to private individuals and the enrichment of the communist nomenclature (so-called hidden privatization). The final chord in the agony of the socialist economic model was the moratorium on foreign debt payments announced in March 1990. Thus, the third debt crisis in socialist Bulgaria ended with bankruptcy and the de facto collapse of the Soviet economic model.

10.4 Contemporary Business Economics and Its Future

Although the difference of the business economics history in Bulgaria in comparison with British economy, USA or German economy, we could outline one and the same spotting lines that make the history analysis much clearer.

In these terms, the global economic history and the industry development are two sides of one and the same medal. As we explained above, the economic theories summarized the main changes of the economic /industrial/ system and gave the explanation of the main factors of the change. We could find one and the same forces that affect the explained history of Bulgarian business economics.

Thus, comparison between Bulgarian and Worldwide business economics' development two major definitions need to be explained:

- **Industry:** any business, trade, undertaking, manufacture or calling employers and includes any calling, employment, handicraft or industrial occupation or avocation of workmen (D. W. Wadegaonkar, *CONCEPT OF INDUSTRY*, *Journal of the Indian Law Institute*, Vol. 23, No. 3 (July–September 1981), pp. 400–420)
- **Industrial revolution:** period of rapid change that is transforming the economic and social structure. During the Industrial Revolution, technological changes are introduced that affect fundamentals of working and living and forced up fundamental social transformations.

The next paragraph explains already defined industrial revolutions and their effect on the Bulgarian industry, economy, and development.

a. *Development of industry from Industry 1.0 to Industry 4.0 and Industry 5.0*

The main pillars within the industrial development could be found by analyzing the major changes of the industrial practices defined as industrial revolution(s). Thus, the key points used in the assessment of the industry development are related to the change (or rather revolutionary) of the methods, approaches, or tools for the establishment and/or operation of the industrial business and/or industrial sub-sectors.

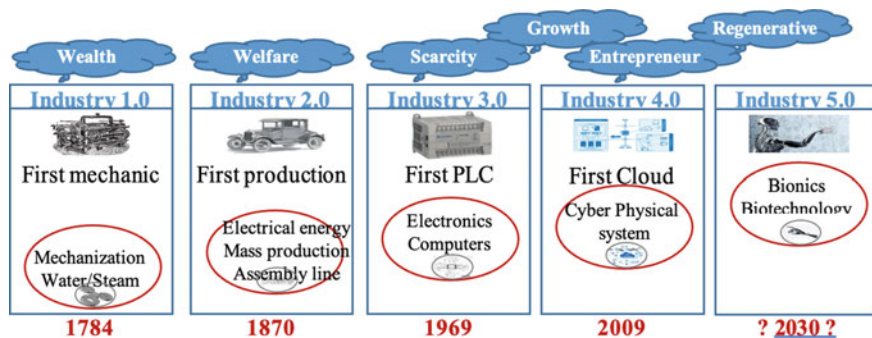


Fig. 10.2 Industry Revolution stages (Source Modification of T&A [Taskforce & Advisor Sàrl], <https://www.ta-ad.biz/en/tindutrie-4-0>)

On this basis, “key” events can be highlighted, leading to a change in the development of industrial production. An example is the creation of a worldwide network—the Internet, which is currently changing the industry and its manufacturing and management-organizational processes from the inside out.

On this basis, five (resp. four past and one upcoming) major “industrial revolutions” can be identified, leading to change throughout the world industry (Fig. 10.2).

Analyzing the main characteristics of any change in industrial production, related to the “revolutionary” changes in the industry and the interrelations between the basic production and organizational–managerial factors, we can summarize the five evolutionary stages in the development of the business economics, named “Industry x.0” or “Industry Revolution x”.

- **Industry 1.0: First Industrial Revolution**, related to the mechanization of labor and the introduction of wind, water and steam (steam engine) into production technologies. It is based on the first business theories that differ household economics from business economics. The industry that has benefited mostly from the change of production is textile industry.
 - o The Bulgarian industry began to develop in the first half of the nineteenth century with establishment of the very first industrial factory in Bulgaria: textile factory, in 1834. Based on the national resources in Bulgaria these days, the total number of established Bulgarian industry sites vary between 11 and 40 factories based on steam, water, or animal power for the next 50 years. Most of the Bulgarian factories are state-owned (resp. Ottoman Empire) and they are built to serve the army needs. The most significant presence in the Bulgarian economy has the households’ economies that supply the local and regional market needs for food and cloths (Iliev, Sterev and Blagoev 2018).
- **Industry 2.0: Second Industrial Revolution**, related to the use of electricity (electric engine) and the use of a “New Organization” of Mass Production. The

radical change of business companies is based on materials inventions: new chemical elements and mining of new resources, new chemical reactions, development of new lighter materials, etc. This period after the Second Industrial Revolution is followed by fast electrification, chemicalization, and metallization.

- o At the end of nineteenth century and in the beginning of twentieth century, there is fast development of Bulgarian industry as the industry producers were encouraged through variety of tariff protections from foreign competition. The period matches with the Liberalization of Bulgaria (in 1878) and the state business is fastly replaced with the private enterprises.

As a young country and young economy, Bulgarian industry needs to be developed as faster as it possible. Thus, the very first industrial protection law was adopted in Bulgaria in 1894. After that 72 industrial factories with 3027 employees were established and the Bulgarian industry enlarges several times till 1912: established 389 industrial sites with 15,560 employees.

It is very important issue that there is start point of diversification of industries' sub-sectors as development of: mining production, food production, textile and clothing production, tobacco production, etc. Between World War I and World War II, industrial development continued at an accelerated pace, with establishment of new-born business as there were established 3815 enterprises (mostly small and medium-sized) with 87,442 employees in 1934. According to the official data, this industrial growth was based on development of the energy industry and the equipment of electricity-generating companies.

- **Industry 3.0: Third Industrial Revolution**—introducing computers to help manufacturing in the 1950s and 1970s. The period is well-known as digital revolution. Based on new materials' development, the first computerized tools have appeared as well as development of the very first robots. So. The **production automation** is achieved. This change leads to shorten the production time with less malfunctions, and basically, the human work has started to be replaced with machines. At the end of this Industrial Era, the mass consumption and mass production need more and more advanced technologies for information transfer.
- o The next restructuring of the Bulgarian industry began in 1947 after the nationalization that held on December 23, 1947. At that moment, there are 4628 enterprises with 158,127 employees. As a result, the "consolidation" of industrial businesses in the state holdings is achieved, with close off almost 40% of existing industrial enterprises. A plan for accelerated industrialization and development of the heavy industry: chemical, metallurgical, and mining industries is also adopted.

After 1966, Bulgaria continues the course for accelerated industrialization, but the emphasis is on the **modernization of production**, as well as the **mechanization** and **automation** of production processes, incl., and the use of electronic

learning machines in manufacturing. The basis is the acceleration of scientific and technological progress.

- **Industry 3.5:** Introducing the digital data transfer not just between the machines but between people in marked this period. The establishment of digital logic technology, which includes computers and World Wide Web (www), is essential for this sub-period. Forcing the fast information exchange, it forces opening local economies to globally once. In the late 1980s, a process of re-locating production according to production efficiency began. It is characterized by “export” of production from developed countries to underdeveloped economies.
 - o The next change in the industrial structure of Bulgaria started in 1989 with the political changes in Central and Eastern countries. At the end of 1989, there are 2,593 industrial enterprises and 1.58 million people employed. A considerable number of enterprises were created, and with the adoption of the Privatization and Post-Privatization Control Act in 1992. Most of the state-owned enterprises are sold through mass and cash privatization. In a large part of the transactions, especially in the case of cash privatization, Bulgarian industrial enterprises become the property of foreign investors. With this industrial change, the Bulgarian industry becomes an integral part of the European industry as an “important” element of European production chains (Industry 3.5) (Ivanov 2013, 2015).
- **Industry 4.0: Forth Industrial Revolution**, related to introducing Internet technologies into production. Based on the latest Industry 3.0 computer technologies, manufacturing processes are extended through a network connection and thus have a physical counterpart on the Internet. They allow the use of various **cloud technologies**, which lead to the so-called big data that is at the core of **organizational excellence**. These ICT technologies allow self-production sites, self-driving cars, etc. Thus, networking of all production systems leads to “cyber-physical manufacturing systems” that build **smart factories**. But smart products, smart factories lead to business downsizing, even re-born of the “one man” (entrepreneurial) companies.
 - o In recent years, since 2000, a special emphasis in the development of industry has been the development of Internet technologies. Following the global development from Internet 1.0 to Internet 4.0, Bulgarian industrial companies are increasingly relying on the use of cloud technologies and big data in their operations. According to experts (Biolcheva 2017), over 40% of industrial enterprises use social networks, Internet of Things (IoT), and other Internet technologies in their businesses.

The Industry 4.0 changed the business so deep, as the “biggest” companies are based on ICT and AI technologies: for example, two Bulgarian companies are appraised as billionaire companies in 2021.

But IoT, AI, and cloud computing technologies lead to one big problem: cyber security, and the future of the Industry 4.0 business is to resolve the main business problem within the cyber technologies.

- **Industry 5.0: (Next-Generation) Fifth Industrial Revolution**, related to introducing **Bionics** and **Biotechnology** into production. Allows the use of biological sensors to control and organize production. The challenge is to use an appropriate open-source biological language to allow the use of biological/synthetic cells in industrial production. All these set the business economics problem from the individual problem decision to the societal problem decision. The previous industrial revolutions are based on the basic business economics law: maximizing business profit, but the smart factories, the collective IoT systems are focused on the maximization of global needs: green economy, blue economy, economic sustainability, etc.
 - o Bulgarian industry has been focused on the Next-Generation Industrial Revolution as the IoT, smart computing systems, cloud technologies, and AI technologies are set as priority to the Bulgarian economy by the (Bulgarian) National plan for recovery and sustainability (<https://www.nextgeneration.bg/14>). It means: more investment in new digital technologies, more investment in digital knowledge and digital education as well as more investment in regenerative and social economy.

The summary of the shift between different eras of Bulgarian industry development could be found on the next figure representing the dynamics of the production produced in Industry for almost a century (Fig. 10.3).

b. Business [social] networking and academic entrepreneurship for accepting Industry 5.0

The Industry 5.0 revolution will be a “war” between the human intellect and the machine (computer) efficiency. So, the human-centric economic theories will put the entrepreneurial creativity in the center of development, but not the creativity of a single MAN, but the creativity of a (social) GROUP /resp. NETWORK/ of creative people.

Thus, the focus of the collective mindset brings out the future development perspectives. It is based on two phenomena:

- **Co-creation:** It appeared in marketing in 1990s, but it exceeds its primary definition. Basically, co-creation is a joint place (resp. cyber one) where different participants overlap their knowledge to establish a quite **new added value**. Nowadays, it is used to create an open innovation opposite to the traditional process of innovating. Co-creation only works when qualified people are willing to **cooperate** and openly share their ideas and knowledge with other people as well as honestly evaluating existing technologies, products, and new ideas. It can also be defined as **crowdsourcing**, since companies use their stakeholders (i.e., crowd) to find new

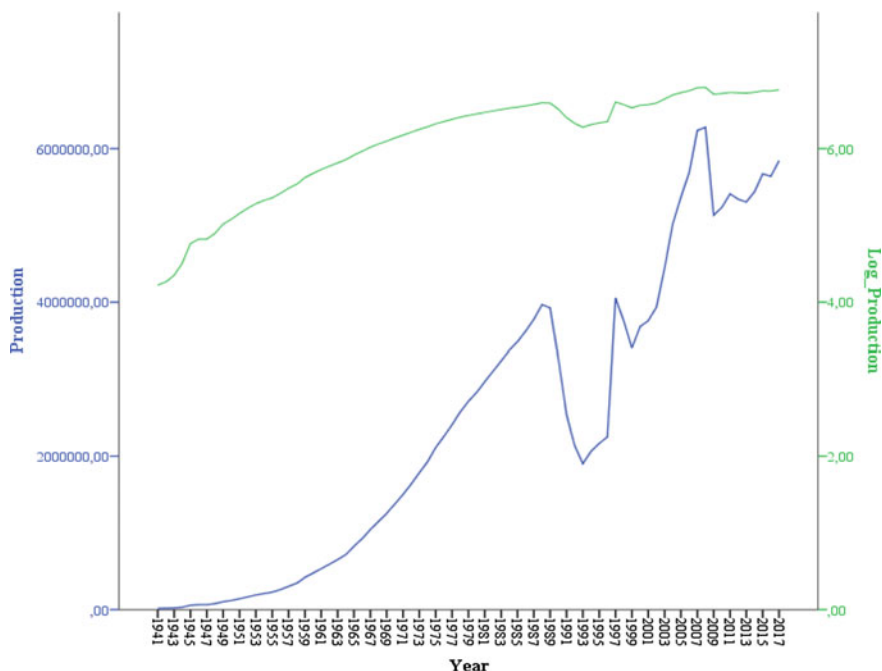


Fig. 10.3 Industry development in Bulgaria (Source Own Presentation and Modification by Kopeva et al. 2012)

solutions or improve existing added value of business processes, technologies, or products.

- **Co-working:** It appeared in human resource management in mid-2000s as a process where working individuals gather in a place to create **new value** while sharing each other an information and wisdom by **cooperating** under the conditions of their choices. The process aspires to balance individual autonomy with collaboration with others in work.

Combining co-creation and co-working in the social economy will lead to establish a numerous business network on the cooperative basics in which people will work together on creation of new ideas and new technologies by using the IoT, AI, and cloud service technologies. Thus, any single man/woman will be self-employed entrepreneur who will work together with other people not just to fulfill its personal needs but to find out decision maximizing the collective value /resp. to be part of the social economy/.

As the First Industrial Revolution has been started within the textile industry, we could appoint the co-creation and co-working within the same industry. So, the Fifth Industrial Revolution is based on acceptance of the next ROADMAP that sets the co-creation and co-working within the different textile stakeholders for establishment new textile technologies, new textile products, and new textile added value. This

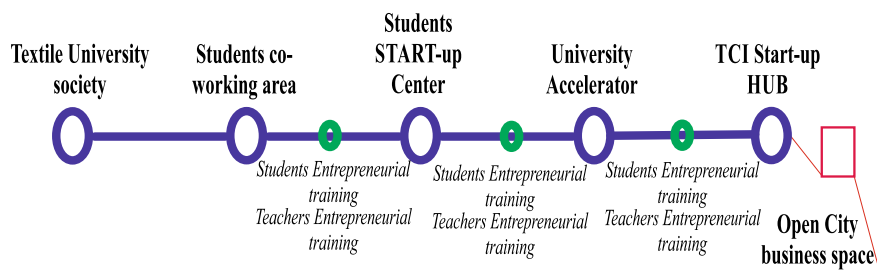


Fig. 10.4 Example roadmap of TCI entrepreneurial business (Source Sterev et al. (2021) Entrepreneurial process in textile and clothing industry: Technical Report, PH-TU Sofia, r4_Entrepreneurial_Process_TCI.pdf (ict-tex.eu))

Roadmap shows a combination of possible networks focused on new cooperative added value establishment (Fig. 10.4).

According to the given roadmap, three main stops that cover co-creation and co-working processes could be found:

1. New Material Research Centers
 - Customization and consumer co-production: Company allows the stakeholders to personalize a range of design elements for textiles.
 - Smart Textiles and Smart Product Innovation: Success may be contingent upon effective collaboration (e.g., with other sectors, universities, etc.)
 - Digital and Smart manufacturing technologies: Textile companies could support developments of digital manufacturing by highlighting smart textile start-ups.
2. Entrepreneurial Learning in Apparel and Textile
 - Entrepreneurial education for the enterprise: This includes important cooperative and collective knowledge and skills required to start and grow the enterprise.
 - Entrepreneurial education through the enterprise: This includes education using the new venture establishment process.
 - The entrepreneurial training focused on: creativity; innovation; identifying opportunities in a climate of change, etc.
3. TCI Start-Up Centers
 - Cyber-physical supply chains establishment: It is flexible on market chain of independent suppliers that has control ability of chain nodes' integration.
 - Green textile and apparel establishment: Modern smart automated textile plants and large amount of textile finishing consumption as well as apparel production should cover not just the increasing demand but also the increasing of the global green effect.

10.5 Conclusions

The development of the industry, both in Bulgaria and globally, goes through different evolutionary stages: from Industry 1.0 in 1784 (for Bulgaria—1836) to Industry 4.0 in 2010s. The key features of this business economics' evolution are the achievement of continuous industrial growth, in which growth is based on creating organizational excellence and bringing production and sales closer together through the digitization of business beyond 2010.

On this basis, the common business economics looks like getting to the end of its life. As the main value of the household/enterprises is maximizing profit by increasing production/sells and decreasing resources/costs, the common business economy is enterprise/household-centered one. But, new technologies, incl. IoT, AI, and Cloud technologies, make any single man as productive part of value chain. Thus, the single profit maximization is rather to be replaced by the social group's value maximization soon. Thus, the next Industrial revolution will be social revolution and the entrepreneurial economy will be shift to the social, resp. group/network, economy.

In that meaning, the Industry 5.0 will be based on co-creation and co-working of different networks of people. And the work on acceptance of new type of business is training of stakeholders to be fully fitted to the augmented needs of innovations and social-entrepreneurial knowledge and skills. Furthermore, the social-entrepreneurial training empowers a faster shift of knowledge from the study bench /resp. higher schools or university/to the business added value proposal. Thus, the Industry 5.0 will force up the University Start-ups establishment in order to provide competitive knowledge transition inside the social-entrepreneurial network from University/ University start-up HUBs/to Society/Open business start-up HUBs/.

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Chapter 11

The Foundation Process of the Central Bank of the Republic of Türkiye



Fatma Şensoy  and Ekrem Yılmaz 

Abstract Central banks are one of the most important financial institutions that carry out the financing transactions of the state administrations. Central banks are institutions that produce money on behalf of the state and carry out monetary policies. The need for resources for war financing by governments has been influential in the establishment of central banks as joint stock companies in the world. The process, which is pointed out by the reasons why a central bank was not established or could not be established in the Ottoman Empire, clearly reveals the purpose of the establishment of the Central Bank of the Republic of Türkiye. In the historical development process, the Bank's basic duties and functions and its importance in the country's economy are clear. The duties of central banks have followed an increasing course throughout history. Unlike other banks, they were established to serve the public interest, not for profit. This study consists of two parts. In the first, the developments that prepared the establishment of the Central Bank will be examined together with the changes in the economic structure that started in the middle of the nineteenth Century in the Ottoman Empire. In the first years of the Republic, the Central Bank of Türkiye was established as a mixed-structured joint stock company with the law numbered 1715 on June 11, 1930, as a result of the search for a Central bank alongside the Turkish Economy and the Ottoman Bank, and the search for solutions that continued with the 1929 crisis. Laws and regulations enacted in 1970, 1983, 1990, 1999, and 2001 are excluded from this research. In the second part, the contribution of the Central Bank of the Republic of Türkiye to the economic development of the country, as mentioned in its establishment purpose, will be examined through the financial reports of the first 5 years in the process starting from 1932. 1933, 1934, 1935, 1936, and 1937 year-end reports and balance sheets and profit-loss account data will be expressed descriptively. The traces of the statist economic policy implemented in Türkiye will be shown by the monetary policy instruments implemented by the CBRT. In the period when a

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sound monetary and balanced budget policy is followed, there are no movements that will cause money and credit expansion.

Keywords Central Bank of the Republic of Türkiye · Monetary Policy · Financing · Note Issue · Balance Sheet · Profit and Loss Account

11.1 Introduction

Today, the functions undertaken by Central Banks in almost every country have emerged in four main sections. To regulate the money supply in the country, namely the money market, to be the head of the banking system by regulating the volume and distribution of credit, to manage the country's gold and foreign exchange reserves, and to fulfill the function of the state's treasurer, or in other words, the financial agency (Tekeli and İlkin 1997: 1). The different experiences of each country in the past have revealed differences in the functions undertaken by central banks and the tools they use. The countries that gained independence in the twentieth century took the central banks of developed countries as reference institutions while establishing their central banks. In addition, the financial policy targets presented to other countries by international financial institutions such as the IMF and the World Bank have led to the formation of a structure that leads to similarity in monetary policy instruments (Al et al. 2014: 15).

The emergence of central banks in the modern sense has been a phenomenon unique to the twentieth century. The debates and national currency reforms in the nineteenth Century before this have an important place in this regard. Politically, the economic indicator of nation-state processes is the introduction of the national currency, which is a symbol of political sovereignty. Discussions on convertibility, the amount of reserves to be held in banks, the amount of banknote issuance and how to prevent excessive issuance have continued throughout the century. The process, which started with the currency reform in England toward the middle of the nineteenth century, was followed by other countries. The collection of paper money issuance authority in one hand for the control of money supply was a turning point for the formation of central banks in the nineteenth century. With the Peel Act enacted in 1844, the privilege of issuing banknotes was concentrated in the hands of the Bank of England. This trend was followed by other European countries, and newly established central banks began to be established with this privilege. Another important development enabled central banks to rise to a supportive position over other banks. The financial crisis that occurred with the bankruptcy of a large bank (Overend, Guerney & Co.) in England in 1866 revealed the dimensions of the intervention of the Bank of England in the system in times of crisis. Discount rate, interest rate and open market operations started to be used as policy tools by central banks in this period (Al et al. 2014: 17).

Financial reforms formed an important part of the Tanzimat and Islahat reforms, which were included in the efforts of innovation in the Ottoman Empire. Reform

initiatives aimed at the creation of financial institutions and the use of financial instruments, as in European states, point to the efforts made to create an advanced money and capital market, which is an important indicator of the economic power of the states.

In 1856, the Ottoman Bank (Bank-ı Osmanî) was established during the Crimean War of 1854 to act as an intermediary for the payment of the foreign debts of the Ottoman Government, which was the first to borrow from abroad. The company incorporation certificate issued by Queen Victoria is dated May 24, 1856. This document is issued to Layard, Bruce, Clark, Cummins, Glyn, Hankey, and Kingscote (Eldem 2000: 52). The powers of this British-owned bank, headquartered in London, are limited to lending in small amounts, providing advances to the government and discounting some Treasury bills. As such, the Ottoman Bank is a modest financial enterprise, devoid of a concession and privilege edict, but with solid provisions (Eldem 2000: 53).

Attempts to establish a “national bank” with a monopoly on issuing banknotes, which were included in the money market reforms, resulted in the granting of the national bank concession to Bank-ı Osmanî-i Şahane, which was established in 1863 with British-French capital. The role of the bank in the state finance was clearly defined with the edict dated February 4, 1863. This bank has a 30-year banknote issuance monopoly and has also undertaken the task of being the treasury of the state. It is also tasked with making the payments of the Treasury, discounting the bonds, making the interest and principal payments on domestic and foreign debts (Tekeli and İlkin 1997: 58; Eldem 2000: 83). In the Ottoman Empire after 1871, public infrastructure investments such as railways and trams created a vitality in the capital market and small financial institutions emerged one after another. The depression in the Vienna stock market in 1873, the Ottoman Empire’s suspension of debt payments in 1875, and the pressures of the 1876–77 war resulted in the elimination of these small banks. In 1875, Bank-ı Osmanî-i Şahane rose to a new and more powerful position. With the participation of the Austrian-Ottoman Bank, its capital was increased to 10 million pounds, half of which was paid, and the concession period was extended for another 20 years (Tekeli and İlkin 1997: 67–71). The process continued with the expansion of the privilege of Bank-ı Osmanî-i Şahane. Established in 1917, the bank of İtibar-ı Milli was merged with “İş Bankası” in 1926 when the necessary transformation could not be made and the Ottoman Empire left the First World War with a defeat. Until 1931, the “National Bank” remained an ongoing concession in the hands of foreign capital (Al et al. 2014: 20).

In this study, only the position of the Central Bank of the Republic of Türkiye (CBRT) within the framework of the law in 1930 will be discussed, and the financial reports of the first 5 accounting periods, under the title of “Administrative Council Report and Auditors’ Report, Balance Sheet and Profit-Loss Account”, will be examined in the period starting from 1932. Different aspects of central bank accounting will be examined. In addition to the titles mentioned in the reports and the general view of the world and Turkish economy, year-end balance sheets (a 15-month period for 1932) and profit-loss account data will be analyzed with a descriptive explanation.

There are many valuable reference sources on the CBRT in the literature (Kayla 1981; Zarakolu 1987; Tekeli and İlkin 1997; Kazgan et al. 2000; Bakır 2007; Parasız 2009; Parasız 2011). In addition to these, the financial reports we accessed from the CBRT's corporate website constitute the data of the second important part of this study. Again, theses and research results accessed from the bank's website are among our reference sources.

In the 1930s, the Republican regime followed balanced budget and sound money-oriented economic policies. These policies and the exchange regime aiming at exchange rate stability brought along important institutional arrangements that are necessary in the fight against inflation. Fiscal stability and independence were also adopted by politicians and statesmen of the period as the principles that ensure the stability of the Republican regime. In this period, fiscal policy instruments, especially taxes, have an important place in order to ensure monetary stability and balance of the budget. Institutional arrangements in these years made it possible for the Central Bank to monitor price stability (Bakır 2007: 65). This study gave the opportunity to observe the traces of this situation through the financial reports of the CBRT. We believe that this study will make a small contribution in addition to the studies in the literature.

11.2 Monetary Policy from the Nineteenth Century to the First Years of the Republic

11.2.1 Ottoman Period Financing Tools

The coin regime was used in the classical period in the Ottoman economic system. Between 1326 and 1757, the akche was used as money for accounts, although it has shrunk and lost its importance in recent years. After 1757, the kurus replaced the akche as the account money. In the Tanzimat period, the representative money system gained weight (Tabakoğlu 1994: 265; Sahillioğlu 1978). At the end of the nineteenth century, the lira basis was adopted.

In the Tanzimat Period,¹ the new esham money, which was in the form of “cash”, was put into circulation in 1840 during the reign of Sultan Abdulmecid (1839–1861), and it is the first forerunner of the practice of token paper money, which was put into effect as a type of domestic borrowing in 1775 and, was circulated among the people. It is intended to be used as a means of payment. Stock shares called “kaime (token money)” or “*evrak-ı nakdiye (treasury note)*” is actually a government bond. It is possible to accept them as paper money, not as representative money, since they are unrequited. The difference between kaime and coin, which is not respected by the tradesmen and the people in the provinces, is quite large.

¹ Literally means “regulations, reforms”. The term “Ottoman Reform” is generally used in Western languages.

In 1844, the coin system was reorganized, the decree “Usul-ı cedide üzere taksim-i ayar” was issued, and coins with a standard setting that could not be trimmed were put into circulation. The silver medjidie of 20 kuruş and the gold money of 100 kuruş were accepted as the basic currencies (Tabakoğlu 1994: 274). The government wanted to forbid the circulation of coins other than the coins it would issue and to stabilize the value of the Ottoman currency against the British pound by temporarily applying foreign exchange stability due to the current situation of the foreign trade deficit (Al and Akar 2014: 47). Until the First World War, the exchange rate of coins remained at the level of $110 \text{ kuruş} = 1 \text{ British Pound}$.

After 1875, silver began to depreciate in world markets. This situation invalidated the gold/silver ratio of 1/15.36 (16) in Ottoman bimetallism and the exchange was broken. The collection of state revenues with silver coins and the expenditures made with gold damaged the treasury. In the face of this situation, first of all, the coining of the Mecidiye was put to an end. In 1881, the Ottoman gold lira was adopted as currency. Despite this, the people’s demand for mecidiye and small money continued in the provinces and in Istanbul. Initially, gold began to be traded at 108 kuruş unofficially in Istanbul. This premium of gold become more pronounced outside the capital. This led to the spread of the institution of money changer (Tabakoğlu 1994: 275; Eldem 1970: 226). According to the Ministry of Commerce (State-i Âliye 1313 statistics), there were 805 money changers and brokers in Istanbul in 1894. In order to prevent this situation, the Law of Unification of Meskukat was enacted in 1916, and the rate of 1 lira = 100 kuruş was adopted. The success of the law has been limited. Because paper money, which was put on the market to meet the increasing expenses with the war, caused the withdrawal of coins and small money from circulation.

In 1860, the amount of paper money reached 1.1 billion. These non-gold coins were not held by the public, and their value fell immediately. Although the government tried several times to remove them from circulation, with the help of the Ottoman Bank, it redeemed 40% of the nominal value to the benefactors in cash and 60% by paying them in bonds issued under the name of “esham-ı cedide” (Eldem 1970: 228). After these first kaimes were withdrawn from circulation in 1862 during the reign of Sultan Abdulaziz (1861–1876), Sultan II. Until the reign of Abdulhamid (1876–1909), kaime was not coined again.

The Ottoman Bank (Bank-ı Osmani-i Şahane) was established in 1863 upon the increase in the credit needs of the state. The bank was given the authority to issue paper money, in other words, the identity of a “central bank”. Token money was put on the market for the second time under the control of the Ottoman Bank, especially for the financing of the Ottoman-Russian war of 1877–78 (1876–77). These banknotes lost 90% of their value in a very short time and at an unprecedented rate. Realizing that the kaime (token money) had no value other than tax payment, the government declared that paper money would be accepted up to 20% of the payable amount and a quarter of its nominal value in payments to state cashiers (Eldem 1970: 228). After the abolition of these kaimes, it was issued for the third time in 1915 during the reign of Sultan Mehmed V. (1909–1918). These kaimes literally had the function of representative money. Just as there are gold equivalents, it is also clear when they will be withdrawn from circulation. These kaimes, which were issued as 7 orders

within the framework of the tight monetary policy followed by the Ottoman Bank, continued until the Republican era (Tabakoğlu 1994: 275). World War I was largely financed by the emission of paper money. In this period, money supply increased almost 4 times and an inflationary environment emerged (Toprak 1985: 746).

11.2.2 The Search for a State Bank and the Establishment of the Ottoman Bank

The classical period Ottoman monetary and financial system was based on the coin system as in traditional economies. The basis of this system was the use of gold and silver as a medium of exchange and minimizing their use as goods. The Ottomans encouraged the entry of precious metals into the country in order for the money supply to be sufficient for the exchange volume, and forbade their exit. Sometimes, they sent the gold and silver items found in the palace and in the hands of individuals to the mint and cut money. The state increased the money supply and financed its expenditures by minting new coins from precious metals and old coins in mints. After sultan Suleiman I. who newly ascended, this policy was abandoned—he banned the circulation of old coins and cut his own coins. Sometimes the setting of the coins was changed and the depreciation of the currency was used as a financing tool (Tabakoğlu 1994: 261). The use of money became very widespread, especially in the sixteenth century, due to the abundance of precious metals and the strengthening of economic links between the countryside and the cities. Small-scale but dense credit networks—with institutions such as foundations, guilds, and janissary middle chests—also developed in Ottoman cities and their immediate surroundings (Pamuk 2014: 26). Cash foundations have been influential enough to be called foundation banks (Tabakoğlu 1994: 278).

Galata money changers held bank and credit transactions in the Ottoman Empire until the banks were established. Not only did they manage other people's money, buy and sell securities, and deal with foreign exchange transactions; they also engaged in lending money to the treasury and the palace (Kayla 1981: 23). Discounting the treasury bonds, benefiting from the agio differences arising from the circulation of gold, silver, and kaimen, breaking the salaries of civil servants, engaging in tax farming and collecting the state's tax revenues were among the main transactions (Eldem 1970: 229).

An agreement was reached with Galata bankers A. Baltazzi and J. Alleon in order to carry out the currency reform in 1844 and to keep the exchange rate of money stable against sterling in foreign payments made with policies, and Banque de Constantinople was established in 1847 (Tabakoğlu 1994: 276; Ortaylı 2006: 220). This bank did not have a certain capital, the policies drawn by the founders due to their commercial reputation were accepted. When the government delayed in paying its short-term debt to the bank, the bank fell into trouble, went bankrupt in 1852 on the eve of the Crimean War, and caused a loss of 600,000 liras to the Ottoman

treasury (Tekeli and İlkin 1997: 54). The budget deficit required by the financing needs of the Crimean War, which started on July 3, 1853, tried to be met by domestic and foreign borrowing. Ottoman finance borrowed from European financial markets such as London, Paris, and Vienna in 1854 by issuing long-term bonds (Pamuk 2000: 68).

The Ottoman Government received offers from British and French investors to establish a bank with the help of foreign capital. In 1856, Bank-ı Osmanî (Ottoman Bank) was established with a capital of £500,000 to deal with deposits, discounts, and commercial transactions. The bank took the name Bank-ı Osmanî-i Şahane with the participation of French bankers and businessmen in 1873, 7 years after its establishment, and became an emission bank. Its capital, which was 67.5 million francs at the time of its establishment, became 520 million francs (1.1 billion kuruş) in 1875, half of which was paid. The redemption of paper money, which could not be put out of circulation until then, was possible. The headquarters of the bank was in Istanbul, but its management was in the hands of committees in London and Paris (Eldem 1970: 231). The bank also acted as a kind of central bank with the privilege and monopoly of printing money. The bank borrowed from European markets at low interest and accumulated gold reserves, printing money 3 times as much as these reserves and giving advances to the government in return for interest. The Ottoman Government could not participate in the profit of this bank (Bakır 2007: 14). The concession period of the bank was determined as 30 years in the first contract, and this period was extended until March 1952 with subsequent amendments (Kayla 1981: 25). The Ottoman Bank assumed the task of more a commercial bank due to the fact that the banknotes it issued were limited in its functions as a state bank, the government limited the issuance of money and treasury bills, and prioritized its own profitability apart from fulfilling the state's treasury (Tekeli and İlkin 1997: 60).

The fact that the bank did not support the Ottoman Empire in issuing banknotes caused the state's domestic and foreign debts to be made with increasing interest and costs after its establishment. Thus, the bank obtained a large part of the financial rents created by the Ottoman debts (Kazgan et al. 2000: 44).

Apart from the bank established in Thessaloniki in 1888, many other banks were also established. Banks such as Credit Lyonnais, Deutsche Bank, Dresdener Bank, Deutsch Orientbank, Winer Bank Verein, which are among the leading banks of the world, have opened branches throughout the country. Deutsche Bank, one of these banks, was also influential in political and economic terms. The bank played an important role in financing the construction of the Anatolian-Baghdad railway (Eldem 1970: 231).

In October 1875, the Ottoman State declared that it could not fulfill its foreign debt obligations by taking a moratorium decision. In December 1881, the Düyün-ı Umumiye Administration was established for the management of debts. In the 1875–76 fiscal year, two-thirds of government revenues were reserved for debt payments only (Güran 2003).

After the II. Constitutional Monarchy, among the banks that were in the nature of national banking were Ziraat Bank (founded for the first time in 1863 under the name “Memleket Funds”) and the “Emniyet Fund”, founded by Mithat Pasha in

1808. Attempts to establish a national state bank started in 1914, first Evkaf and then İtibar-ı Milli Banks were established. Anatolian merchants, whose economic power gradually increased, established banks and credit cooperatives in various cities of Anatolia after 1909 (Tabakoğlu 1994: 276).

11.2.3 The Need for the Central Bank in the War of Independence

The disagreement that started with the Ottoman Bank's refusal to respond positively to the government's demands for advance and banknote issuance during the First World War was overcome when the bank announced that it gave up its privilege of printing banknotes during the war and was free to print kaime for the government. During the war, the Ottoman Empire minted 7 orders, a total of over 160,000,000 liras (Kazgan et al. 2000: 44).

Government officials applied to the Düyün-u Umumiye Administration in order for the money to be issued to arouse prestige among the people. With the treaty signed, the administration made a commitment to be paid in gold at the end of the war, on the back of the money to be issued in return for the gold to be given to it. 5 million liras worth of gold to be used for this was obtained from Germany. In addition to the gold spent for war preparations, gold advances were received from Germany and Austria again a portion of 6,519,179 liras of this amount was deposited in Reichbank and Austro-Hungarian Bank by the General Directorate of the World. In 1915, the same amount of paper money bearing the commitment of the administration was minted. The equivalent of the re-issued paper money for war expenses was determined as German treasury bonds. At the end of the war, 158,748,563 liras remained in the market from these coins.

The coins taken over as a means of payment when the National Government was established are the coins issued with the commitment of the Ottoman Government to the Düyün-u Umumiye. After the First World War, as the gold of Germany and Austria was delivered to the allied states with the Versailles and Saint Germain treaties, these coins remained unrequited (Kayla 1981: 27).

One of the most important features of the Turkish War of Independence is that it was financed without a state bank behind it. The Ankara Government financed this war like a miracle. However, the Greeks financed the war not only with their weapons, but also with the drachmas suppressed by the central banks. During the War of Independence, the constant depreciation of Ottoman paper money against gold and the victorious state currencies of the First World War put a lot of pressure on the Ankara Government (Kazgan et al. 2000: 45). According to Vedat Eldem, who estimates the total expenditures of the War of Independence as 147 million, 63.9% of this financing comes from budget revenues, 6.8% from non-budgetary sources and 15.7%. Of seizures, 4.8% from donations, 8% from the aid of the Soviet Union. In addition to the savings measures such as the increase in different taxes during the

war, not paying civil servants' salaries by law for one month, and 20% reduction in salaries and wages, a compulsory domestic borrowing resource was applied in 1921 with the "*tekalif-i milliye*"² orders.

The foreign resources of the War of Independence consisted of 125,000 British Liras sent by the Indian Muslims, the material left by the French after the armistice, and 11 million gold rubles and 100,000 Ottoman gold bullion sent by the Soviet Union (Tekeli and İlkin 1997: 166–168).

11.2.4 *The First Years of the Republic, İzmir Economy Congress*

The Republic of Türkiye, which was founded on October 29, 1923, had different problems as well as political problems as a newly established nation-state. The formation of the national market, the provision of goods, services, and money flows at the national level, the formation of common rules in industry and trade, and the establishment of a nationwide payment system are some of these problems. The economy, which the Republic of Türkiye took over, is mainly based on agriculture. 52% of the Gross National Product in 1907 and 54% in 1914 were produced in the agricultural sector. At the İzmir Economy Congress, which was convened shortly after the proclamation of the Republic, the principles regarding the abolition of Tithe Tax, ending the tobacco monopoly, security, mechanization, and transportation were adopted in relation to the agricultural sector. It is understood from the composition of imports in the same period that industrial production could not meet domestic consumption. In the congress, a consensus was reached on the principles of protecting the domestic industry from foreign competition with customs walls, granting customs exemptions in the purchase of machinery and equipment, reorganizing the "*Teşvik-i Sanayi Law*",³ establishing banks for the financing of industry, and organizing chambers for industrial education. In this context, İşbank was established in 1924 and "*Sanayi and Maadin Bank*"⁴ was established in 1925. In 1927, the Teşvik-i Sanayi Law was reorganized and entered into force. The 1920s were the years when foreign capital took place in the Turkish Economy and was especially invited (Kazgan et al. 2000: 53–62).

The historical trauma caused by the loss of national economic and political independence in the past shaped the economic policies of the Republican regime. The Republican regime implemented economic policies based on balanced budget, sound

² Before the Battle of Sakarya, one of the turning points of the Turkish War of Independence, to meet the needs of the army and to prepare for the Battle of Sakarya are the "National Obligation" orders. It was published on August 7, 1921.

³ It is the law that aims to provide exemptions, concessions and incentives to enterprises that will make industrial investments. The law, which was enacted on May 28, 1927, remained in force for 15 years.

⁴ It was established in 1925 as a state bank in line with the decisions taken at the İzmir Economy Congress.

monetary principles, foreign exchange and foreign trade controls, avoided foreign deficit and debts, and did not compromise on tax collection (Bakır 2007: 15).

11.3 Establishment of the Central Bank of the Republic of Türkiye

11.3.1 The Need for a Central Bank

The lack of a national central bank, which was an important element of economic independence, was among the biggest problems of the Government of the Republic. The foreign-owned Ottoman Bank did not provide advances and emissions to finance the First World War. The destruction caused by the high inflation in this period on the society and the constant depreciation of the Turkish Lira made it a necessity for the new republic to establish its own central bank. The first wishes regarding the establishment of the Central Bank were expressed at the Izmir Economy Congress. The implementation of this idea took place in three stages from mid-1926 to 1930 (Tekeli and İlkin 1997: 253).

The emission authority of the Ottoman Bank with the concession decrees issued in 1863 and 1875 was renewed by the government in 1925. However, a clause was added to the agreement stating that the bank would not oppose a separate emission bank to be established in the future. In addition, the opinions of domestic and foreign experts were also taken. In 1927, the draft law submitted by the Minister of Finance Abdulhalik Renda on the establishment of a central bank was accepted. In his report, Dr. G. Vissering, Member of the Dutch Central Bank Board of Directors, who was invited to Türkiye in 1928, drew attention to the necessity of an independent central bank that is not affiliated with the government. In 1929, Count Volpi, the former Italian Finance Minister, stated that the establishment of a central bank was essential for the stability of the Turkish currency. After this, the draft law on the Central Bank was prepared with the contributions of Prof. Leon Morf from the University of Lausanne, who examined the draft law on the central bank. At the same time, the Law No. 1567 on the Protection of the Value of Turkish Currency was enacted on February 20, 1930. The negative effects of the 1929 world economic depression began to be felt in Türkiye as well, and speculation in foreign exchange transactions could not be prevented.

The negotiations held in the Turkish Grand National Assembly, the establishment of a central bank, the stabilization of the Turkish currency and the expectations of national banks to play a role in increasing their credit capacity were met with great enthusiasm in the press (Kazgan et al. 2000: 91). In such an environment, the draft was accepted by the Turkish Grand National Assembly on June 11, 1930 and published in the Official Gazette on June 30, 1930 under the name of the Turkish Republic Central Bank Law No. 1715. The CBRT undertook the government's internal and external payments, foreign exchange, and treasury transactions. The bank started its

operations on October 3, 1931 as the 38th Central Bank in the world (Bakır 2007: 19; Parasız 2011: 379).

Taking the privilege and monopoly of printing money from the Ottoman Bank, which had undertaken the task of collecting the “*Düyun-ı Umumiye Administration*”,⁵ to the CBRT, symbolized economic independence. The development of national banking, the prevalence and validity of the view that every country should have a central bank, the states participating in the Universal World Administration were in an economic depression at least as much as Türkiye. The Banks Consortium established in 1930 provided stability in the foreign exchange market and the other reasons for the establishment of the bank were the long preparation period for the establishment of a National Central Bank in the country (Tekeli and İlkin 1997:252–292).

11.3.2 Establishment Law of the Central Bank of the Republic of Türkiye

The CBRT was established as a joint stock company holding the privilege of issuing banknotes in Türkiye. This legal nature of the bank was a conscious choice of the legislator as well as the difficult financial conditions of the period. Care has been taken to ensure that the bank’s capital does not belong to the state entirely; this contributed to the institutional structure of the CBRT that supports its legal independence. This is the reason why the name of the bank “Central Bank of the Republic of Türkiye” was given (Bakır 2007: 20). Its aim was to help the economic development of the country. Its duties were to determine the discount rate, to regulate the money market and its circulation, to carry out treasury works, to take all necessary measures to ensure the future stability of the Turkish currency together with the government.

According to the new law, 158,748,563 lira evrak-ı nakdiye, which was issued by the state with the law no. 701 on December 30, 1924, passed into the responsibility of the bank. With the stability law to be enacted in the future, the bank had committed to pay the value of this money over the value to be given to the Turkish Lira. In return for this commitment of the Bank, the Government also owed money to the bank. The government issued treasury bonds with 1% interest. Until the stabilization law was enacted, the bank has been required to circulate the documents in cash. Also, this amount cannot be increased. However, the purchase of gold or the advances made against gold may actually emit in return for the double discount of the foreign exchange and commercial papers that can be bonded to gold. (Rediscount) The capital of the bank must be paid in full in order for the commercial papers to issue in return for the double discount. In addition, the amount of banknotes that it can issue until the stability law comes into force will be determined by a commission consisting of representatives of banks with a paid-in capital of not less than 4 million.

⁵ Düyun-U Umumiye is the institution that supervised the internal and external debts of the Ottoman Empire between 1881 and 1923. It was established during the reign of Abdulhamid II.

It was envisaged to make the Turkish currency convertible to gold, but this decision was abandoned because it was understood that this purpose could not be realized (Kayla 1981:28). The capital of the bank is 15,000,000 Turkish Liras, divided into 150,000 shares of 100 Turkish lira each. The bank's stocks are divided into 4 groups. Class A shares belong to government institutions and cannot exceed 15% of the total capital. These will be paid by the Government to the Central Bank in pure gold at the prices on the date of deposit. Class B shares are reserved for national banks operating in Türkiye. A maximum of TL 1.5 million of Class C shares has been allocated to banks and privileged companies other than national banks. Class D shares are reserved for Turkish Commercial Companies and Turkish real and legal persons.

It is envisaged that the reserve fund of the bank will be provided from three sources. The first is "*Adi İhtiyaç Akçesi*". It will be formed by the allocation of 20% of the profit each year. When this reserve amount reaches 75% of the capital, a 10% reserve fund will start to be set aside from the profit. The second is the "*Fevkalade İhtiyat Akçesi*". It will be formed by the allocation of 10% of the remaining profit after the allocation of ordinary reserves and certain shares for the shareholders from the net profit. The third is "*Hususi İhtiyat Akçesi*". It will consist of some extraordinary profits in favor of the bank, for example, 50% of the banknotes that have expired.

The organization of the bank, which was established as a joint stock company, consists of the General Assembly of Shareholders, the Board of Directors, the Auditors, the Discount and Credit Committee, the Board of Directors, the General Directorate and branch managers. As in every joint stock company, the General Assembly will make the basic decisions regarding the existence of the bank. Such as examining the annual report, acquitting the Board of Directors, increasing the capital, making changes in the main regulation, and making the liquidation decision of the bank. However, the General Assembly is not free in the decision of liquidation. It is subject to the conditions that the bank fulfills all its commitments and is approved by the Board of Directors (Tekeli and İlkin 1997: 291–293).

The CBRT was not directed to collect private deposits, as it is a banknote issuing institution and has the authority to hold government deposits without interest. Since it is in a position above banks, the interest it can give to private deposits is limited to 2% by law.

In the division of the bank's net profit, the first 20% will be reserved for reserve funds. From the remainder, the portion corresponding to 6% of the nominal value of the shares will be deducted as the first dividend. A maximum of 5% of the remaining profit will be given to civil servants as bonuses. 10% will be reserved for extraordinary reserves, 50% of the remaining profit will be given to the treasury and 50% to the shareholders as dividends. If the remaining amount after 20% of the profit is reserved for reserve is not sufficient to distribute 6% dividend to the shareholders, the difference will be covered from the extraordinary reserve fund. Republic governess, who wanted to sell their stocks to a large audience, wanted to reach large audiences by guaranteeing a 6% dividend to their shareholders (Tekeli and İlkin 1997: 291–302).

In order for the bank's account status to be easily monitored by the public, it is stated in the law that the bank's balance sheets will be published in the Official

Gazette, and a bulletin will be prepared every week showing a summary of the account status and sent to the press and foreign central banks. Under the title of balance sheet, in Article 80: It is written that the bank's balance sheet, which is prepared clearly every year, is submitted to the Ministry of Finance and will be published in the Official Gazette at least one and a half months before the general assembly meeting. In Article 81, it is stated that the bank will publish a bulletin that summarizes its position every week, and it is stated that the bulletin will be sent to the issuing banks, stock exchanges, chambers of commerce and other places in foreign countries through official and other newspapers. In this bulletin, the bank's cash, gold, gold exchange situation, the total of the bills to be "tediye" (paid) inside, its deposits in foreign countries, other assets owed, its capital, reserve funds, the amount of banknotes in circulation, its debts and other assets owed must be shown.

With Law No. 1715, the Ministry of Finance has been given the right to audit all kinds of transactions and accounts of the Bank at any time. The first form of the CBRT emerged within a very complex system in terms of organization and authority. A new draft law was prepared as a result of the amendments made on this law, which was arranged with the principle of issuing money for gold and has been implemented for nearly 40 years (Kayla 1981: 32, 32).

A significant portion of the bank's capital was borrowed from the American-Turkish Investment Corporation (ATIC) starting from July 1, 1930, in return for the match concession, with an interest rate of 6.5% and a maturity of 25 years, amounting to USD 10 million. In return for this debt, the government granted ATIC concessions for the production, import, export and sale of matches, lighters and similar flammable materials (Bakır 2007: 20; Tekeli and İlkin 1997: 305–311).

11.3.3 Evaluation of the Central Bank's First Five-Year Activity Reports, Balance Sheet and Profit and Loss Accounts

The institutional structure and policies of the Central Bank of the Republic of Türkiye have also undergone changes over time depending on the requirements of the economy and the day. While making transfers over the first 5 years of the establishment process, later developments, and regulations were excluded from this study.

During the establishment period; for the (A) class share group, which constitutes 15% of the total shares, government institutions can purchase gold, stocks, jewellery, etc. In return, they bought 2,250,000 Turkish lira of shares. National banks showed interest in (B) class shares. Ziraat Bank bought 3,000,000 Turkish lira, Real Estate and Eytam Bank 1,000,000 Turkish lira, İşbank 500,000, Security Fund 300,000, Industry and Maadin Bank 250,000 Turkish lira, totaling TL 5,050,000. This class of shares constituted 34% of the total shares. However, when the required amount was short on the last day for the sale of stocks, Ziraat, Emlak and Eytam, and İş Banks formed a

company union and the missing 500,000 Turkish lira was completed. Thus, the share of Group (B) shares increased to approximately 37%. A share of TL 1,500,000 was reserved for Class (C) shares, 10% of which was reserved. The Ottoman Bank bought shares worth TL 1,000,000, and the rest was bought by Banca Commerciale Italiana and Deutsche Bank. Finally; Publicity campaigns were carried out for the public to buy shares for (D) class shares, and the purchase of bank shares by government officials were supported.

According to the Establishment Law, the main purpose of the Central Bank is to support the economic development of the country. The bank has been brought into a position where it has the authority to issue banknotes from a single source. The Bank is also authorized to set rediscount rates, regulate the money market and money circulation, perform treasury transactions and take all measures to protect the value of the Turkish currency (Zarakolu 1984: 53; Kayla 1981: 30). In addition to these, the bank also assumed the responsibility of the state treasurer. Under the fixed exchange rate regime applied in this period, the authority to determine the exchange rates belongs to the Government. The main policy instrument of the Central Bank is the rediscount rates. The 1930s were the years when the independence of the Central Bank was in the foreground and inflation remained at low levels.

11.3.3.1 1932 1st Account Period Report and 31.12. 1932 Balance Sheet and Profit and Loss Account

The accounting of Central Banks is quite different compared to other institutions. Some accounts that are not in commercial banks are included in the Central Bank records. It is clear that a section of accounts seen in other bank accounts also have different characteristics (Kayla 1981: 38). Money, which is an asset for everyone, is a liability for the Central Bank. Therefore, the balance sheet of the CBRT works in the opposite direction compared to the balance sheets of other institutions. All banknotes in the cash register are added to the current banknotes account. Another difference is the profit account. After the profit generated during the year is reserved as a reserve and distributed to the shareholders, the remaining T.C. is transferred to the treasury. Balance sheets of Central Banks are important sources of information shaped by the interaction of monetary policies and the financial system. For this reason, it is necessary that the balance sheet is prepared in a clear and understandable manner and its relationship with the monetary aggregates used in the execution of monetary policy, should be established (Parasız 2009: 300).

In the first accounting period of the first year ending on 31.12.1932, the report of the administrative council and the audit commission was presented to the general assembly. The effects of the economic crisis continue in international relations. The departure of the British pound from the principle of being changed to gold on September 21, 1931, 12 days before the CBRT started its operations, did not cause any harm, unlike other Central Banks. Türkiye was protected from the losses such as the abundance of goods, low sales, and unemployment caused by the Great Depression in other countries, but was affected by the low prices of agricultural

products. Compared to 1929, in 1932 the price of hazelnuts and opium fell by 73%, wheat by 63%, cotton by 48%, and tobacco by 50%. The decrease in export revenues were accompanied by the contraction in import volume. The shrinkage of international trade and the deterioration in the balance of payments revealed the necessity of resorting to production opportunities within the country. These measures were supported by legal provisions. Thus, it was desired to reach the goal of a fundamental and permanent balance in economic life. However, due to the shrinkage of the trade volume, the money in circulation accumulated as deposits in banks, before it could find a field of activity. There was no demand for re-discount for commercial papers other than treasury bills.

While the 1931–32 budget was 186.7 million liras, the 1932–33 budget made was over 169.1 million liras. There is a significant decrease in tax revenues (21 million TL).

The accounts in the assets of the balance sheet dated 31.12.1932 are: Cash, Domestic correspondents, Foreign correspondents, Advances, Treasury bills, Esham and bond book, Discount book, Fixtures, Shareholders, Miscellaneous, and Off-duty Accounts. Accounts included in the liabilities of the balance sheet are: Capital, Banknotes in circulation, Deposit, Foreign currency commitment, Miscellaneous, Profit, Off-balance Accounts.

The balance of the cash account is 33,989,649.49 liras.

The balance of gold transactions at the end of the year is 18,483,380.88 Turkish Liras.

Banknotes in circulation: 148.582,193 liras.

During the accounting year, 3,919,022.34 TL was collected against the bonds of 158,748,563 TL delivered by the Treasury when the bank was founded.

Thus, the balance of the account at the end of the year is: 3,316,163.48 liras of 3,919,022.34 liras of which 154,829,540.66 liras were collected income from the bank's obligatory securities.

According to the statement in the report, the Profit and Loss account linked to the balance sheet is divided as Embezzlement and Debit. In the table, which is stated as 2.201.109, 24 kuruş, the net profit of the first accounting period is 1.471.822 liras and 37 kuruş (CBRT 1933).

The CBRT balance sheet size was 226⁶ million TL at the end of 1932 (Total of Assets-Off-the-shelf Accounts: 342.998.145, 06–115.242.082,53 = 227.756.062,53).

A large part of this amount consists of banknotes in circulation. At the end of the year, there were 163.5 million lira banknotes in circulation. 14.9 million lira of this was in the safe. Therefore, the printed banknotes are printed in exchange for cash, the documents being received from the treasury.

The CBRT's liabilities mainly consists of 154.8 million TL treasury bills, the documents of which were given to it in exchange for cash. The assets of the CBRT consist of treasury bills and promissory notes.

⁶ This amount was given as 226 Million Liras by Önder (2005: 105).

On the foundation day of the CBRT, 158.7 million liras of bonds (documents in cash: Banknotes) were delivered to the CBRT with 1% interest, and 3.9 million liras was collected within the accounting year, and the year-end balance of 154.8 million liras has regressed. The second important part of the assets of 1932 is the securities portfolio worth 28.2 million Turkish liras (Önder 2005:105).

11.3.3.2 Second Accounting Period Year-End Report of 1933

The report started with an explanation of the general state of the economy and how the internal and external conjuncture was. By 1933, despite some positive developments such as a decrease in unemployment, a decrease in stocks and an increase in the prices of some goods, the traces of the 1929 crisis, still continue. The separation of the US dollar from gold on April 19, 1933, after the pound and some other currencies, increased the financial problems in the world economy. In this context, the Cash and Economics Conference was held in London on June 12, 1933, with the participation of more than 60 states, on issues such as taking necessary measures, money credit, customs policies, capital movements, prices, etc. The conference was dissolved on July 27, 1933, without the disputes being resolved. Clearing agreements, the originals of which were laid in 1931, gained more popularity. It has been stated that Türkiye is in an effort to increase its foreign trade with these agreements. Foreign trade volume also contracted. It decreased to 411 million liras in 1929, 299 million liras in 1930, 253.9 million liras in 1931, 187.2 million liras in 1932 and 170.8 million liras in 1933.

The value of the national currency has been preserved without the slightest tremor since 1930. The statement given by the Prime Minister and the determined attitude of the government gave confidence to the savings and capital owners in the country. The budget of 1932–1933 was closed without a deficit, and this principle was followed when the budget of 1934 was being prepared. Of the 12 million lira bond required for the construction of the Ergani railway line, the 8 million lira portion, which was exported to the market in 1933, was completely sold. The law on the circulation of new coins such as 1 lira silver and nickel was published.

The low price level of agricultural materials continues in these years as well. It has been stated that measures have been taken to establish and advance industry and to protect agriculture. At the end of the description of this general economic situation, it was stated that branches were opened in Samsun and Mersin, following branches opened in Istanbul and İzmir.

The Board of Directors was acquitted with the declaration that the bank transactions and assets are in compliance with the laws and regulations, and that the balance sheet items and the profit and loss account are in accordance with the bank records. At the end of 1932, with the addition of 22,332,851 liras in 1933 to the 163,517,540.66 lira circulating banknotes, including the banknotes in the safe, the total reached 185,850,391.66 liras. However, out of this total, 25,152,322.88 lira banknotes were withdrawn from circulation in 1933, and the remaining 160,6698.068.78 liras. According to the statement in the report, the total of banknotes in circulation in

the market is 160,698,068.78 liras, 13,871,965 in safes at the end of the year, and 146,826,303.78 liras when the lira is subtracted.

Banknotes in actual circulation, which were 165.6 million liras at the end of 1931 and 148.6 million liras at the end of 1932, reached 138.2 million liras in August 1933 and rose to 146.8 million at the end of the year. With the new gold added in 1933 to 21.5 million liras in 1932, the total reached 24,890,005.49 liras at the end of the year. Foreign exchange holding: 5,710,739, 60 lira in external correspondents, 4,167,600 TL in discount wallet, 1,730,236,98 TL in advances account, totaling 11,608,576, 58 TL.

The precautionary fund has been included in the balance sheet items since the beginning of 1933. This amount, which was 349,110,26 liras, will be 663,914.30 liras in 1934 with the approval of the general assembly in 1933 dividend distribution.

In the report, it is stated in the profit and loss account statement that there was a dividend of 1,349,300.13 liras for the year 1933, from this total, the legal reserve is divided into 5% civil servants' shares and 10% extraordinary reserves, after 6% dividend is deducted to the shareholders. Half of the remaining 382,024.09 lira is reserved for treasury shares and the other half as additional dividends to shareholders (CBRT 1934).

11.3.3.3 Third Account Period Report of 1934

1929 In 1934, a year when the effects of the Great Depression were still felt, the low raw material prices, unemployment and contraction in international trade continued. Measures such as protectionist measures, customs prohibitions, moratorium announcements, transactions on currency value, refraining from giving foreign currency, tax, and tariff changes for export goods, affect international trade.

The situation within the country has been drawn more positively. In agricultural production, the yield of some products is better than the others compared to the previous year. There are negatives in the production of corn, rye, oats, sesame and opium, grapes and figs, but there are positive yields in cereals, beet, potatoes, mohair, and olive oil. With the measures taken by the state, agricultural products were sold at better prices. The foundations of industrialization were laid by the state.⁷ The foundations of weaving factories in Kayseri and Ereğli, paper in İzmit, bottles and glass in Paşabahçe, sulfur in Keçiözümlü, and coking coal factories in Zonguldak were laid. Turhal sugar factory started to work. Isparta rose oil factory was opened and a milk powder factory was established in Kars. Bakırköy cloth factory was expanded and renovated.

The tariff discount made in the railways were effective in the increase in the domestic trade volume. The budget for the 1933–1934 fiscal year was closed in balance. Extraordinary tax revenue and the amount of 4 million belonging to the

⁷ Türkiye is the first country after the USSR to implement planning in the world. The First Five-Year Industrial Plan was prepared in 1933 and put into practice between 1934 and 1938 (Kazgan 2009: 60).

Ergani loan contributed to this balance. With the clearing agreements made with 13 states, exports to these states reached 62% of all exports and 69% of imports.

With the gold purchased in 1934, the current value of 27.46 million lira at the end of the year reached 19,522 kg. Some of these golds were sometimes kept in reserve for foreign exchange supply. This debt, for which foreign currency is immediately provided by being pledged, is 790,533 liras at the end of the year. This debt has also increased to 4.8 million liras in 1933.

The banknotes in circulation at the end of 1933, together with the ones in the safes, amounted to 160,698,069 liras at the end of the current year, and 169,698,692 liras when 9,000.63 were added to this in 1934. When the 5,085,407 liras withdrawn from circulation are subtracted from this total, there are 164,613,285 lira banknotes at the end of the year. In order to reach the amount of banknotes actually circulating in the market, it is necessary to deduct 6,456,382 lira banknotes in the safes from this total. As a result, there were 158,156,903 lira banknotes in circulation for 1934. From 1933 to 1934, more than 11 million banknotes were found in circulation. These banknotes were put on the market especially through discount and bond books and advance transactions. This year, a provision of 50,000 lira was made for the cost of reprinting old and worn banknotes.

Total assets in the balance sheet dated 31.12.1934: 403.198.964.96 liras.

In the balance sheet, the reserve fund is 663,914.30 liras. When the proposals for the sharing of 1934 profits are approved, this amount will increase to 1,026,756.67 liras.

In the profit and loss account, which is divided into embezzlement and lien, the 1934 net profit is 1.520.865,61 liras. The share of this will be 20% as reserve funds and 6% as dividends to the shareholders. Of the remaining amount, 5% will be allocated as civil servants' shares and 10% as extraordinary reserve shares, and the remaining amount will be divided into two and belong to the treasury and shareholders (CBRT 1935).

11.3.3.4 Fourth Account Period Report of 1935

The general situation of the world, with the signs that production indices have started to revive, but prices have risen, unemployment has decreased, and international trade has begun to revive; in addition to positive opinions that the effects of the world crisis have decreased, there are opinions that it is eliminated with measures and medicines everywhere. In addition to the economic problems, political problems began to appear.

The monetary situation, which is important for a Central Bank, is not peaceful and stable. The dollar remained stable; the sterling remained stable, but the Luxembourg franc, the Danzig florin and especially the German mark lost their value. Due to the silver policy followed by the United States, China left the silver coin principle. French, Swiss, and Dutch currencies, which did not deviate from gold, maintained their stability despite significant gold losses. Central banks and states began to accumulate more gold in their vaults, and in 1935 this figure reached 20,000 tons.

Agricultural production in the country has increased and prices have also increased. The implementation of the five-year industry program continues. Sümerbank's Kayseri cloth combination was inaugurated; the construction of Ereğli cotton and İzmit paper mills have been completed. The foundations of cotton factories in Nazilli and woolen fabric factories in Bursa, Merinos were laid. Keçiborlu sulfur, rose oil factories in Isparta started to operate. Mineral research and exploration institute and the general directorate of electrical power resources survey and development administration are established to provide the country with cheap electricity. Etibank started operations toward the end of the year to finance these two important issues.

The development of Turkish agriculture and industry in balance is the main objective of the economic policy. For this reason, it has tried to grow long fiber cotton, which is needed by cloth factories, and to produce merino in Bursa and Karacabey. Building and animal taxes were reduced, agricultural debts were paid in installments, laws were drawn up for the establishment of agricultural sales cooperatives, the price of salt was cheapened, the creation of a unit to protect grape production... has become an indicator of the state's aid in the field of agriculture. The goal of economic policy is to increase production and consumption in a balanced way. For this reason, the prices of sugar, coal and cement have been greatly reduced.

A total of 19,522 kg of gold, which was 27.5 million liras in 1934, increased to 29.5 million liras at the end of 1935. Some of these golds were pawned and foreign currency was obtained.

There are 162,753,627 lira banknotes in circulation at the end of the year.

Total assets in the balance sheet dated 31.12.1935: 294,776,633,07 TL.

11.3.3.5 Fifth Account Period Report of 1936

The war between Italy and Abyssinia and the revolution in Spain show the turmoil in the world. Humanity's ability to walk confidently toward the peace and prosperity it needs, and the security sought by labour and capital, could not be realized in 1936 either. The volume in international trade started to increase and unemployment decreased a little more. However, this situation was created by the amount that the states spent on arms races along with credit and public works. Apart from Belgium, there is no country that is tied to gold anymore. The depreciation of the French franc into gold affected Swiss and Dutch currencies, as well as the Italian lira and Czechoslovak currency depreciated Latvian and Greek currencies were tied to sterling. Moving away from the gold measure supports a formation called the foreign exchange control coin.

It has been a good year in terms of agricultural production in the country, and the development has become visible. As a result of the successful implementation of the industrial plan, industrial production has also increased. Despite the rise in wholesale prices, the cost of living did not rise. Export figures of agricultural products are also higher than the previous year. A paper factory started production in İzmit. The construction of textile and wool factories continues. An agreement was made with British industrialists and investors for a factory to be established in Karabük.

While the First Five-Year Industrial Plan was being implemented, the principles of the Second Five-Year Plan were determined. These will be for the mining, coal mines, power plants, soil, food, chemical, mechanical, maritime industries.

In 1936, the value per ton of export increased. Railway constructions continue, and the Eastern Railways were also purchased and nationalized. At the end of the year, there is a total railway network of 6284 km. For the Erzurum-Sivas line, which cost 30 million liras, a 3rd order borrowing of 4.5 million lira was made.

In the report, under the title of gold status, it was written that the total amount of 21,103 kg of gold at the end of the year was 33,902,868 liras. It has been stated that foreign exchange is procured from these gold by giving pledges when necessary.

In the case of foreign currency, it was stated that the area of exchange with free foreign currency narrowed again in 1936 with the clearing agreements made with 3 countries. The foreign exchange obtained through clearing agreements with 20 countries and trade with other countries has increased. However, the austerity measures implemented by the government also contributed to this situation. In 1936, the discount rate was 5.5%.

The banknotes in circulation amounted to 198,840,578 liras, with an additional 27,000,000 liras added to the current 171,840,578 lira in circulation banknotes in 1935. During the year, 11,156,626 lira banknotes were withdrawn from circulation, and a balance of 187,683,952 lira banknotes remained. In order to detect the banknotes in circulation in the actual market, it is necessary to remove the 6,924,946 liras in the CBRT safes. Thus, at the end of the year, there are 180,759.006 lira banknotes in circulation.

The bank's reserve fund at the end of 1936 was 1,551,182.53 liras. If the proposal for the distribution of the profit is approved, this amount will be 2,105,172,40 TL. As a result of the decision taken at the extraordinary General Assembly meeting on February 4, 1937 and the changes made in the bank law, a special reserve was included in the reserve funds after 1937. From the beginning of 1936, this amount was 4,516,007.70 TL at the end of the year.

Profit from 1936 transactions is 2,203,535.27 liras. 20% of this amount will be deducted from the reserve fund 440,707.05 TL and 6% to the shareholders 630,000 TL, the sum of these two (1,070,707.05 TL) will be deducted from 2,203,535.27 TL. Of the remaining 1,132,828.22 liras, 45,269.01 liras, and 10% extraordinary reserve funds will be allocated to civil servants (113,282.82 liras). When the sum of these two is 158,551.83 liras, half of the remaining 974,276.39 liras is 487,138.20 liras to the treasury and the other half is 487,138.19 liras to the shareholders. It was stated that the distribution of profit was made in accordance with Article 88 of the Bank's Law and Article 94 of the regulation (CBRT 1937).

11.3.4 Turkish Economy, Statist Economic Policies, and CBRT

With the establishment of the Central Bank of the Republic of Türkiye, Türkiye-dominated its own currency. The Law on the Protection of the Value of the Turkish Currency was published in the Official Gazette on February 25, 1930 in the same year and TL was separated from the free exchange regime. *“In the 1933 report, it was stated that this was done with the measures taken since 1930 with the statement that “our country is one of the countries that are trying to keep their money stable”.* In 1931, Türkiye connected its imports to the quota system, and the foreign trade with the clearing agreement started with France in 1932 was expanded to trade with other countries. Thanks to the measures taken, the external value of TL has stabilized. Interest rates, which remained in the free variable system until 1933, were transferred to the supervised system where the maximum interest was determined by the Law on Lending Affairs, which was put into effect in 1933. Thus, while Türkiye has the right to seigniorage, it has taken the interest rate, foreign exchange system, finance capital and foreign trade under control; It was able to follow the path followed by the independent part of the world during the crisis years (Kazgan 2009: 65).

In the 1930s, direct monetary policy instruments such as deposit and loan interest ceilings and the authority to determine required reserves were not under the authority of the CBRT. Required reserve application started for the first time in Türkiye in 1868 with the obligation to keep at least 10% of the collected money in the safe, which is included in the 8th article of the Istanbul Security Fund Regulation. The first legal regulation regarding required reserves (deposit reserve requirements) in Türkiye was dated 30.05.1933, which looks like a liquidity ratio.

It was introduced with the Law No. 2457, which amended the Deposit Protection Law No. 2243 in 1934. With the banking law dated 09.06.1936 and numbered 2999, the system of applying the reserve ratio to total deposits was introduced, and no obligation to deposit to the CBRT was imposed. Banks were obliged to buy State Domestic Loan Bonds or income-generating securities such as these bonds with required reserves, the provisions were determined as 20%–30% for demand deposits and 10% for time deposits until 1936. 15% is determined as a single rate for demand deposits. According to Article 26 of this law, the obligation to deposit the reserves set aside to the CBRT was not envisaged, and banks were allowed to use these reserves (Önder 2005:102). In this context, the reserve requirement application was used in the 1930s and later years not as a monetary policy tool, but rather with the motif of public financing and the protection of the saver (Önder 2005: 103).

The 1930s were the years when statist economic policies were used intensively. However, in the early years, the CBRT’s founding law significantly limited the CBRT’s lending to the public. The CBRT Establishment Law No. 1715 did not contain provisions that included the discounting of Treasury bills and the powers of enterprises and institutions in the public sector to rediscount their bills with Treasury guarantee or to give advances in return. These shortcomings were rearranged, respectively, by adding a clause to the 38th article of the Establishment Law with the

Law No. 2062 enacted in 1931 and by amending the 38th article of the CBRT Law with the Law No. 3492 enacted in 1938:

“Article 38- Agricultural bills with a maturity not exceeding 9 months can also be accepted for discount, just like commercial bills. Agricultural notes with a maximum maturity of 9 months may also be accepted for discount, provided that their amount is equal to 15% of our paid-in capital and does not exceed 15% of our (commercial) discount wallet. However, the Bank Board may increase the paid-in capital to 25% if it “deems fit”. As a result of the effective intervention of the state in the economy in these years, the restrictions foreseen for treasury bills were relaxed in 1936. In 1938, the Central Bank was given the authority to discount the treasury-guaranteed bills of public sector enterprises and institutions or to give loans in return for these bills. (Önder 2005: 106; Zarakolu 1984: 55).

In the 1930–1939 period, when a sound monetary and balanced budget policy was followed, there were no behaviors that would cause money and credit expansion. The soundness of the finances and the balanced budget were considered above all as the principles that ensure the stability of the regime. It gains the immutability of the line of “balanced budget and solid money”, on the other hand, from the immutability of the money volume. The volume of banknotes was hardly changed in the 1930s, and a great deal of care was given to this. Money is always expensive, interest rates are high (Kuruç 1987: 44; Bakır 2007: 41).

Institutional arrangements, including the CBRT Law of 1930, are steps taken to establish the principles of “balanced budget and sound money”. One of them is the “balanced budget” oriented fiscal policy, which aims to increase tax revenues and to finance expenditures and to keep government expenditures under control. This policy is a formal institutional arrangement that prevents monetary expansion that will lead to inflation.

The legislator initially bound the CBRT’s emission regime to very strict rules for fear of inflation. In the 1930s, on the one hand, there were efforts to eliminate the effects of the 1929 crisis and at the same time to meet the development need of the country. In the face of the contraction in domestic demand due to tight monetary policy, the government forced civil servants to use domestic goods. Against the price increases that may be caused by such an application, general price control practices have come to the fore (Parasız 2011: 380).

The internal and external resources necessary for statist industrialization were realized through other means, not through open financing. Monetary balance was maintained with a balance policy in the capital movements of the period. The money supply was only slightly increased from the early 1930s to 1939. Compared to the total national income, which has increased by 5–6% per year at constant prices, the money supply has been slightly increased (Kepenek 2019: 63). This understanding, which emerged in the 1930s, transformed into an economic policy and formed the general framework of Türkiye’s economic policies to the extent that it was compatible with the world and domestic conditions for the next half century (Table 11.1).

Table 11.1 Basic economic indicators in the period 1932–1936

	1932	1933	1934	1935	1936
Reserve Currency	158	165,7	171,5	172,6	187,7
Issuance	148,5	146,8	158	162,7	180,8
Bank Deposit	8,2	18,9	7,7	7,5	5,5
Issuance Increment %	10,1	−1,7	2,4	4,4	9,2
Inflation	−5,7	−15,9	0,5	11,1	5
Rate of Growth %	−10,7	15,8	6	−3	23,2
Parity of Dollar/TL	2,3	1,35	1,27	1,25	1,25
Short-Term Rediscount Interest	8–7	7,5–6	5,5	5,5	5,5

Source (Önder 2005: 102)

11.4 Conclusion

Central Banks are one of the most important financial institutions that carry out the financing transactions of the state administrations. Central Banks are institutions that produce money on behalf of the state and carry out monetary policies. The need for resources for war financing by governments has been influential in the establishment of central banks as joint stock companies in the world.

The process, which is pointed out by the reasons why a central bank was not established or could not be established in the Ottoman Empire, clearly reveals the purpose of the establishment of the Central Bank of the Republic of Türkiye. In the historical development process, the Bank's basic duties and functions and its importance in the country's economy are clear. The duties of central banks have followed an increasing course throughout history. Unlike other banks, they were established to serve the public interest, not for profit.

Türkiye's sovereignty over its own currency was realized with the establishment of the Central Bank in 1930. This phenomenon is also an indicator of national economic independence. In the 1930s, when a solid money-balanced budget policy was followed, the external value of the TL stabilized thanks to the legal regulations and measures taken. While Türkiye has the right to seigniorage; It took the interest rate, foreign exchange order, finance capital and foreign trade under control and followed the path of the independent part of the world during the crisis years.

The first Central Bank Law, numbered 1715, was implemented for nearly 40 years. Sometimes, due to difficulties in implementation (like the gold equivalent of banknotes), the relevant articles were removed, and changes were made. Considering that the boundaries of the study were the first years of establishment of the CBRT, the framework of these changes was drawn with the years discussed.

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Chapter 12

An Overview of the Turkish Tax Framework and the Relationship with Tax Regulations and Accounting in Historical Perspective



Arif Ayluçtarhan

Abstract A strong tax system should be designed in order to meet the public benefit-based objectives of taxation, especially financing of public expenditures. In the Turkish tax system, after the Ottoman Empire, a new structure was tried to be created by making continuous changes. However, after the abolition of the tithe (aşar), a new and modern tax system structure was tried to be reached. In this context, it can be stated that there has been a shift from the traditional tax approach to an understanding targeting the payment capacity. However, even after an important tax reform, the tax system could not be structured to fully grasp the payment capacity and economic structure. Considering its current structure, the Turkish tax system is still largely based on unfair indirect taxes. Furthermore, the direct taxes applied are also mostly collected in the form of withholding tax. Turkey is faced with international tax competition with unbalanced tax structure. On the one hand, it applies to tools such as lowering of direct taxes under competitive conditions; on the other hand, it participates in international tax cooperation efforts. The impact of tax rules on the accounting practices in Turkey has not developed in a healthy way. In this context, it can be considered that accounting and reporting practices remained under the shadow of the tax legislation for a long time. However, when the changing accounting thinking and practice is evaluated, it is seen that accounting practices find a wider environment and progress in a way that serves its purpose. Based on this implications, this study focuses on the following research questions. First, what are the historical and economic factors affecting the current taxation structure? Second, what are the main problems of the Turkish tax system? And finally, how is the interaction of tax rules and accounting practices within its historical development and current structure?

Keywords Turkish tax system · Tithe · Tax history · Tax reform · Tax accounting · Accounting history · International accounting

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12.1 Introduction

Turkey is a very important participant in the international economic system since a long time. Over time, the forces of globalization required the country being more and more integrated to the world through various channels. One and probably the most important way of this integration is international commerce that runs in many forms such as international trade, direct foreign investments. Moreover, tax liability is a significant factor to be considered in terms of all economic activities. No doubt the more international economic integration grows in Turkey, the more the need of understanding tax regime of Turkey. In the chapter, the traditional approach of Turkish tax regulations will be explained, and current tax environment will be introduced in general terms. Considering the nature of international trade relations, the role of accounting regulations is introduced within the framework of the mentioned tax regulations.

12.2 General Information About Taxes

Before looking into the details of the Turkish tax system, it would be appropriate to highlight some general information about taxes. Including three characteristics, a tax might be defined as “*a compulsory levy imposed by an organ of government for public purposes.*” First and foremost, important essence here is in the compulsion; law provides this **compulsion** (Williams et al. 2000). The political essence is **public purposes**. In addition, a government organ imposes the taxes due to these public purposes. Main public purposes basically might be articulated as.

- a. Providing revenue to cover government expenditures,
- b. Redistribution of wealth and income by means of progressive increasing tax rates and welfare services,
- c. Controlling the economy by imposing taxes on the demand (e.g., high custom duties to protect some domestic products)
- d. Social control purposes (e.g., taxing alcoholic beverages and tobacco products)
- e. Making sure people pay full price of some goods and services (i.e., the main idea here is to pay for the environmental pollution that will occur. For example, when buying bags, consumer should pay the price of pollution as well) (Williams et al. 2000).

In order to apply taxes for these purposes in the best form, some principles are needed to follow. Adam Smith in his famous book “Wealth of Nations” sets four main principles for better taxes (Williams et al. 2000).

1. The tax should be applied as a contribution to the rate of personal income and wealth.
2. Taxes should be certain, not arbitrary.
3. All taxes should be implemented in most convenient way.

4. All costs should be kept to a minimum in tax enforcement.

Furthermore, taking into consideration international commerce and global economy, it is suggested that taxation should also be competitive (Williams et al. 2000).

After this general information, Turkish tax system will be explained in detail with historical and current implications and relationship with accounting regulations.

12.3 Historical Background

Fundamentally, tax regulations of Turkish Republic inherited from late Ottoman Empire times. Therefore, the last appearance of tax structure of Ottoman Empire should be mentioned as introductory remarks.

12.3.1 Late Ottoman Period

In late Ottoman times, economy was primarily based on agricultural production. Since, agriculture was the main source for the economy, tax system was also based on agricultural yield besides religious taxes (İbrahim 1934). As a matter of fact, during Tanzimat reform, it was also aimed to shift tax burden from land to urban in the way of direct taxes to follow ability to pay, however that was partially achieved at that time (Shaw 1975). In order to show a general frame of tax system during late Ottoman era, some figures of revenue in budgets are given in percentage of total revenues as follows.

In Table 12.1, government revenues are given in percentage of total revenues.

As it is seen in Table 12.1., majority of tax revenue is based on agricultural taxes (explained below).

Aşar (Tithe): A tax in kind, which was generally imposed on one tenth of agricultural products, provided a quarter of the public revenues during the period in question.

Land Tax: This tax could only provide 10% of public revenues in the last period but provided 20% of public revenues in the period 1863–64. While this ratio decreased over time, a significant contribution level of 10% was still maintained.

Ağnam (Tax on livestock): Sheep, goat, ox, water buffalo, camel, etc. It is a kind of animal tax received from animals and it provides 8% of the public revenues.

It can be briefly said that approximately 60–70% of public revenues came from agriculture in this period. Another important point is that the only flexible tax that tracks agricultural production with 10 percent is the Aşar. As a primitive tax structure inherited from ancient times, undoubtedly, the Ottoman tax system could not achieve modern public goals and follow modern tax principles.

Table 12.1 Government budget revenues as percentage of public revenues 1863–1864, 1874–1875, 1893–1894– 1902, 1911 (%)

	1863–1864	1874–1875	1893–1894	1902	1911
Aşar (Tithe)	27,4	30,0	22,2	23,3	25,0
Land Tax	20,0	18,0	13,5	10,8	10,0
Ağnam (Tax on livestock)	6,6	9,0	10,0	11,0	8,0
Compensation for Military Service	4,0	3,4	4,6	5,8	3,5
Royalty Tax (Patent)	–	–	3,7	2,2	1,5
Various Duties	–	–	1,3	1,8	5,0
Custom Tax	16,4	9,0	11,0	12,5	15,0
Indirect Taxes	15,6	17,3	15,0	15,2	19,2
Various Revenues	10,0	13,3	18,7	17,4	12,8
Total	100	100	100	100	100

Source Mustafa Recep Erdoğan, “Türkiye’de Tarımın Vergilendirilmesi ve Kalkınma”, İ.Ü. İktisat Fakültesi Mecmuası, 30, p. 230

Table 12.2 Contributed national income by production segments’ percentage, 1923–1932

	1923	1924	1925	1926	1927	1928	1929	1930	1931	1932
Agriculture	39,8	47,6	48,6	49,0	41,4	44,3	51,9	45,8	45,5	40,2
Industry	13,2	9,9	9,7	10,1	13,0	11,6	9,9	11,4	2,9	14,1
Commerce	7,8	7,1	7,2	7,0	8,0	7,3	6,3	6,5	6,9	7,2
The Other Services	39,2	35,4	35,1	33,2	37,6	36,8	31,9	36,3	34,7	38,5
Total	100	100	100	100	100	100	100	100	100	100

Source Kepenek and Yentürk (2003)

12.3.2 Tax System Structure in Early Stages of Turkish Republic

The new Republic of Turkey’s economy still relied mainly on the agricultural sector. The following table shows the proportions of the main sectors contributing to GDP in the early period of the Republic of Turkey.

During this period, the government, contrary to the attitude of the Ottoman Empire, tried to develop the industry and direct the investments of government enterprises by using a protective tariff. The corporate type of business, however, was still relatively rare; investments were usually made directly in real estate (İbrahim 1934).

The main change in the understanding of taxation from the Ottoman to the Republic is taxation based on tax payment capacity instead of taxation based on religion and custom (Miynat and Tunçay 2014).

Essentially, it is worthwhile at first to dwell on income tax history to frame the main structure of tax system from Ottoman to Turkey Republic.

Although the first law of the Turkish Grand National Assembly dated April 24, 1920 was about the quadrupling of the Aghnam tax, the main feature of the tax policy at that time was the effort to ease the tax burden on the agricultural population, whose ability to pay was greatly reduced. In this context, the Republic of Turkey as the first fundamental reform of the tax system, the tithe (aşar) has been removed in 1926. Because of perceived pressure and burden (Akgül and Aral 2004), Tithe was one of primary issue in Izmir Economic Congress program in 1923. All the different Congress groups reached a consensus on the removal of Tithe, and some groups on the replacement of a new and fair tax (İzmir Büyükşehir Belediyesi 2004).

Temettu tax (the dividend tax—the tax charged over profit) was introduced in the Tanzimât reform period (dated 1840), taking into account the annual earnings of tradesmen and craftsmen. Later on, labor and self-employed incomes were also included in the subject of the tax (Şahin 2013, pp. 45–57). This tax was collected under the name of temettu tax until the Law of Income Tax (until 1926). In actual fact, the temettu tax was calculated based on estimated profit instead of calculating real profit through the accounting registry system. However, this tax has formed the basis of today's personal income and corporate income tax (Güvemli et al. 2019).

After the temettu tax, the income tax (dated 26.2.1926) became the first law to provide true and sufficient information for taxation. According to this law, commercial and industrial companies, service businesses, self-employed persons were subject to tax. These taxpayers were obliged to keep books on the basis of balance sheet and pay tax at the rate of 11% of their earnings (Güvemli et al. 2019). However, in the application of income tax, taxpayers' various income items were being taxed separately. This method of taxation is a method that causes injustice in taxation by not considering the personal conditions of the taxpayers. On the other hand, in case of unitary income tax application, the personal situation of taxpayers could also be taken into account. In this way, the system could possibly eliminate excessive taxation of taxpayers (Arda 1949). This social goal was one of the aims of tax reform, which will be explained in the next section.

Apart from income taxes, consumption taxes have always played an important role in taxation. Although not a right choice since the first period of the Republic of Turkey, indirect taxes play an important role in the Turkish tax system. Immediately after Tithe was abolished, the government sought to tax agricultural products with indirect taxes to compensate for the resulting loss of income (e.g., special consumption taxes such as taxes on sugar, petroleum; state monopolies' revenues) (İbrahim 1934).

In addition, in 1926, a copy of the French tax of the same nature was introduced as general consumption tax. On the other hand, alongside ağnam tax and road taxes, land crop tax and export taxes were codified in this period (Pur 2015).

However, the general consumption tax was abolished just a year later, and transaction tax was introduced in 1927. This tax is considered as the first form of value added tax. By contrast, the tax only covered industrial production (Güvemli et al. 2019).

Table 12.3 shows the most important figures of tax system during this time.

As can be seen in the table, after the tax restructuring efforts mentioned above, the tax system was now largely based on indirect taxes.

Table 12.3 Central government budget revenues 1946–1950 (Million, TRY)

	1946	1947	1948	1949
Revenues	894.7	1021.2	1115.6	1251.8
Tax Revenues	784.1	987.7	1069.1	1118.6
Income Tax	133.2	157.0	169.3	176.4
Ağnam (livestock) Tax	27.0	27.4	31.0	32.0
Transaction tax	137.3	188.0	234.0	234.5

Source Ministry of Finance, Budget Expenditure and Income Realizations (1924–1995), 2nd Edition, Finance Ministry, Budget and Financial Control General Directorate, No:1995/5 (Ankara 1995), 140

12.3.3 Reform in Turkish Tax System

Given the primitiveness and complexity of the tax structure at that time, there has always been a need for a new and modern Turkish tax system. Some reforms have been implemented gradually to establish a new tax system.

It is suggested that the reforms of the republican period tax system consisted of three milestones: 1. Tithe (Aşar) was abolished in 1926, 2. Income taxes (Personal Income Tax and Corporate Income Tax) and Tax Procedure Law were enacted in 1949, 3. Value Added Tax was enacted in 1984.

As stated earlier, the first major reform in the Turkish tax system was the abolition of tithe in 1926.

In general, a modern tax system is based on income taxes, with taxes on consumption and property. However, in modern times, the main tax system on which the tax system is built is income tax. The income tax was mainly due to the war in Britain against Napoleon. Firstly, the tax, which was temporarily accepted during this period, was revised and started to be implemented permanently. Before the Napoleonic wars, taxation in general was based on the collection of excise taxes on things like land, servants, tea, and wigs. Customs taxes were also extremely important at that time (Williams et al. 2000).

To reach a modern tax system, the most significant issue was income taxes. Second and a general reform in Turkish tax system was initiated by the late 1940s and 1950s. This essential reform was commenced to form Turkish tax system as basic structure of today's system. First of all, in 1949, income taxes (Personal Income Tax and Corporate Income Tax) are legislated instead of previous income tax (earning tax). Moreover, in order to implement all taxes in technical aspect, Tax Procedural Law is legislated. These three taxes were modeled after the German system. Thus, there was a discussion about whether it is appropriate for Turkey these taxes. Because it was claimed that the mentioned taxes were mainly designed for developed and industrialized countries. The other arguable issue was putting agricultural income out of scope of the tax at that time (Öncel et al. 2002).

In following these three taxes, Tax for Collection of Public Claims was legislated in 1953 in order to collect all public claims to replace property collection law which

is inherited from Ottoman Empire. Later, Inheritance and Gift Tax, a tax based on transfer of property, was issued within this scope (Öncel et al. 2002).

In 1957, the Consumption Tax Act was passed to replace the transaction tax. In this tax, instead of a wide tax base, the tax issue is based on the delivery of raw materials, which are narrow and the main input of production (Table 12.4).

In the 1970s, while agricultural income was added to income tax subject, some tax incentives were also introduced. During the same period, certain taxes on wealth were enacted (i.e., the Property Tax was introduced and the personal automobile tax was converted into Motor Vehicles Tax).

Although income taxes were reshaped in the 1980s to include some other novelties, the vital change in the Turkish tax system in this period was the first implementation of Value Added Tax (VAT) in 1985. VAT is a different than the other taxes in terms of spreading more rapidly around the world (Schenk et al. 2007). The difference between transaction tax and VAT is that the tax is not only levied on one level (e.g., production or gross sales level) but also covers every step of value chain based on sales price (Akdoğan 2002).

Then in 2002, the latest important change was introduced as special consumption tax.

By 2007, the novelist changes were in transfer pricing, thin capitalization, anti-avoidance measures, foreign participation exemptions, and provisions specific to controlled foreign companies.

One of the most visible changes introduced by the new law was a 10% reduction in corporate tax rate, from 30 to 20%. On the other hand, the withholding tax rate on profit distribution increased from 10 to 15%.

Table 12.4 Central government budget revenues 1951–1960 (Million, TRY)

Years	1951	1952	1953	1954	1955	1956	1957	1958	1959	1960
Revenues	1345.0	1551.4	1959.8	2288.5	2789.1	3325.0	4006.7	4475.6	5980.6	7281.7
Tax Revenues	1259.2	1455.0	1850.1	2139.7	2558.7	3054.6	3351.4	3831.9	5650.4	6911.7
Income Tax	260.0	270.0	360.0	485.0	620.0	775.0	960.0	1150.0	1470.0	1800.0
Corporate Tax	30.0	32.0	70.0	90.0	110.0	120.0	132.0	145.0	160.0	345.0
Tradesman Tax	25.0	27.0	30.0	33.0	33.0	30.0				
Ağnam (livestock) Tax	26.0	28.0	30.5	29.0	32.0	30.0	30.5	31.0	33.0	36.0
Transaction Tax	225.0	322.0	440.0	460.0	515.0	635.0				

Source: Ministry of Finance (1995)

12.4 Current Structure of Taxation System

With the current framework, Turkish tax system can be classified as follow: income taxes, taxes on consumption, taxes on wealth, and the other taxes (local administration taxes) (Doğan 2009).

Income Taxes (Personal Income Tax-Corporate Tax): While real persons' annual income is subject to Personal Income Tax, corporations are liable to pay Corporate Income Tax.

Personal Income Tax (PIT): PIT is levied on the income of real persons for one calendar year. A real person's income may consist of one or more income elements listed below:

- Business profits (commercial income),
- Agricultural profits (income),
- Salaries and wages,
- Incomes from independent personal services,
- Incomes from immovable property and rights (rental income),
- Incomes from capital investment (income from movable property),
- Other incomes and earnings (capital gains and incidental incomes).

Unitary income tax system with some exceptions is applied to Personal Income Tax in Turkey (i.e., all income components that a real persons obtain from different sources are added then taxed in this method) (Başpınar 2011). A tariff with progressive tax rates is applied to calculate Personal Income Tax payable. This practice provides a basis for fair taxation, with exceptions that also take into account certain personal situations (e.g., disability, minimum living allowance).¹

The Corporate Income Tax (CIT): CIT is levied on the income and earnings derived by corporations and corporate bodies. Taxpayers are legislated as follow in Corporate Tax Code (CIT law art. 2).

- Capital Companies: Joint Stock Companies—Limited Companies—Limited Partnership Association, (funds, e.g., investment funds, retirement investment funds, housing financing funds, asset financing funds, investment trusts) (similar foreign funds and companies)
- Cooperatives,
- Public enterprises,
- Enterprises owned by foundations and associations,
- Joint ventures.

Corporate income which is subject to CIT is composed of income elements exactly same as PIT (stipulated in article 2 of Personal Income Tax Law). However, these

¹ In article 73 of Turkish Constitution in first and second paragraphs financial and social aims of taxation; generality and equality are stipulated as follow “*Everyone shall be liable to pay tax in accordance with his/her financial situation to the cover public expenses. The fair and equitable distribution of tax burden is the social aim of the fiscal policy.*” Particularly, progressive tax rates in income taxation reflect fair and equal characteristic of taxation.

income elements² shall be considered as corporate income as a whole (Başpınar 2011) and shall be taxed as commercial income. A flat rate is applied to compute corporate tax unlike to PIT. Both for PIT (commercial income) and corporate income to compute taxable income accounting income (profit or loss) is a starting point. Starting from this point, special tax regulations (non-deductible expenses and exceptions, etc.) are also taken into account for the determination of taxable income (Article 38 PITL and Article 6 and 22 CITL).

When comparing both taxes, PIT is personal, subjective, and progressive direct tax, while CIT is non-personal, objective, and flat-rate tax (Mutluer et al. 2001). Profit distribution is significant point between PIT and CIT. When corporate profits are being distributed to individual shareholders, after 15% withholding tax in case half of total dividend exceed second tax bracket this half of dividend shall be tax base for PIT as the income from capital investment. Withholding tax will be deducted from the calculated partial imputation system³ (PIT).

Taxes on Consumption: In today's tax application approximately one-third of tax revenue composed of consumption taxes in OECD countries. These taxes mainly classified in two categories: (1) General taxes on goods and services (e.g., value added tax, sales taxes), (2) taxes on specific goods and services (e.g., excise taxes, customs and import duties, taxes on insurance premiums and financial services) (OECD 2018).

Turkish taxation system includes several consumption taxes, but the most important ones are Value Added Tax and excise tax (also called special consumption tax).

Value Added Tax (VAT): As a general tax, VAT is a broad-based tax which collected by businesses through a staged process (OECD 2018). This process has a systematic which "offsetting of tax charged on inputs against that due on outputs" (ITD 2005). Although, VAT is taken on added value (added nominal value) at each stage, actual tax burden is carried until final consumer by means of reflecting in prices. VAT is levied on deliveries of goods and services in the scope of commercial, self-employed, and agricultural activities in Turkey.⁴ These deliveries connect VAT with PIT and CIT since they also create revenue which leads profit or loss. VAT offsetting system leads to conflict of interests among taxpayers thereby creating a control mechanism within the tax system. This auto-control system increases PIT and CIT revenues (Öncel et al. 2002). However, the offsetting system and the event raising the tax is with absolute meaning based on invoice (and lieu documents) in Turkey (issuing an invoice leads to charge VAT even before delivery and in order to offsetting tax charged, legal document is a requirement) (VAT, Art. 10/b and 29). Document based system leads the majority of tax frauds to stem from "fake invoices."⁵

² (Business profits (commercial income), Agricultural profits (income), Salaries and wages, Incomes from independent personal services, Incomes from immovable property and rights (rental income), Incomes from capital investment and other incomes and earnings).

³ For more information on the partial imputation system, see (Avi-Yonah et al. 2011).

⁴ And also importation of certain goods.

⁵ Fake invoice: Issued invoice without good or service delivery (Tax Procedural Law Art. 359).

Due to “destination principle,” both goods and services deliveries shall be taxed at the arrival country for international transactions. According to this internationally applied principle, the goods and services are taxed at arrival places. Therefore, export deliveries are excluded from VAT.

Excise tax is a tax levied on particular selected goods, unlike VAT. The tax is normally collected at once generally at first stage of the supply chain (e.g., production, importation stages).

There are mainly four product groups that are subject to excise tax at different tax amounts or rates (The Republic of Turkey Ministry of Finance, Revenue Administration 2016).

“List (I) is related to petroleum products, natural gas, lubricating oil, solvents and derivatives of solvents,

List (II) is related to land, air and sea vehicles (cars and other vehicles, motorcycles, planes, helicopters, yachts etc.),

List (III) is related to alcoholic beverages and cola soda pops, cigarettes and other tobacco products,

List (IV) is related to other consumption goods (caviar, furs, mobile phones, white goods and other electrical household machines etc.).”

VAT tax base also covers taxes including excise duties (VAT, Art. 24). Therefore, an increase in excise tax on any good also increases VAT burden.

Another tax levied on banking and insurance transactions is “Banking and Insurance Transaction Taxes.” This tax is basically the equivalent of VAT applied in banking and insurance transactions.

Special Communications Tax: Telecommunication services are subject to special communication tax. This tax is not included in the VAT base.

The other taxes on transactions are Fees, Stamp Duty Tax, and Tax on Customs which are basically based on more limited transactions.

Taxes on Wealth: Inheritance and Gift Taxes mainly charged for non-commercial transfers of any type of property between deceased—theirs (inheritance tax) and between living persons (gift tax).

The other taxes levied on wealth are Property Tax and Motor Vehicle Tax.

Other Taxes (Local Administration Taxes): These taxes are collected by municipal authorities. (E.g., Announcement and Advertisement Tax, Entertainment Tax, Communications Tax, Electricity and Gas Consumption Tax, Environmental Consumption Tax, Local Administration Fees).

12.5 Two Fundamental Issues for the Taxation System

First and the most significant issue of tax structure in a country is balance of distribution of tax burden. After World War II, governments began to increase tax revenues both to implement important economic policies and to meet increased public services. In particular, the function of the state mechanism to redistribute income was very

important for developing countries. However, for this function of modern government, it is very important to design a good tax structure (balanced distribution of the tax burden) as well as effective public expenditure (Tanzi 2016).

As a developing country, fundamental problem of tax structure in Turkey is the balance of distribution of tax burden. This point might be explained with proportion of direct and indirect taxes in total tax revenue. In Turkey, government generally solves the financing problem by resorting to indirect taxes that are easy to collect, instead of increasing the efficiency of existing taxes; as a result, the already imbalanced indirect–direct tax balance worsens (Demirli 2011). In Table 12.5, direct and indirect taxes from 2014 to 2019 and the share of these taxes in total tax revenues are shown.

The direct–indirect tax distinction provides information on the revenue source and fairness of the tax system. In tax systems, the shift of revenue to indirect taxes, while giving favorable results in terms of efficiency, is harmful in terms of ensuring justice (Demirli 2011). In the table, it is seen that the share of direct tax in the post-2004 period was below 34% on average and decreased to 31% in some years.

Apart from the government's choice of easy financing, another reason for the high share of indirect taxes in budget revenues was international tax competition. Particularly, to attract international direct investments, there have been various reductions

Table 12.5 Distribution of indirect and direct taxes [2004–2019]

				(Billion TRY)	
	Indirect Taxes	Direct Taxes	Total Tax Revenue	Proportion In Tax Revenue (%)	
				Indirect Taxes	Direct Taxes
2004	62.080	27.997	90.077	68,9	31,1
2005	74.256	32.673	106.929	69,4	30,6
2006	94.222	43.258	137.480	68,5	31,5
2007	100.991	51.844	152.835	66,1	33,9
2008	109.086	59.023	168.109	64,9	35,1
2009	111.308	61.133	172.440	64,5	35,5
2010	143.995	66.566	210.560	68,4	31,6
2011	171.752	82.057	253.809	67,7	32,3
2012	186.231	92.520	278.751	66,8	33,2
2013	225.728	100.442	326.169	69,2	30,8
2014	238.093	114.422	352.514	67,5	32,5
2015	279.291	128.528	407.818	68,5	31,5
2016	308.821	150.180	459.002	67,3	32,7
2017	359.768	176.849	536.617	67,0	33,0
2018	390.105	231.431	621.536	62,8	37,2
2019	416.720	257.140	673.860	61,8	38,2

Source Ministry of Treasury and Finance, Budget Expenditure and Revenue Realizations (1924–2019)

in tax rates of income and corporate taxes since the 1980s in Turkey. Most recently, significant reductions were made in income and corporate tax rates in 2006. However, the fact that it ranks third among OECD countries in terms of electricity prices (Bilici 2006) and the increase in other energy prices due to the high excise tax application negatively affects the competitiveness of the industrialist. This situation has adverse effects on foreign direct investment in Turkey (Demirli 2011). In addition, high rates of unfair taxes cause erosion in the tax base, damage the main purpose of taxation, and cause informality in the economy.

The unbalanced nature of income and excise taxes is clearer when the rates are compared to the OECD average.

In Table 12.6, revenue statistics for 2017 in comparison with OECD average is shown.

As seen in the table, it is much higher than the OECD average share of income tax in Turkey. On the expenditure side, especially in Turkey consumption taxes (excise duties), share is over 23%, which is nearly twice the OECD average. Even when we look at the figures alone, for the Turkish tax system to achieve a fair tax structure, the income-consumption tax structure must almost completely reverse (Demirli 2011).

Another issue that needs to be addressed regarding income tax revenues is that a significant part of the total income tax revenue is collected with withholding tax. An important part of the withholding is made up of deductions from wage and salaries of employees (Demirli 2011). Moreover, the height of the tax burden on the average wage in Turkey is seen as an obstacle to employment and is counted as one of the most important reason for informal employment (Kızılot 2006).

The other fundamental Issue for Turkey taxation is tax competition. After the 1980s, as a result of free trade in goods and services, free capital flow, and other liberal policies (creating a convenient environment for international direct investments, etc.), tax competition has also increased rapidly. In the framework of tax competition, governments have reduced taxes (i.e., reduced tax rates, tax cuts). Simultaneously, they have made efforts to compensate for tax losses by expanding tax bases (limiting tax expenditures, combating tax havens, controlled foreign company-CFC, and transfer pricing regulations).

Another measurement for tax competition has been to make mutual effort with the other competitors to combat tax evasion under OECD guidance (Öz 2016).

Under these conditions, Turkey had struggled with the harmful effects of competition and should reach a balance in growing international tax competition environment. As a member of the OECD, Turkey had to join and take counter measures to challenge harmful tax competition. Therefore, Turkey has lowered personal and corporate income tax rates. In 2006, a new Corporate Tax Law was enacted, which included CFC and transfer pricing tax security measurements. In addition, Turkey has taken some additional steps in this direction (e.g., the expansion of the tax information exchange agreement framework, ensuring access to bank information) (Öz 2016).

Table 12.6 Revenue statistics: overview

	Tax revenue as % of GDP				Tax revenue as % of total tax revenue in 2017						
	2018	2017	2016	2000	Taxes on income, individuals (PIT)	Taxes on income, corporates (CIT)	Social security contributions (SSC)	Taxes on property	Value added taxes	Other consumption taxes	All other taxes
OECD – Average	34.3	34.2	34.4	33.8	23.9	9.3	26.0	5.8	20.2	12.2	2.6
Turkey	24.4	24.9	25.3	23.6	14.5	6.8	29.3	4.5	20.1	23.3	1.3

Source OECD, Revenue Statistics 2019. <https://doi.org/10.1787/0bbc27da-en>

12.6 The Relationship Between Tax and Accounting Regulations in Turkey

Given the overall arrangements in Turkey, it is seen that commercial law, tax law, and accounting regulations are in a very close relationship.

In the first stage, Commercial Law (e.g., 1926, 1956 and 2011 Commercial law) has shaped equity capital to protect partners' rights. It has also regulated and fostered joint stock companies and capital market environment. On the other hand, the accounting information system has contributed to commercial and tax law at the point of verifying calculation and transaction processes with evidence. In addition, tax regulations also benefited from this equity capital in terms of computing tax receivable (based on increase of capital between beginning and end of accounting period) (Güvemli 2019).

With the adoption of the first income tax law (dated 26.02.1926) in Turkey, it was established a close relationship between accounting and tax regulations. According to the law, taxpayers were those who keep books on the base of balance sheet among commercial and industrial companies, service enterprises, and self-employed people. Moreover, payable tax was calculated over profit by keeping books on the basis of balance sheet for the first time in Turkey. In addition, double-entry bookkeeping and additional books (i.e., ledger, transaction book, daybook, inventory book) were introduced with this tax law.⁶ The period starting with this law and ending with the great tax reform (from 1926 to till 1949) is called the multiple book period in Turkish accounting history.⁷ The balance sheet specified in this law is mainly for tax purposes. In addition, tax balance sheet remained dominant throughout in the twentieth century in the accounting application (Güvemli 2019).

Income tax law was divided into three laws (Personal Income Tax Law, Corporate Tax Law, and Tax Procedural Law) by the tax reform in 1949. In terms of new taxes on income (Personal Income Tax and Corporate Tax), taxation on balance sheet basis has been taken as basis besides the operating book method. Accordingly, profit and loss will be calculated by comparing the amount of equity at the end of the period and the beginning of the period. In addition, the Tax Procedure Law valuation provisions would also be taken into account in the calculation of profit or loss (Küsmenoğlu 2010).

After the tax reform, both the Commercial Code and the Tax Procedure Law contained explanations regarding the obligation to keep books. There were also additional obligations in the Tax Procedural Law such as documents, valuation and similar issues. Tax reform was an important attempt to bring Turkish accounting thought to a modern level. However, the Tax Procedure Law has transformed the accounting practice into tax accounting (Güvemli 2019). When Tax Procedure Law redrawn up in 1961, the law made a great impact on accounting to develop within the frame of tax accounting. Later on based on article 175 Tax Procedure Law, Finance

⁶ Journal and inventory book took already place in Commercial Law at that time (Güvemli 2019).

⁷ There were some additional books to keep according to Transaction Tax Law and Consumption Tax Law (e.g., manufacturing book, sales book, warehouse book) (Güvemli 2019).

Ministry prepared a general uniform account plan in 1992 and started to implement 1994. The dominant effect of the Tax Procedure Law on accounting has continued until today.

Eight factors were suggested to have a significant influence on accounting development (i.e., legal system, taxation, political and economic ties, inflation, level of economic development, educational level, and culture) (Choi and Meek 2011). Legal system, taxation, and culture seem more applicable for Turkey case. The Turkish tax system as part of the code law country group is based on a legal form requiring highly prescriptive and procedural rules. As mentioned in the previous section, new Turkish tax codes were inspired by German tax regulations. It was also suggested that Turkey's accounting culture stays near to values such as statutory control, uniformity, conservatism, and secrecy (values derive from Hofstede classification of cultures) as part of Near Eastern Area (Gray 1988).

As a last chain of westernization and a result of globalization in Turkey, Turkish Commercial Law no 6102 enacted in early twenty-first century (dated 14.12.2011). Within the framework of the law, international accounting standards and international auditing standards have become part of the Turkish accounting practice on a broad basis and turned the accounting thought into globalization (Gray 1988).

Tax and accounting regulations are basically differing in terms of their objectives and regulation methods. While accounting principles are principle based, tax rules are rule based regulations. According to tax regulations all transactions and events should be validated by documents and based on clear facts. In contrast, accounting regulations are principle based which give rooms for tailor made reporting for every entity and situation. Main purpose of accounting is to provide all stakeholders particularly investors (Pekdemir and Türel 2010) with information needed to evaluate an entity's financial position, performance and cash flows. However, the aim of tax and tax accounting is to present information in order to secure and collect correct amount of tax.

12.7 Conclusion

In order to reach the scope of this study, some general knowledge of basis of taxation, a historical background for Turkey taxation experience, reforms in tax laws, current structure of taxation, and the relationship between tax and accounting regulations are examined.

Legislative arrangements for the implementation of tax obligations should be designed in accordance with some principles and public purposes. The first and maybe most important principle should be applied is that contribution must be in proportion of personal income and wealth. While tax legislation should follow some basic principles, there are some social and political dynamics as well as globalization and international business factors that direct and enforce legal regulations.

First tax regulations of Turkey Republic inherited from Ottoman times before establishment of Turkish Republic (in 1923). Starting from this period, the abandonment of tithe (      ) tax depending on social and economic conditions has led the tax system to indirect taxes. A major tax reform was made in 1949 with the change in economic and social conditions in Turkey.

However, as can be understood from the data presented in this study, the structure of the Turkish tax system basically based on indirect taxes has not changed in the course of today. Some economic and political approaches also need to be changed to change this structure (e.g., the government should not only follow tax policies based on changes in VAT or excise tax rates).

Turkey with this unfair and harmful structure of the tax system must also combat international tax competition. Turkey has to attract foreign direct investments on the one hand by reducing their tax liability. On the other hand, as a member of the OECD, Turkey has to join and take counter measures to challenge harmful tax competition. Turkey can only meet the tax loss which is due to increased tax competition by expanding tax base and the formal economy.

In addition to tax regulations, accounting practice also took part in this development course. The dual recording system and began to be implemented in Turkey with record income tax application. Thus, the accounting practice continued its development within the framework of tax accounting. As a result of globalization and international commerce factors in Turkey, by new Turkish Commercial Law international accounting standards and international auditing standards became part of Turkish accounting application and turned accounting thought toward globalization. In this context, accounting thought and practice should go beyond tax accounting and reach its main function of providing true and fair information to all parties including government.

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Chapter 13

Overview of Turkey's Tourism History



Emel Gönenç Güler

Abstract People have been traveling from one place to another since primitive times in order to live better, to find more fertile lands, to create better nutrition opportunities and to live more safely. The first traces of settled life can be seen in the lands between the Tigris and Euphrates and on the banks of the Nile River. The foundations of tourism were laid for the purpose of commuting between cities, establishing a commercial marketplace, visiting holy places and participating in festivals. The phenomenon of traveling, which started in the first ages, with the aim of meeting nutritional needs continued with the migrations that began with the aim of finding fertile lands. As change and development took place in historical times, the tourism sector was also affected and people gradually turned to different areas of interest. Since the first years of the republic in Türkiye, the tourism sector has shown rapid progress. Factors such as hunting, a sense of curiosity, visiting for health, the desire to discover new places and leisure time have played a role in the act of travel in the sector that has developed over time. Türkiye, which is the connection point of Asia, Africa and Europe, includes historical monuments such as caravanserais and inns, which is built as a bridge between the continents. It has always attracted the attention of tourists because of the fact that Türkiye is surrounded by seas on three sides and has a very cultural heritage in terms of history. In this study, evaluations were made on the historical process flow and development of tourism in Türkiye.

Keywords Tourism · Tourism in Türkiye · Tourism history

13.1 Introduction

The concept of tourism started in the early ages when people moved to meet their nutritional needs. It is known that the Sumerians started the travel history in 4000 BC and visits were made to Ancient Egypt in 3000 BC to see the pyramids and

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temples (Tunç and Ve Saç 1998: 11). The invention of the compass, the developments in navigation and cartography, the development of highways, the invention of the printing press, the developments in communication, that is, every step of civilization, people's need to see new places, their curiosity to learn new things, their search for adventure, conquest movements and religious forces have increased people's tendency to see different countries (Sezgin 1995: 17).

In the Middle Ages, with the Renaissance, there were developments in fine arts and science, and these developments gained importance in science and art in Florence, Rome and Paris (Tunç and Ve Saç 1998: 11). Just as Thomas Cook's first trip to continental Europe was to the Paris Exhibition, the first collective and organized trip to the Ottoman Empire, or in other words the first modern tourism movement, started with such an exhibition. Due to the opening of the exhibition "Sergi-i Umum-i Osmani" in 1863, tourism groups from various places, especially Austria, came to Istanbul. The first tourist groups from the Ottoman Empire started to go abroad with various arrangements.

In the post-republic period, rapid progress has been made in tourism movements. People's understanding of travel and their leisure time travels have increased over time, and alternative tourism types and the special interest tourism have developed.

13.2 Development Periods of the Tourism Sector in Türkiye

In studies dealing with the development of the tourism sector in Türkiye periodically, two main periods are mentioned. The period until 1960 is considered as the Pre-Planned Period and the period from 1960 to the present as the Planned Period (Soyak 2013: 10).

13.2.1 *Pre-Planned Period*

It can be said that in Pre-Planned Period (1923–1950), serious breakthroughs in tourism could not be made. Between these years, on the one hand, there was a period of political ups and downs and there was a life often spent in war; on the other hand, there were domestic and foreign economic, political and social problems arising from the new establishment of the Republic of Türkiye; therefore, tourism activities are prevented from being done at the required level (Dalgın et al. 2015: 177). It is accepted that the first movement related to tourism in Türkiye started with the "Turkish Traveler Society" in 1923 (Tunç and Ve Saç 1998: 97). Today, this society continues its activities under the name of Turkish Touring and Automobile Association. The first posters, the first tourist guides and the first road map of Türkiye were printed, the first language courses were opened, the first translator guide exams were held, the first tourism reviews were written and published, and the first tourism congresses and conferences were held. Organizing the first tour to Istanbul and Bursa,

the institution contributed to the promotion of historical and cultural heritage (İnan 2009: 39).

The subject of encouraging the first investments related to the tourism sector of Türkiye was handled in 1950 with the Law on Encouragement of Tourism Institutions, and a tourism loan fund was established in the Turkish Real Estate Credit Bank in the same year (Yıldız 2011: 58). In order to increase foreign capital investments, the Law of Encouragement of Foreign Capital Investments was enacted in 1951 and then followed by the Law of Encouragement of Foreign Capital (Kuşluvan 2016: 180). In 1953, the Tourism Industry Encouragement Law No. 6086 came into force, and with this law, entrepreneurs were encouraged to invest and tax exemption was provided for tourism investments for 10 years (Tunç and Ve Saç 1998: 98). In 1960, "TR Tourism Bank Inc.", "General Directorate of Press and Broadcasting Tourism" and "Tourism Advisory Board" were opened, and researches on tourism were conducted (Güner 2018: 11).

13.2.2 Planned Period

The Planned Period refers to a long period in which resources are managed appropriately in order to achieve the social and economic goals and objectives that the society wants to achieve during a certain period, in light of the valid economic, social and political values of the country (Sarı and Aktürk 2018: 2302). It started to be implemented with a temporary plan in 1963 and still continues. In Türkiye, the Planned Period has been put into practice with five-year development plans, which we call the middle period. In Türkiye, the Planned Period is implemented with five-year development plans, and when this planning cannot be implemented, transitional programs have been implemented. 1978, 1984, 1995 and 2006 were the years when these transition programs were implemented (Büyüksalvarcı et al. 2016: 11). The plans are guiding and contain imperative content for the public sector, while encouraging content for the private sector.

Within the framework of the first three development plans, between 1963 and 1978, tourism promotion activities were unsuccessful, physical plans and infrastructure investments were insufficient, and sufficient importance was not given to tourism education. In the fourth five-year development plan (1979–1983), the necessary importance has been given to the private sector, foreign capital inflows, infrastructure, physical plans, protection of the natural and historical environment, protection of the coastline, promotion and tourism education (Sözen 2007: 67). During this period, the camps and recreation facilities built for public institutions were opened to foreign tourism, and it was ensured that they did not spread to wider masses.

Within the framework of the fifth five-year development plan (1985–1989), the state supported subjects such as the development of the superstructure, increasing the bed capacity, management training and provided foreign capital incentives (Akça 2016: 723). In this period, the Foreign Investment Law came into force, foreign investment of up to 100% was allowed in projects, and the right to partner with

Turkish Development Banks and companies was granted (Çiçek and ve Sarı 2018: 1002). The period of 1980–1990 is the years in which the tourism sector developed the fastest in Türkiye. In the said period, the bed capacity increased from 56,000 to 173,000 thousand, and the number of tourists coming to the country increased from 1.2 million to 5.3 million (Kan and Kuleyin 2017: 53). In this period, the “Tourism Incentive Framework Decision” was taken on June 20, 1980, and in this decision, the “Tourism Coordination Board” was established to determine the areas where investments will take place, to take new financing decisions for the sector and to regulate the principles regarding the encouragement of foreign capital (Şanlıoğlu and ve Özcan 2017: 101).

In the sixth five-year development plan (1990–1994), importance was given to alternative tourism types. Increasing the qualified workforce, developing the infrastructure and superstructure, improving the management of touristic facilities, increasing the facility occupancy rates and extending the tourism season are among the factors expected to be realized in this plan period (Dinçer and veCetin 2015: 14). During this period, certification programs were introduced to increase the sustainability of tourism. Among the campaigns implemented by the Ministry of Culture and Tourism in 1993, “Environmentally Friendly Organization Certificate and Plaque” were given to some enterprises as a result of the evaluations made in order to create environmental awareness in enterprises and to contribute to environmental protection (Satar and ve Güneş 2017: 35).

In the seventh five-year development plan (1996–2000), promotion and marketing activities were given importance. Licensing and certification systems aimed at increasing the service quality and increasing the bed capacity are among the factors realized in this period.

In the eighth plan (2000–2005), ensuring the long-term and healthy development of the tourism sector and working for sustainable tourism activities are among the factors expected to be realized in this period.

In the framework of the ninth development plan (2007–2013), health tourism was given importance if alternative tourism types were encouraged. In addition, it is seen that policies such as increasing the income per tourist and providing high value-added services are adopted. The growth rate of the sector decreased to 1% in 2008 due to terrorism, natural activities, high oil prices and fluctuations in the exchange rate and experienced a contraction of 3.5% in 2009. It is expected that the sector will grow at an annual average rate of 4% and create 6 to 8 million new job opportunities every year (Destek and ve Ajansı 2010: 4).

In the tenth plan (2014–2018), it is aimed to increase the quality of qualified workforce, facilities and services in tourism and to make tourism an international brand (Akça 2016: 725). In this context, our country has made great strides in the tourism sector and increased its tourism revenues during ten five-year development plans (Dinçer and veCetin 2015: 26). It is estimated that travel will increase further in the next ten years, reaching 1.6 billion in 2020 and 2.6 billion in 2050 (Toy and ve Çalışkan 2016: 111).

13.3 Development of Turkish Accommodation Management

In the Ottoman period, inns in large settlements and caravanserais on commercial roads were accepted as the first accommodation facilities in Anatolia. Although the history of hotel management does not accept inns and caravanserais as the first hotels in the literature, it is proof that hotel management with its commercial and social dimensions started in our land at that time (Yurtlu and ve Akçay 2019: 1098).

State officials sent to the states for official business were hosted here for up to three days, with people and their goods and animals, without making any distinction between local and foreigners.

Most of the inns of Istanbul were shared by different nations. Merchants from the same nation gathered in certain inns. Auberge, the first hotel opened in Edirne in the late 1860s, was built on the traditional inn structure; rooms were very poorly furnished and the hotel had a food service.

The meeting of the Ottoman Empire with modern tourism movements in 1863 and the opening of the "Orient Express (Oriental Railway)" connecting Istanbul to Paris in 1870 were influential in the subsequent increase in the number of tourists. The construction of the first hotels in Istanbul further encouraged this. Orient Express had the Pera Palace Hotel built in 1892 to host its customers. Meanwhile, for the first time, a tourism sector had started to form, and hotels, restaurants, money exchange and guidance services were in the way of organization in Pera.

Pera Palas, Türkiye's first hotel in a modern sense, and Tokatliyan Hotel were considered to be among the most luxurious hotels in Europe and the Middle East at that time (Batman and Soybalı 2009: 97). Istanbul was followed by other Anatolian cities. With the Divan and Hilton Hotel, which became operational in Istanbul in the 1950s, the Turkish hotel industry gained acceleration (Yurtlu and ve Akçay 2019: 1098). In the period from 1980 to 1990s, the increase in accommodation facilities in Türkiye was 7 times, and with the 2000s, there was a great increase in accommodation facilities and the number of tourists in Türkiye, which has a rich cultural, natural and historical heritage (Alaeddinoğlu et al. 2006: 149–150).

13.4 Development of Food and Beverage Services in Türkiye

The food and beverage industry has a history concurrently with the accommodation industry. The emergence of inns and caravanserais for accommodation purposes led to the emergence of the hotel management and thus the food and beverage industry (Benli, 4).

According to Türksoy, the reasons that improve food and beverage services are grouped under the following headings (Demirkol 2009: 136);

- Increasing free time
- Increase in income and changes in living standards
- Increasing the number of businesses
- Changes in menus
- Increase in social activities
- Concentration of business activities.

13.5 Historical Development of Transportation in Terms of Tourism

It is one of the most important needs of people to go from one place to another since the first ages of history. Historical records show that the transportation system has enabled the development of the understanding of travel since ancient times. This movement, which occurred due to reasons such as migrations and wars in the first times, was realized for economic, social, political and touristic purposes in the following periods (Burak 2009: 34).

Travel activities carried out in the medieval period include the journey of the Polynesians over 2000 miles with sailboats from the High Society Islands to Hawaii in the 500 s, the Vikings' exploration of North America, which developed maritime trade, Marco Polo's journey to Iran, Tibet, Burma, India, Siam and other places, Ibn Battuta's 6 pilgrimages between 1325–1354, enabled people living in this period to be informed about the outside world and to increase their desire to travel (Çallı 2015: 12).

It can be said that the studies that pioneered the displacement for tourism purposes started with Thomas Cook. In the nineteenth century, the railway and private cars, and in the twentieth century, air transport provided the development of national tourism. Especially after the war periods, the demand for tourism started to increase with the increase in leisure time and the decrease in working hours.

Just as Thomas Cook's first trip to continental Europe was to the Paris Exhibition, the first collective and organized trip to the Ottoman Empire, or in other words, the first modern tourism movement, started with such an exhibition. Due to the opening of the exhibition "Sergi-i Umum-i Osmani" in 1863, tourism groups from various places, especially Austria, came to Istanbul. The first tourist groups from the Ottoman Empire started to go abroad with various arrangements (Ahipaşaoğlu and Arıkan 2005:88).

13.6 Conclusion

Türkiye's tourism, as in the rest of the world, has been mobilized with the First World War. Our country, which was mostly seen as a transition point until the 1950s, has come to an important place in the world tourism statistics as we approach 2020.

Studies on customs, passports, travel, accommodation, translation, guidance and tourism education during the transition period from the Ottoman Empire to the Republic of Türkiye have made Türkiye a leader in the field of world tourism.

In this period, it is seen that Istanbul, Izmir, Ankara, Bursa, Edirne and Konya, which have higher tourism potentials, transportation opportunities and economic conditions compared to other cities, are among the regions that are prioritized in terms of tourism and accommodation. Archeological excavations that shape the history of Anatolian civilization, restoration of historical artifacts and places, creation of museums, printing and publication of promotional and marketing materials, national and international exhibitions, fairs and meetings, tourism education activities, especially guidance, have been factors that accelerate tourism and promotion activities throughout the country. In this sense, efforts to expand and develop the transportation network and means and support the accommodation sector in order to facilitate tourism activities draw attention.

Due to its intercontinental strategic location, Türkiye has gained the image of a country worth visiting and seeing in the world with its destination promotion and marketing approach on a macro and micro-basis and has earned the place it deserves in the history of world tourism.

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