

High growth companies and how to fund them – a real driver of economic growth?

Corporate Acquisitions and Joint Ventures Commission

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National Report of Turkey

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The working session in Prague is entitled “*High growth companies and how to fund them – a real driver of economic growth?*” In the working session we plan to address funding alternatives for high growth companies (i.e. companies with significant annual growth over time); opportunities and challenges that both entrepreneurs and investors may encounter in your jurisdiction. The working session will also look at corporate governance issues in connection with investments in high growth companies. This questionnaire mainly concentrates on these two topics in relation to high growth companies, but will also cover commercial and regulatory opportunities and constraints.

1. CORPORATE FINANCE – FUNDING ALTERNATIVES

1.1 Which financial instruments are typically used when investing in high growth companies; ordinary shares, preference shares, convertibles, warrants, stock options, debt instruments such as bonds, hybrid instruments such as participating debentures etc.?

In general practice, when investing in high growth companies, two types of financial instruments are mostly used; ordinary shares and preference shares (both are defined in the Turkish Commercial Law. This general approach is subject to any special requirements of the investor and qualities of the target company which may mean that an alternative instrument is more appropriate.

Debt instruments such as loans are also used where the high-growth investments are made in target companies where high debt exists.

Using convertible or stock option for investment is not common for private commercial law but is applicable for companies which operate within the scope of Capital Market Law.

As a general comment on recent trends, investors have begun to show a tendency towards using financing instruments rather than simple cash payments.

1.2 Please elaborate on the pros and cons of the instruments used (ref. 1.1 above) (Describe 2-3 most widely used instruments more in-depth (any combinations as well, if applicable). Also other features, i.e. typically electronically registered instruments or not? etc.)

As per Turkish Legislation, share certificates provide rights regarding:

- Partnership,
- Participation in the target company's management,
- Acquisition of dividends and dividend advances from the target company,
- First refusal or tag-along,
- Acquisition of shares in the event of liquidation, and
- Certain information about the company.

As per Article 484 of the Turkish Commercial Code numbered 6102 (“TCC”), share certificates may be issued as either registered or bearer share certificates. Both of these types are subject to quite different provisions in terms of share transfer.

Preference shares are generally used and these are subject to legislation regarding ordinary shares. However, the legislation provides certain privileges to investors which are often used in the context of high growth investments. These include inclusion of different conditions from other shareholders regarding profit participation, election of BoD members, and voting rights, among others..

Warrants and debt instruments do not provide voting rights to investors.

1.3 Are there any regulatory constraints to the instruments used (ref. 1.1 above)?

There are no regulatory constraints regarding the instruments mentioned above according to Turkish Legislation.

It is noteworthy that within the scope of profits acquired from stock options, there is jurisprudential difference in opinions regarding determination of the timing of the taxable event.

1.4 Is crowdfunding a funding alternative in your jurisdiction? How wide is the practice? If at all, please describe pros and cons.

Crowdfunding is not currently a funding alternative in Turkey.

A few websites function as platforms connecting lead investors with other entrepreneurs who may wish to become investors in potential venture capital transaction (such as www.projemefon.com).

2. INVESTORS VIEWPOINT – OPPORTUNITIES AND CONSTRAINTS, LEGAL AND COMMERCIAL

2.1 Who are typical investors into a high growth company in your jurisdiction? Sources of funding (i.e founders-family-friends, angel investments, venture capital investments, private equity)

In Turkey, there are no legal limitations regarding the sources of funding. As a result, investors include founders-family-friends, angel investments, venture capital investments, private equity. Funding via founders-family-friends is the most common source of these investments.

Angel investments are regulated in Turkish Law under the Regulation regarding Individual Participation Capital. However, due to attractive tax incentives, investors have begun to prefer this method.

2.2 Is there a typical size of the investment into a high growth company in your jurisdiction?

There is no typical size of investment for high growth companies in Turkey.

2.3 Describe the process of documenting the investment (Which documents are typical? Which terms need to be included in the articles to be enforceable? etc.)

The Turkish investment process involves three main stages:

- Due diligence and early negotiation process,
- Preparation of definitive agreements, and
- Closing.

Below is brief information about typical documentation. Use of each type is determined according to the characteristics and transactional requirements of each deal.

- Non-disclosure Agreement (NDA) - Signed and executed among the principals prior to accessing the data room. NDAs usually include a contractual penalty, under which the claiming party is not required to prove damages.
- Termsheet - This can be considered to be a declaration that clearly includes the intentions of the parties to enter an agreement and the main provisions of the definitive agreements. This document is generally a non-

binding document which may include some binding provisions as no-shop and confidentiality.

- Share Purchase Agreement (SPA) - Executed if the investor purchases shares from the founders instead of issuing new shares via a capital increase.
- Shareholders Agreement (SHA) – This states the detailed investment process, including but not limited to precedent conditions, representations and warranties regarding the shares, target company or enterprise, claims and indemnities in case of breach of representations, warranties or closing provisions.

According to the specific conditions of the investment, the parties may also execute these agreements:

- Asset Purchase Agreement (APA)
- Voting Agreement
- Option Agreement
- Loan Agreement
- Convertible Notes
- Share Pledge Agreement
- Escrow Agreement
- Management & Investor's Rights Agreement

After signing the related agreements, to finalize the process and close the deal, an application for registration must be made to the relevant trade registry office.

2.4 Are there incentive schemes for investing into high growth companies (governmental grants (including co-investment funds, state as a guarantor of loans, etc.)?)

As of 1 January 2012, a new investment incentives system came into effect in Turkey, comprising four different schemes which both local and foreign investors have equal access to:

1. *General Investment Incentives Scheme* - The major investment incentives are exemptions from customs duties and VAT. The customs tax exemption applies to imported machinery and equipment for projects with an

investment incentive certificate. The VAT exemption includes an exemption for domestically purchased or imported machinery, as well as equipment for projects with an investment incentive certificate.,

2. *Regional Investment Incentives Scheme* - The sectors to be supported in each region are determined in accordance with the scale and potential of the local economy in each region. The level of encouragement given by such incentives varies depending on the level of development in each region.
3. *Large-Scale Investment Incentives Scheme* - This includes 12 investment sectors with the intention of encouraging and supporting Turkey's capacity and competitiveness in technology and R&D. Minimum fixed investment amounts apply. The sectors include:
 - Production of refined petroleum products,
 - Production of chemical products,
 - Harbors and harbor services,
 - Automotive OEM,
 - Automotive supply industries,
 - Production of railway and tram locomotives and/or railway and tram cars,
 - Transit pipeline transportation services,
 - Electronics industry,
 - Production of medical, high-precision and optical equipment,
 - Production of pharmaceuticals,
 - Production of aircraft and spacecraft and/or related parts,
 - Production of machinery (including electrical machinery and equipment), mining (including metal production).
4. *Strategic Investment Incentives Scheme*.

2.5 Any instruments referred to in section 1 preferred from the point of view of an investor? Why? Would the answer differ if the investor is international or domestic?

Investors generally favour Preferred Shares, usually supported by liquidation preference rights, anti-dilution provisions, privileges in management and profit distribution. In Turkey, it is not possible to have convertibles in companies which are not subject to the requirements of the Capital Markets Board. It is also not possible to convert a bridge finance granted by the investors to the companies into capital by allocating some portion of such amount as emission premium since the emission premium must be paid in cash. Therefore, different legal mechanisms are created case by case considering the necessities of the high growth companies.

3. ENTREPRENEUR'S VIEWPOINT – OPPORTUNITIES AND CONSTRAINTS, LEGAL AND COMMERCIAL

3.1 Which company form is most popular? (Special company forms for high growth companies? Tiers of management typical for a high growth company? Liability point of view?)

The main corporate entities involved in private acquisitions are joint stock companies or limited companies.

For both company types, Article 338 of the Turkish Commercial Code (TCC) allows shareholding structures which involve a single shareholder.

In terms of liability of shareholders, for both company types, each shareholder's potential liability is limited to an amount equivalent to the capital which they invested (Article 329 of the TCC for joint stock companies and Article 573 of the TCC for limited companies).

3.2 What sectors are most preferred by high growth companies in your jurisdiction (information and communications technologies, biotech, etc.)?

The Turkish government aims to complete its conversion into an information society by 2023 and is targeting the local **information and communication technologies (“ICT”)** market to be worth US\$160 billion annually by 2023, as well as other targets which include:

- reaching 30 million broadband subscribers,
- supplying 50 percent of the ICT sector with domestic products and services,
- reaching 8 percent of GDP as the ICT sector's share,
- becoming one of the top 10 countries in e-transformation,
- providing all public services electronically by 2019,
- having 80 percent of the population computer literate.

This growth carries an associated increase in transactions and investments, both within Turkey as well as extending beyond its international borders.

The **automotive and parts sector** is an important part of Turkey's manufacturing industry and overall economy, producing more than a million vehicles annually. Production looks set to increase, with large investments, manufacturing facility upgrades, and global players adding new models to the ranges they already produce in Turkish facilities. Since 2001, Turkey's automotive industry has exported between 60 and 80% of overall production.

Energy, along with utilities and renewables, are commonly seen as among the most promising and attractive fields of investment in the Turkish economy. This is especially supported by the liberalization and privatization activities which have taken place in all segments of the Turkish market during recent decades.

According to the Turkish Statistical Institute, **Industrial Production** in Turkey increased an average of 4.56% year on year from 1986 until 2013. While these sectors are highly sensitive to interest rates and consumer demand, legislative amendments with the explicit intention to increase productivity and remove obstacles to competitiveness are continued. Local policies and legislation are steadily moving towards standardization with common international standards.

3.3 Are there incentive schemes for entrepreneurs incentivising high growth companies (e.g accelerators/incubators? Other?)

Capital incentives are available in relation to a range of aspects relevant to high growth companies. These are administered and obtained by several organizations, including:

- Scientific and Technological Research Council of Turkey (TÜBİTAK),
- Foundation of Technologic Development in Turkey(TTGV), and
- Small and Medium Industry Development Organization (KOSGEB).

3.4 Any instruments referred to in section 1 preferred from the point of view of an entrepreneur? Why?

There are no instruments particularly preferred from the point of the entrepreneur. However, lack of convertible notes makes it really difficult for the entrepreneur in

case of urgent need of cash since it is really difficult to convince all shareholders regarding the valuation of the company and to come to an agreement for the capital increase. Besides, tax and foreign exchange regulations make shareholder loans less preferable.

4. CORPORATE GOVERNANCE – CONTROL ISSUES

4.1 In a typical investment into a high growth company, whether a loan related investment or equity investment, how much control would a typical investor take? and what is of particular importance to an entrepreneur? In particular, please elaborate on the following terms from the perspective of your jurisdiction and practice:

a. Anti-dilution measures

Shareholders' pre-emption rights are protected by the TCC. However, investors generally prefer to include anti-dilution provisions for the down-rounds. Usually, anti-dilution provisions do not set full ratchet protection, but cover weighted average terms. .

b. Rights of first refusal, pre-emption rights, drag and tag along

To incorporate a company, the founders conclude an agreement, the articles of association. This agreement must satisfy the principles and mandatory provisions regulating companies set forth in the TCC. The articles of association are publicly available. Provisions included in the articles of association bind the founders, the existing and future shareholders, as well as the company. The articles of association include internal organization, powers and duties of the directors and rights and responsibilities attached to the ownership of shares.

However, the articles of association may also include provisions that are not required by the TCC. Within this concept, the rights arising out of these provisions will not bind the company, its branches or the existing and future shareholders. Therefore, these rights cannot be enforced via the mechanisms set forth in the TCC even though such provisions are included in the articles of association. Such provisions only create contractual obligations under the Code of Obligations and bind the parties who have consented to their terms.

In light of above, investors prefer to conclude another agreement, apart from the articles of association. Referred to as the **shareholders' agreement**, this reflects the relationship amongst the shareholders, indicates the agreed terms and conditions for some certain situations, such as rights of first refusal, pre-emption rights, drag and tag along rights. Since only the first option rights can be regulated within the framework of the linkage system in the articles of association, rights of first refusal, pre-emption rights, drag and tag along rights can only be constituted by a shareholders' agreement.

Since the obligations arising from shareholders' agreements are contractual in nature, those obligations will only bind the parties to such agreements. The obligations will not be binding against third parties acting in good faith.

c. Protective provisions

The TCC provides freedom of contract in terms of the defining the principles and management of a company, provided that certain mandatory provisions are reserved. Accordingly, shareholders are allowed to agree to provisions in favour of themselves, provided they act in line with the mandatory rules. In order to do so, the shareholders may both insert these provisions into the company's articles of association and the shareholders' agreement. As explained above, even though the provisions are inserted into the articles of association, they may not bind the company and the shareholders must include these in a separate shareholders agreement.

Shareholders may agree on heavier meeting and decision quorums for specific resolutions which are likely to affect the company's financial and operational future, the management and shareholding structure, division of shares into groups and granting privilege rights to the shares, etc.

d. Information rights

Information rights cannot be restricted or abolished by the articles of association or by decisions of the company's organs (for example, the board of directors).

Pursuant to the TCC, each member of the board of directors is entitled to ask for information regarding all company operations and transactions, as well as all records, legal books, agreements, correspondences and all kind of documents.

In terms of the shareholders' information rights, financial statements, annual activity report of the board of directors members, profit distribution requests should be provided to the shareholders for their examination 15 days prior to the general assembly meeting. Additionally, a shareholder may request information from the board of directors regarding the company's operations and from the auditors regarding the methods and consequences of audit.

If the Board of Directors rejects an information request by a member of board or a shareholder, the TCC states that the requesting party may (i) notify the chairman of the board of directors about the rejection and (ii) if the chairman also rejects the request for information, then the requestor may ask the court to order access be given.

e. Dead-lock resolution

There are no specific provisions under Turkish law regarding dead lock resolution. Therefore, the dead-lock resolution can be provided as a contractual obligation in the shareholder's agreement by the shareholders. The terms, conditions and the remedies of the dead-lock resolution are provided in line with the shareholder's freedom of will, provided that they remain within the scope of the parties' inalienable rights and the mandatory provisions of Turkish law.

f. Board seats / observer rights

Investors usually prefer to receive a seat at the board level, choosing to have a veto right supported by restricted matters. They do not usually prefer to manage the company by themselves unless they have majority stake. Since the board members have some non-transferrable liabilities, usually they prefer to appoint a management company as the board member.

g. Any other terms specific/important in your jurisdiction?

Liquidation preference is one of the most important terms in the investment agreements for high growth company investments. Investors usually prefer a 1x liquidation preference rights which entitles them to claim the amount of investment if the company is liquidated, or any other deemed liquidation event occurs.

5. EXIT STRATEGIES AND TIME HORIZON
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5.1 Type of exit which is most common (sale to venture capital/private equity firms/funds, trade sale, write-off, initial public offering)? Typical transaction length?

In Turkey, the most common exit strategies used in the general practice are share transfers to private equities and trade sales. Initial public offerings are rarely initiated and the conditions for such offerings are regulated under Capital Market legislation.

Generally, the share transfer to private equities and trade sales take approximately three months to six months, consisting of a due diligence process, drafting the term sheet, negotiation between the parties, drafting share purchase agreements and completing the closing procedures.

Initial public offerings take approximately six months and the procedure involves making applications to the Turkish Capital Market Board, public announcements and other transactions concerning company secretarial tasks.

5.2 How are new investors dealt with in your jurisdiction? How would the issues set out in section 5 above be dealt with? Are initial investment and shareholders' agreements/shareholders' agreements upheld in the next round, or new agreement is entered into?

Usually a new agreement is negotiated and signed. However, although the previous agreements are terminated, the initial investors' rights under the previous agreements are reserved by the surviving clauses.

6. REGULATORY ISSUES

6.1 Any tax implications (positive or negative) that a high growth company encounters in your jurisdiction?

There is no specific tax imposture or exemption for highly growth companies in Turkey. There are some exemptions for R&D companies. Also there are some incentives and government aids which are exempted from tax.

6.2 In addition to any of the issues set out above, any other regulatory incentives or constraints with respect to high growth companies? Any constraints deriving from obligation for local participation in a high growth company? Co-investment obligation? etc.

No.

7. OTHER

7.1 Please elaborate on any other issues relevant to your jurisdiction with respect to high growth companies which have not been discussed in responses to earlier questions (if any).

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