

Private equity in Turkey: market and regulatory overview

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A Q&A guide to private equity law in Turkey.

The Q&A gives a high level overview of the key practical issues including the level of activity and recent trends in the market; investment incentives for institutional and private investors; the mechanics involved in establishing a private equity fund; equity and debt finance issues in a private equity transaction; issues surrounding buyouts and the relationship between the portfolio company's managers and the private equity funds; management incentives; and exit routes from investments. Details on national private equity and venture capital associations are also included.

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Market overview

1. What are the current major trends in the private equity market?

Turkey's decline in M&A activity in 2019 stemming from the political and economic challenges faced by both global and local markets was also reflected in the level of private equity (PE) activity in the country. The number of PE deals went down to a total of nine in 2019. This low number of deals was not due to new legislative or regulatory developments but more likely due to a lack of attractive targets for investors who therefore chose to focus on companies already existing in the portfolio.

Despite this, the second largest M&A transaction in 2019 was the acquisition of a 43.9% stake in Boyner Perakende by the offshore PE firm Mayhoola for Investments for a purchase price of USD405.2 million, which indicates that Turkey still remains an attractive investment hub for both local and foreign investors.

There is no clear distinction between PE and venture capital (VC) investments under Turkish law. PE activity in Turkey is generally carried out either through legal structures such as VC investment companies (VCICs) or

VC investment funds (VICFs) or through foreign offshore PE funds (generally through a special purpose vehicles (SPVs)). For the purposes of this overview, PE activities also cover the activities of VCICs and VCIFs.

While there is no specific legislation governing PE activities in Turkey, the Capital Markets Board (CMB) issued two Communiqués, namely the:

- Communiqué on Venture Capital Investment Companies (VCIC Communiqué) governing VCICs (2013).
- Communiqué on Venture Capital Investment Funds (VCIF Communiqué) governing VCIFs (2014).

These communiqués set out the requirements for the establishment of VCICs and VCIFs. No material legislative changes having a material effect on the terms of investment documents or any other market practice developments have occurred in the past year.

2. What has been the level of private equity activity in recent years?

Fundraising

The number of both VCIFs and VCICs in Turkey significantly increased following the issuance of the VCIC and the VCIF Communiqués. The CMB requires all VCICs to make their initial VC investments within 18 months and launch a public offering within three years of incorporation.

Private placements of VCICs are realised through share capital increases, which can be increased up to the registered capital ceiling without the need for a board of directors' resolution, providing a great deal of flexibility during the fundraising period.

Since information on the structures of offshore PE funds is not publicly available, a definitive picture of offshore fundraising activities concerning investments in Turkey cannot be provided.

Investment

VC investing, that is, investing in early stage and start-up businesses, has been on the rise in Turkey in the recent years. The number of VC and angel investment deals has risen dramatically in the last few years, making up almost 80% of all financial investor deals in 2019.

Technology and mobile services were popular sectors for VC targets in 2019, while PE investments were divided between a number of industries, such as the e-commerce, technology, pharmaceuticals and food and beverage sectors.

Transactions

The total number and value of PE transactions in 2019 have been decreasing in light of unfavourable market conditions. In 2019, the number of PE transactions in Turkey was only nine. In comparison, the number of PE deals

in 2013 was 35, with a total value of approximately USD2.1 billion. In terms of sector popularity, there seems to have been a shift from manufacturing to technology over the past few years.

Exits

In the past few years, trade sales, secondary buyouts, and private placements were used for PE exits. The most common form of exit is a trade sale, but there have been several IPOs and secondary buyouts as well. In 2019, there were a total of 12 exits, a majority of which were trade sales. Secondary buyouts also took place, but IPOs were not the most preferred form of exit in 2019.

Funding sources

3. How do private equity funds typically obtain their funding?

VCICs usually finance transactions through a combination of equity finance and debt finance. In terms of equity finance, the necessary funds are primarily raised through share capital increases and the sale of issued shares within the context of an IPO or private placement. Debt finance, on the other hand, is raised from a variety of banks and financial institutions. The VCIC Communiqué regulates the limits for indebtedness, and thus the availability of debt finance.

A VCIC is permitted to be indebted, provided that the amount of the short-term borrowings with a maturity date (repayment term) of less than one year does not exceed half of its shareholders' equity, as determined in such VCIC's most recent independently audited financial statements, and that the amount of borrowings with a maturity date (repayment term) of one year or more does not exceed twice its shareholders' equity as determined in the most recent independently audited financial statements of the VCIC.

In recent years, VCICs have generally taken the IPO route for fundraising. While Verusaturk had one IPO in 2015, Hedef Girişim launched two separate IPOs in 2015 and 2018 and one is expected from Hub Girişim in 2020, all of which are VCICs incorporated in Turkey. For VCIFs, the only legally viable option is a private placement to qualified investors.

Tax incentive schemes

4. What tax incentive or other schemes exist to encourage investment in unlisted companies? At whom are the incentives or schemes directed? What conditions must be met?

Incentive schemes

There are no general tax incentives aimed at encouraging investments in unlisted companies. However, the following tax incentives introduced through the Turkish tax legislation aim to encourage investment in VCICs and VCIFs, as well as companies in general:

- The revenues of VCICs and VCIFs are exempt from corporate tax. Dividends derived from VCICs' shares and VCIFs' participation shares are also exempt from corporate tax.
- Share transfers by corporate shareholders who have held the relevant shares for more than two years, as well as share transfers by all real person shareholders, are exempt from value added tax.
- As a general rule, share purchase agreements are exempt from stamp tax.
- If the seller is neither a VCIC nor a VCIF, the gain to the seller from the sale of its shares will give rise to corporate income tax of 20% if the shareholder is a legal entity. (There may be exemptions applicable to 75% of such gains subject to certain conditions, provided that the selling shareholder has held printed share certificates representing the sold shares for a minimum of two years.)

If the seller is a real person, the gain will be fully exempt from income tax provided that the sold shares represented by the printed share certificates are held by the seller for a minimum of two years. If the shares sold belong to a company publicly traded on Borsa Istanbul, it is sufficient to hold the shares for one year before the sale to qualify for this exemption.

At whom directed

These incentives are mainly directed at the investors of VCICs and VCIFs, as well as VCICs and VCIFs themselves.

Fund structuring

5. What legal structure(s) are most commonly used as a vehicle for private equity funds in your jurisdiction?

PE activity in Turkey is commonly conducted through offshore PE funds, which acquire shares in Turkish portfolio companies directly or through an SPV.

While the use of SPVs is still very common, the communiqués regarding VCICs and VCIFs have contributed to PE activities in Turkey through VCICs and VCIFs.

However, it should be noted that the number of Turkish VCIFs and VCICs have increased in number over the past few years.

6. Are these structures subject to entity level taxation, tax exempt or tax transparent (flow through structures) for domestic and foreign investors?

Venture capital investment companies (VCICs)

See [Question 4](#).

Venture capital investment funds (VCIFs)

See [Question 4](#).

7. What (if any) structures commonly used for private equity funds in other jurisdictions are regarded in your jurisdiction as being tax inefficient (whether by not being recognised as tax transparent or otherwise)? What alternative structures are typically used in these circumstances?

Not applicable.

Fund duration and investment objectives

8. What is the average duration of a private equity fund? What are the most common investment objectives of private equity funds?

Duration

The average life of VCICs or VCIFs varies between seven and ten years, and the average length of an investment period is five to ten years.

Investment objectives

Traditional PE funds usually invest in mature companies to achieve gains through the improvement of their management structures. VC funds, which are governed by the same secondary legislation, generally tend to invest in technology-based sectors, such as mobile services and e-commerce.

There is no available data on the rates of return sought or gained.

Fund regulation and licensing

9. Do a private equity fund's promoter, principals and manager require authorisation or other licences?

VCIFs must be founded and managed by portfolio management companies or VC portfolio management companies licensed by the CMB.

VCIFs are represented by the board of directors of the founders, who are subject to certain qualifications (that is, five years' experience in VC investments). Founders must also form an investment committee comprising of board members, a general manager, and a person with five years of VC experience.

VCICs are incorporated in the form of joint stock corporations, the incorporators/shareholders of which can be real persons or legal entities that are not subject to any licensing requirements. VCICs can be managed by a CMB-licensed portfolio management company or portfolio managers. There are also certain qualification requirements imposed on members of the board of directors and the general manager (such as VC experience and a university degree).

10. Are private equity funds regulated as investment companies or otherwise and, if so, what are the consequences? Are there any exemptions?

Regulation

Since VCICs and VCIFs are different legal structures, there are fundamental differences in their organisation. VCICs must be incorporated in the form of joint stock corporations, while VCIFs are funds without legal personality. However, both are subject to the authority of the CMB.

Marketing or advertising VCIFs in all kinds of media is prohibited excluding publicity and advertisements directed specifically at qualified investors.

Marketing or advertising VCICs during the IPO stage is allowed subject to certain restrictions. If a VCIC eventually opts for the sale of its shares through a private placement to qualified investors and decides to make advertisements

and announcements to that end, it must explicitly state in the relevant advertisements and announcements that the sale will not be conducted as a public offering but will instead only concern qualified investors. The board of directors of the VCIC will be held liable for any fraudulent or misleading information contained in any marketing materials and/or advertisements.

Exemptions

11. Are there any restrictions on investors in private equity funds?

Investors in VCIFs must be qualified investors exclusively. For VCICs, real person investors must comply with certain criteria (for example, be of good financial standing, not have been convicted of a crime, have no outstanding tax liabilities).

There are no limitations on the nationality of investors except for sector-specific rules and regulations, if any (for example, in the media and airline sectors).

12. Are there any statutory or other maximum or minimum investment periods, amounts or transfers of investments in private equity funds?

As a general rule, VCICs must establish their investment portfolio within a maximum of three years of incorporation (the first VC investment of the VCIC should be realised within 18 months of incorporation), and the VCIC must apply to the CMB with the necessary documents including the prospectus and information for launching an IPO. The amount of shares subject to the IPO must be at least 25% of the company's issued share capital. If the IPO is launched through an offering of newly issued shares, the amount of the offered shares must equal 25% of the company's total issued share capital following the share capital increase. The same timeline is applicable for private placements (that is, 18 months for the first VC investment and three years for launching a private placement). Private placement is subject to less strict standards than the IPO process.

13. How is the relationship between the investor and the fund governed? What protections do investors in the fund typically seek?

For VCIFs, in addition to the fund bye laws (*fon içtüzüğü*), the issuance certificate (*ihraç belgesi*), and the relevant legislation, the main document governing the relationship between the fund and its investors is the investment agreement (*yatırım sözleşmesi*).

There are no organisations that provide guidance or propose "best practices" for funds and the investor/fund relationship; however, as per the VCIF Communiqué, the investment agreement must include at least any matters not covered by the bye laws and the issuance certificate.

Information on privileged fund participation shares, if any, must be included in the investment agreement (as well as the fund bye laws and the issuance certificate).

The investment agreement must also include principles regarding fundraising conditions (for example, payment terms, payment plans, upper and lower limits and payment default provisions).

The VCIF Communiqué states that it is possible to include the holders of privileged participation shares in investment committees of the VCIFs and obtain their opinion regarding the selection of the venture enterprises and portfolio managers and the determination of the exit strategies.

Interests in portfolio companies

14. What forms of equity and debt interest are commonly taken by a private equity fund in a portfolio company? Are there any restrictions on the issue or transfer of shares by law? Do any withholding taxes or capital gains taxes apply?

Most common form

Both the VCIF Communiqué and the VCIC Communiqué impose certain portfolio restrictions on VCIFs and VCICs.

VCICs can invest in portfolio companies, participate in their management and provide consultancy services to those companies. Subject to certain exemptions, investments in portfolio companies must make up at least 51% of the portfolio value of VCICs. Investments in portfolio companies also cover debt instruments issued by portfolio companies.

To diversify their portfolios, VCICs can invest in:

- Capital markets instruments that are being traded in secondary markets.
- Reverse repurchase transactions on a stock exchange.
- Takasbank money market transactions and investment fund participation shares.
- Participation accounts or deposit accounts both in Turkish lira and foreign exchange.

VCICs cannot invest in capital market instruments or monetary market instruments issued by a single company exceeding 10% of their portfolio value.

For VCIFs, venture investments must make up 80% of the portfolio at a minimum.

Restrictions

Both for VCIFs and VCICs, any share transfer restrictions (such as lock-up periods, any exit rights, options, rights of first refusal, and drag-along or tag-along rights) as well as principles regarding the management of the portfolio company and dividend policies must be governed in the shareholders' agreement to be executed between the VCIC/VCIF and the controlling shareholder (shareholder having management control) in the relevant portfolio company.

Taxes

No withholding or capital gains taxes are applicable to the purchase of equity in portfolio companies.

Buyouts

15. Is it common for buyouts of private companies to take place by auction? If so, which legislation and rules apply?

Buyouts of private companies that take place by auction are not common, and there is no specific legislation governing these.

16. Are buyouts of listed companies (public-to-private transactions) common? If so, which legislation and rules apply?

Buyouts of listed companies are uncommon in Turkey, and there is no specific legislation governing this (save for regulations regarding the delisting of public companies where 95% of such company is held by a single shareholder).

Principal documentation

17. What are the principal documents produced in a buyout?

As investments made by a PE company in a target company are conducted through a purchase of shares, the principal documents produced in a buyout are the share purchase agreement, and if the target company has other shareholders, the shareholders' agreement.

Documents for the financing of a transaction as well as non-disclosure agreements and any closing documents are among the documents produced in a buyout.

Buyer protection

18. What forms of contractual buyer protection do private equity funds commonly request from sellers and/or management? Are these contractual protections different for buyouts of listed companies (public-to-private transactions)?

Buyers usually seek a variety of standard representations and warranties linked to indemnification clauses. Specific indemnification clauses and escrow mechanisms are also used.

19. What non-contractual duties do the portfolio company managers owe and to whom?

Under the Turkish Code of Obligations and the Turkish Commercial Code, portfolio company managers owe several duties to the portfolio company and its shareholders arising from their employment relationship with the company, and if they are also directors, as company directors. These duties include the duty of care, the duty of confidentiality, the duty of non-competition, and the duty to account for any managing decisions on the request of the shareholders.

20. What terms of employment are typically imposed on management by the private equity investor in an MBO?

MBOs are not carried out in Turkey.

21. What measures are commonly used to give a private equity fund a level of management control over the activities of the portfolio company? Are such protections more likely to be given in the shareholders' agreement or company governance documents?

Investors in a portfolio company (including VCICs and VCIFs) can have board appointment or board nomination privileges attached to the shares they hold. It is also common for them to have veto rights over certain matters regarding the management of the company.

These protections are usually set out in the shareholders' agreements and the articles of association of the portfolio company.

Debt financing

22. What percentage of finance is typically provided by debt and what form does that debt financing usually take?

The VCIC Communiqué regulates the limits for debt financing. A VCIC is permitted to be indebted, provided that the amount of the short-term borrowings with a maturity date (repayment term) of less than one year does not exceed half of its shareholders' equity, as determined in the VCIC's most recent independently audited financial statements, and that the amount of borrowings with a maturity date (repayment term) of one year or more does not exceed twice its shareholders' equity, as determined in the most recent independently audited financial statements of the VCIC.

Lender protection

23. What forms of protection do debt providers typically use to protect their investments?

Security

Lenders usually prefer typical collateral such as mortgages over immovable properties, share pledges, letters of guarantee, bank account pledges, and pledges over movable assets, such as receivables, revenues, dividends, and machinery.

Contractual and structural mechanisms

Contractual subordination is a typical form of protection used by lenders to protect their investments. However, in the case of bankruptcy, the order or priority for creditors set out in the legislation will be applicable (see [Question 25](#)).

Financial assistance

24. Are there rules preventing a company from giving financial assistance for the purpose of assisting a purchase of shares in the company? If so, how does this affect the ability of a target company in a buyout to give security to lenders? Are there exemptions and, if so, which are most commonly used in the context of private equity transactions?

Rules

A joint stock company is prohibited from granting advance payments, loans and securities to third parties for the purpose of assisting the purchase of its own shares.

Exemptions

There are two main exceptions to the prohibition on financial assistance:

- Banks and other credit and finance institutions (as a target) can provide advance payments, loans, and securities to third parties for the purchase of their own shares.
- A company can also provide advance payments, loans, and securities to its own employees and the employees of its affiliates for the purchase of its own shares.

However, these exceptions are only valid if they do not result in a decrease of the reserves such companies are required to allocate by law or by their own articles of association.

Insolvent liquidation

25. What is the order of priority on insolvent liquidation?

Creditors with secured debts are given priority in the event of liquidation. After the secured creditors collect their receivables, certain due taxes such as stamp tax are paid. Subsequently, unsecured creditors are satisfied in the following order of priority by law:

- **First tier.** Employee receivables, including notice and severance payments, accrued within the year prior to bankruptcy, as well as payments accrued due to bankruptcy; debts in relation to employee retirement schemes, funds, and plans; and alimony receivables accrued within the past year.
- **Second tier.** All receivables arising from the debtor's administration of the creditor's goods through an agency or guardian relationship.
- **Third tier.** Receivables designated as privileged in accordance with other legislation, such as attorney's fees under certain conditions, receivables of the Social Security Institution, as well as any remaining tax claims.
- **Fourth tier.** All other receivables.

Equity appreciation

26. Can a debt holder achieve equity appreciation through conversion features such as rights, warrants or options?

It is possible for a debt holder to achieve equity appreciation through a convertible loan. This is usually done through a conditional share capital increase where the debt holder is given the option to purchase new shares in the company provided that the articles of association of the borrowing company permits a conditional share capital increase.

Portfolio company management

27. What management incentives are most commonly used to encourage portfolio company management to produce healthy income returns and facilitate a successful exit from a private equity transaction?

Compensation packages and equity-based incentive arrangements are used to incentivise the management of portfolio companies. One possibility, and the most common option, is to grant to the management minority shares equal to 1% to 3% of the company's shareholding, together with tag-along rights in favour of the management to ensure a prompt exit, if necessary.

General market practice is to provide equity incentive arrangements to the management of portfolio companies. Subject to the satisfaction of certain conditions (such as achieving turnover targets or certain purchase price levels to be calculated against specific EBITDA), management would also be granted an additional earn-out payment.

Exit bonuses are also seen as an option.

28. Are any tax reliefs or incentives available to portfolio company managers investing in their company?

There are no specific tax incentives directed to portfolio company managers investing in the company other than the dividend exemption mentioned under *Question 4*.

29. Are there any restrictions on dividends, interest payments and other payments by a portfolio company to its investors?

Companies can only pay dividends to their investors if they have no existing losses from the past year in their balance sheet. If the portfolio company has profited within the past year, dividends can be paid out of its reserves allocated for the payment of dividends.

The company must hold a shareholders' meeting in which the financial statements of the company are discussed and approved. After approval, the shareholders can pass a resolution regarding the distribution of dividends.

Dividends cannot be paid until the threshold for legal reserves required by law has been reached. This threshold is 20% of the share capital for joint stock corporations.

30. What anti-corruption/anti-bribery protections are typically included in investment documents? What local law penalties apply to fund executives who are directors if the portfolio company or its agents are found guilty under applicable anti-corruption or anti-bribery laws?

Anti-corruption or anti-bribery protection is generally not included in investment documents.

Exit strategies

31. What forms of exit are typically used to realise a private equity fund's investment in a successful company? What are the relative advantages and disadvantages of each?

Forms of exit

The most common form of exit is a trade sale. However, there have been a number of IPOs and secondary buyouts in previous years.

Advantages and disadvantages

These include:

- Trade sales are advantageous because they are relatively easy to arrange.
- IPOs are likely to yield better proceeds for the investor but are more complicated to launch.
- As secondary buyouts are sales between two VCICs, VCIFs, or PE funds, the negotiation process is likely to move faster but this type of exit tends to result in lower profits for the parties.

32. What forms of exit are typically used to end the private equity fund's investment in an unsuccessful/distressed company? What are the relative advantages and disadvantages of each?

Forms of exit

If the investment fail to generate the expected revenues, investors can pursue an exit plan through put options if they were negotiated in the shareholders' agreement or the share purchase agreement. The fund can also try to negotiate a share sale deal with the company's existing shareholders or other prospective shareholders.

Reform

33. What recent reforms or proposals for reform affect private equity in your jurisdiction?

Currently, there are no plans for any legal or regulatory reforms that can affect PE activities in Turkey.

Contributor profiles

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Areas of practice. Corporate and M&A; Competition; Capital Markets.

Recent transactions

- Represented Scientific Games in the establishment of a joint venture between Scientific Games and a member of the Demirören Group.
- Represented Telia Sonera in the sale of the company's subsidiaries throughout the Eurasian region and the acquisition of shares in Fintur Holding.
- Assisted Arcelormittal France in the management buy-out of the one of the Group's Turkish subsidiaries through a 100% share transfer to the subsidiary's former CEO.

Languages. Turkish, English, French

Professional associates/memberships

- President of International Law Institute (ILI), Istanbul Chapter.
- Board Member of Transparency International- Turkey.
- Board Member of the Corporate Governance Association of Turkey (*Türkiye Kurumsal Yönetim Derneği, TKYD*).

- Member of the Ethical Values Association, *Etik Değerler Merkezi* (EDMER).

Publications

- *Chambers & Partners – Global Practice Guides: Data Protection & Privacy 2020, Trends & Development and Law & Practice chapters, March 2020, co-author.*
- *Thomson Reuters – Practical Law, Employees (private company acquisitions) Q&A: Turkey, January 2020, co-author.*
- *IBA European Regional Forum, Turkey Regulates Online Streaming Platforms, December 2019, co-author.*
- *Hergüner Bilgen Özeke Newsletter – An Important but Overlooked Rule: Board Members and Conflicts of Interest, Summer 2019, co-author.*

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Recent transactions

- Assisted Newrest Group Holding in the acquisition of a large company operating in the dining halls and catering operations industry.
- Represented Johnson Controls Holding in the sale of its 48% shareholding stake in Karat.
- Assisting a major investment holding company with their investment in a carbon black plant.

Languages. Turkish, English, French

Professional associates/memberships

- Member of International Law Institute (ILI), Istanbul Chapter.
- Member of the Corporate Governance Association of Turkey (*Türkiye Kurumsal Yönetim Derneği*, TKYD).

Publications

- *Law Business Research - Getting The Deal Through: Risk & Compliance Management, April 2019, co-author.*
- *Hergüner Bilgen Özeke Newsletter – An Increasingly Popular Tool in M&A Transactions: Warranty & Indemnity Insurance to Optimize Risk Allocation, November 2019, co-author.*
- *Hergüner Bilgen Özeke Newsletter – New Corporate Governance Compliance Report Templates: Efforts to Build Better Investor Confidence and Engagement, April 2019, co-author.*

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Recent transactions

- Assisted major industrial packaging client in several employment disputes.
- Provided legal assistance to a client operating in the chemical distribution sector on a potential share sale dispute.
- Advised a major financial services client on COVID-19 related issues.

Languages. Turkish, English, French

Professional associates/memberships

- King's College London Alumni Association.
- Robert College Alumni Association.

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