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The Challenge of "Doing Business with Strangers": Audit Reports as a "Signaling Instrument"

"Yabancılarla İş Yapmanın" Zorluğu: Bir Sinyal Aracı Olarak Denetim Raporları

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Abstract

This paper discusses how firms in Turkiye have used audit reports of companies like Deloitte as a "costly signaling" instrument. The paper shows that the firms integrating into the global economy during 1990s were in intense competition to find global business partners. The need to do "business with strangers" created a new challenge for this firms: Broadcasting strong signals proving the capacity of being a reliable, long-standing business partner. When the partnerships were formed in smaller business circles, these signals were produced by face-to-face social interactions. But when the entrepreneurs cooperate/negotiate with firms from different national and cultural backgrounds, audit reports from prestigious companies became a universal signal about the firms' reliability. To illustrate the transformation in this "signaling" process, we conduct in-depth interviews with the managers of auditing firms, entrepreneurs and did an archival study on many resources of the period.

Jel Codes: *M21, M42, F15*
Keywords: *Accounting History, Evolutionary Economics, Costly Signaling, Auditing*

Öz

Bu çalışma, Türkiye'deki firmaların Deloitte gibi şirketlerin denetim raporlarını "gösterişçi tüketim" aracı olarak nasıl kullandıklarını tartışmaktadır. Makale, 1990'lı yıllarda küresel ekonomiye entegre olan firmaların küresel iş ortakları bulmak için yoğun bir rekabet içinde olduklarını göstermektedir. "Yabancılarla iş yapma" ihtiyacı, bu firmalar için güvenilir, uzun süredir devam eden bir iş ortağı olma kapasitesini kanıtlayan güçlü sinyaller yayınlamak gibi yeni bir zorunluluk yaratmıştır. Daha küçük iş çevrelerinde ortaklıklar kurulurken, bu sinyaller yüz yüze sosyal etkileşimlerle üretilmektedir. Ancak girişimciler farklı ulusal ve kültürel geçmişe sahip firmalarla işbirliği/müzakereler yaptıklarında, prestijli firmaların denetim raporları firmaların güvenilirliği konusunda evrensel bir sinyal haline gelmiştir. Bu "sinyalleşme" sürecindeki dönüşümü örneklemek için denetim firmalarının yöneticileri ve girişimciler ile derinlemesine mülakatlar yapılmış olup; dönem ile ilgili pek çok kaynaktan arşiv taraması yapılmaktadır.

Jel Kodları: *M21, M42, F15*
Anahtar Kelimeler: *Muhasebe Tarihi, Evrimsel Ekonomi, Gösterişçi Tüketim, Denetim*

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1. Introduction

Today, many economists rightfully define globalization as increasing interaction, cooperation, or division of labor among people worldwide. As a result of these interactions, we observe a rise in all kinds of flows between nations: Commodities, capital, people, culture, ideas, and even viruses. These flows present many challenges, socially and politically, but at the same time, they offer incredible opportunities. Thanks to globalization, economic players can get what they need from global markets: Capital, human resources, and technology. But to do that, they need to establish partnerships with different organizations in different countries. Sometimes these are firms, sometimes banks or financial institutions, and sometimes governments. And sometimes, these can be shareholders. Without the ability to form these partnerships, or in other words, without being a part of the global division of labor, one cannot take advantage of globalization.

Many economists believe that globalization and a global division of labor among different economic actors can occur spontaneously if nation-states create the necessary macroeconomic institutional framework. According to this belief, economic actors in global markets—just as they do in the national markets—come together only on a contractual basis, and their relationship is *impersonal* based on these contracts. What nation-states and other global institutions should do is simply create the framework for these contracts to be created and enforced. In this understanding, there is merely an economic transaction that reflects only a loose relationship or no relationship at all between the actors.

In this paper, we argue that the division of labor amounts to more than a contractual relationship as discussed in economic theory and has a more social character. Economic agents taking part in a division of labor want to know more about their partners than their functional role in the partnership. They seek continuous information flow about the character of the potential partner, their ability and willingness to keep their promises, and their values. This information-gathering process is possible in small business circles at the local or national level. Before capitalism and even during capitalism before globalization, regular meetings, rituals, and festivities were critical for businessmen to form partnerships. These events enabled them to observe the qualities and background of the others and find some clues about their potential as business partners through face-to-face contact. Therefore, before capitalism and during its early stages, partnerships were established among people who knew each other *personally*. But globalization and the international division of labor made this regular, face-to-face contact difficult if not impossible. In this new economic order, firms and organizations in different countries (and even continents) do business without knowing each other closely. In this context, rather than looking for detailed personal information, they look for signals that convey "unobserved" characteristics of their potential partners, who are now strangers.

We will show that international audit firms are institutions that broadcast these signals and help facilitate business with strangers. We will argue that while the financial reports of these firms provide objective and technical information such as debt/capital ratios, the inventories of the company, and short- and long-term debts or growth potential, they also contain some symbolic meanings and can constitute a source of prestige. The symbolic meanings of financial reports and the hard facts provided by them served an essential function in establishing global partnerships when face-to-face contact was becoming increasingly difficult. To illustrate our argument, we will discuss Turkiye's economy before and after the rapid globalization of the 2000s. As we will see, Turkiye quickly became integrated into the global economy during the first decade of the 21st century and attracted a high amount of foreign capital. During that period, local firms sought to access these new sources of capital via partnerships with foreign companies or loans from foreign investors. Some macroeconomic and institutional reforms made this integration possible, but this cooperation necessitated interaction between Turkish and international firms at the micro-level. We will argue that in the absence of an information channel formed by personal relations as in the previous period, the interaction was built and sustained mainly by institutions like international audit firms whose symbol-producing capacity substituted for fiduciary ties. We will show that these firms, which date back to the rise of joint-stock companies in Western countries, came to the stage only after the advent of globalization increased the incentives of doing business with strangers.

We begin with a discussion of the division of labor. As we perceive globalization as a vast, international division of labor, understanding its nature, social character, and the importance of information for it is crucial. In the second section, we focus on some of Thorstein Veblen's writings about the importance of the signaling process in social life and apply this perspective to the financial realm to understand how firms build a reputation. We then turn to the case of Turkiye and discuss the economic transformation of the 2000s, during which the country joined the global economy. In the following two sections, we show how Turkish businessmen used close personal relations to form partnerships before globalization and resorted to the signaling process and audit firms after globalization, when the former personal relations became costly. In the last section, we compare the Turkish experience with those of a few other countries.

2. Literature Review and Method

There are a lot of studies about the development of the division of labor, and it is safe to say that the division of labor is the main topic of classical economic theory, starting with the Wealth of Nations by Adam Smith. But the question of "How did the conditions of a broader division of labor develop in human history" has been usually addressed by anthropologists. And within this literature, Lionel Tiger and Guang Zen Sun are the most striking authors who underscore the importance of the signaling process, as we did in this paper. (Tiger, 1979; Sun, 2005) But research about the signaling function of finance is absent in the literature. Veblen, the main inspiration of this paper, wrote both on signaling and finance, but his writings on the first topic usually focus on consumption. Therefore, we believe this paper can significantly contribute to the literature.

Non-theoretical part of our research is based on unstructured, in-depth interviews with four managers working in audit firms in Turkiye. Most of them occupy very high positions in the leading firms of the industry and we interviewed them for approximately 90 minutes each on Zoom as we conducted that part of the study during the pandemic. We selected our interviewees through personal connections or sometimes via snowball sampling, with the first participants recommending others. Usually, we began with a few specific questions, after which the discussions evolved organically, with the interviewees generally sharing more information than we initially requested. Our interviewees asked us not to disclose their identities, and we have complied with their requests.

3. Division of Labor as a Social Relationship

Many economic textbooks begin by posing the question, "What is economics?" They often answer that economics is a science of scarcity, meaning its primary purpose is to allocate scarce resources in the most efficient way to satisfy our unlimited wants. One could answer the same question differently after a careful reading of Adam Smith, the founding father of economics, who argued that we owe the "wealth of nations" to the division of labor and its radical effect on production efficiency. Indeed, he discussed the concept so extensively that it is hard not to think of economics as "the science of the division of labor."

Although the division of labor is one of the key concepts of the field, it is surprising that mainstream economics fails to discuss many of its aspects.[3] The implicit assumption of mainstream economics (and its textbooks) is that division of labor can occur spontaneously because, as rational decision makers, we can immediately see its benefits and cooperate with others happily to increase total production. The various parts of the production process are each connected with common interests, and therefore the process can be controlled simply by providing more or less pecuniary incentives. Necessary information regarding the nature of the partnership can be exchanged during the contract-making moment. In this approach, the division of labor and related concepts such as business partnerships appear to be purely economic and technical issues. They can be planned and applied with an engineer-like perspective. Just as engineers predict, direct, and manipulate the motion of inanimate materials for their purposes, the engineers regulating the global economy can do the same thing with firms.

Obviously, this perspective misses the social and dynamic dimension of the division of labor. First, division of labor is an economic and social relationship that includes more than a short-term profit maximization motive. Alfred Marshall rightfully explained this point by discussing it in biological terms. He wrote in *Principles of Economics* that division of labor in industry includes intense cooperation among different parts of it, just as we can observe in a human body. And just as the body is not the sum of its organs, division of labor is not the sum of its parts. First, division of labor creates an increase in efficiency but also in fragility, as each part "depend[s] for its wellbeing more and more on other parts, so that any disorder in any part of a highly developed organism will affect other parts also" (Marshall, 2009: 201). In other words, the division of labor in modern economies relies on strategic partnerships. The interdependency here means sharing a common fate, making the relationship less a bloodless, short-term commercial one than one similar to friendship. Second, the division of labor and

[3] This point is underscored by Schumpeter, too: "There is nothing original about it, one feature must be mentioned that has not received the attention it deserves: nobody, either before or after A. Smith, ever thought of putting such a burden upon division of labor. With A. Smith, it is practically the only factor in economic progress" (Sun, 2015: 12)

the interdependency it causes gives rise to something bigger and, to some extent, independent from the individuals. It makes a new collectivity or a community sharing common values possible. Emphasizing these characteristics of the division of labor, Emilie Durkheim wrote that "the most notable effect of the division of labor is not that it increases the productivity of the functions that are divided in this way, but that it links them very closely together. In all these cases, its role is not simply to embellish or improve existing societies, but to make possible societies" (Durkheim, 1949: 21). It follows, then, that the division of labor constitutes a continuous relationship rather than a one-time transaction based solely on rational calculations. That explains why big firms prefer to work with subcontractors, whom they refer to as members of their team, to obtain intermediate goods rather than buying them on the market.

The division of labor can occur smoothly in a simple economy, where the flow of information happens in its natural order. In these economies, individuals within the division of labor were from the same society who shared common values, language, norms, and location. That means that in these societies, the local community members and individuals taking part in the division of labor overlapped. Production took place in workshops where it was planned, and orders were submitted directly by workshop owners (Sun & Guang-Zhen, 2005: 19-20). Every part of the organization has easy, face-to-face contact, facilitating the flow of information. Similarly, to raise capital and expand investment, entrepreneurs generally established partnerships with investors they knew personally. But in a complicated economy, where the division of labor, trade, economic relations, and partnerships is not limited to the same local community, the spatial expansion of production makes this daily face-to-face interaction difficult. Therefore, the flow of information is only possible through certain institutions.

Frederick Hayek was successful in seeing the changing nature of the division of labor in modern society. Because the information needed to conduct commodity production was no longer concentrated at a single center (like a workshop), division of labor meant "division of knowledge" or "dispersion of knowledge" (Durkheim, 1949: 24). In such a context, we can rely on the price mechanism to collect and distribute the information from one part of the division of labor to the other.[4] In other words, the price mechanism is efficient to maintain communication among individuals belonging to different communities in modern economies, and "[w]e can have a far-reaching division of labor only by relying on the impersonal signals of prices" (Quoted by Durkheim, 1949: 25).

But contrary to the belief of Hayek, division of labor requires many "nonmarket information devices," in other words, non-price instruments. Even Adam Smith wrote that the division of labor would be easier if members of the same trade could find an efficient way to communicate and exchange their own experiences (Arrow, 1984: 172). And history shows that from the early days of capitalism, merchants strived to do that. With the expansion of trade, they "required more frequent and more exact information about distant events." This led them to build the first modern post offices, which turned the great trade cities into "centers for the traffic in news" (Habermas, 1991: 16). Post offices are just an example, but it can be argued at this point that these institutions made the division of labor among strangers

[4] For Hayek, market mechanism was a "information-gathering process" (Hayek, Fatal Conceit, 1998: 14).

possible. According to Paul Seabright, cooperation with strangers and the institutions making this possible are among the most distinguishing characteristics of our species.[5]

Auditing can be regarded as another institution invented to increase communication and information exchange and thereby make cooperation easier. Auditing first appeared as an internal control mechanism that allowed a firm to monitor whether managers were performing the tasks delegated by the firm's owners (as, under capitalism, the two were no longer the same). Financial reporting was thus a means by which managers (or agents) discharged their accountability to their shareholders (principals) (Evans, 2003: 32-33). After the 1600s, auditing was also used as an external tool to facilitate the information flow and cooperation between firms and third parties.

Although the development of auditing occurred very late in Turkiye, as we will see, it followed the same patterns observed in the economic history of developed countries. While auditing in Turkiye began to be demanded in the 1980s in the context of globalization, it appeared in developed Western countries "when the manager did not supply all the capital" (Evans, 2003: 33). The transformation of accounting first appeared in the West as a way to regulate the relations between the firm's managers and its shareholders, and it developed fully only where shareholders were not personally known by the manager. For example, in England, where early firms managed to find extra capital through face-to-face relations, the development of auditing lagged behind other Western European nations in the 18th century. But in the Netherlands, where partnerships among small merchants were common through the stock exchange, new accounting practices, and consequently, financial reporting, were invented to make anonymous financial markets possible (Baskin, 1988: 202-203).

Similarly, in Germany, the need for auditing first appeared when firm owners opened new branches in remote places and wanted to control them. While this type of "internal auditing" was common in Germany, external auditing was weak even in the early 20th century. This created a barrier to doing business with foreign (especially American) firms before World War I. As Lisa Evans writes (citing Hugh Markus's work on the history of public accounting in Germany), "The lack of comprehensive regulation of the audit resulted in a reluctance by foreign lenders and investors to provide capital to German firms unless they had been audited by the lenders' or investors' own auditors. (...) This led a number of Anglo-American audit firms to establish branches in Germany." (Quoted by Evans 2003, 46). The case of Germany is interesting as auditing blossomed as a result of globalization, as it did in Turkiye. We will say more about this topic below.

To reiterate, the most effective way to exchange personal information is through direct dialogue and informal social environments. For example, what made London the world's financial center was the city's informal "pub culture," which kept open the casual flow of information that might otherwise be difficult or costly (Quoted by Dolfsma, 2019: 344). This example shows how important the quality of relations and information flow among economic

[5] Paul Seabright, The Company of Strangers: A Natural History of Economic Life: 4. In this sense, the definition of institutions by Partha Dasgupta, which underscores their role in the division of labor, is also illuminating: "By institutions I shall mean, very loosely, the *arrangements* that govern collective undertakings." (Partha Dasgupta, Economics: A Very Short Introduction,2007: 27)

actors are to the success of the economy. Therefore, to create trust, according to Gary Herrigel, we need institutions that are "capable of creating a close dialog with firms, of intervening directly in relations, and of adjudicating disputes among firms" (Herrigel, 1995: 28). Business associations emphasizing the importance of social events at the local level are an example of such institutions.[6] The observations made at these local events enable firms to get to know each other better and predict the other side's behavior in a possible partnership. In addition, such events help foster collective values and community spirit, which can make information flow more easily. Some of the events were so effective in creating a collective consciousness and facilitating cooperation within the community that they resembled the rituals characteristic of religious sects in the Middle Ages (Durkheim, 1949). But these local gatherings are not easy to organize and not frequent enough when the industrial organization is global. Moreover, if the partnerships are multicultural, reaching a conclusion through social observation and creating common values is not always easy, as different behaviors can have different meanings for people from different cultural contexts. Therefore, a need for a quick, universal language transmitting the necessary information and serving as a symbol for shared values has appeared in global business life—a language or code, similar to price in terms of universality but more inclusive in terms of the information it includes. Veblen wrote in the early 1900s that the financial sector served such a function in capitalist countries. His ideas have similarities with the agent theory referred to above but also some differences. In the next section, we will discuss his views on this topic.

4. Veblen, "Immaterial Capital" and the Finance Sector

Veblen is well known for his writings on consumption, explaining how we use it to acquire status in society. According to Veblen, goods are not consumed solely for their "serviceability," that is, the use-value of a good or its capacity to meet a functional need (Quoted by Rick, 2006: 110). The goods also have a "ceremonial" or "honorific" aspect, meaning that their consumption can have a different meaning within a particular social context and "in the institutional structure of the society" (Rutherford, 1981: 657-673). In other words, consumption is a means of communication we use to send signals about ourselves to other people. These signals are especially important in a modern society as they define our persona and status in the eyes of those who don't know us closely. Having a higher status brings many advantages to individuals, from finding better jobs and better sexual partners to establishing a solid network in business life (Gad, 2003: 126). In sum, consumption can be seen as a flow of information among people about their personal qualities.

While Veblen's writings on the signaling function of consumption in daily life have been widely read and discussed, his ideas on the same function in business life are not comparably influential. But Veblen was aware that the signals in business life were as important as they are in daily life and that they could bring some competitive advantages beyond technical knowledge to the production process. If firms could prove their status, or reputation, to other firms, they could potentially access more credit opportunities, sell their products at better

[6] For an example, see: Emre Balikci, Business Associations as a Regulatory Institution and Its Relations with Nation State: The Case of Gaziantep and Nicosia.

prices, establish better business relations, (Ganley, 2004: 398) and gain a stronger hand in bargaining (Veblen, 1908: 534).

Veblen thought that reputation and signals were so vital that they could be a more significant source of wealth accumulation than physical capital. Capital in classical economics refers generally to technological phenomena like machines and other kinds of equipment. But for Veblen, capital also includes "immaterial capital," which is closely related to public perceptions of a business. According to him, immaterial capital, which is also treated as goodwill, "included established business relations, reputation for business transactions, and processes protected by secrecy. A more general sense of goodwill could go far beyond these matters to include almost any potential for growth the firm could create for itself as a business entity" (Ganley, 2004: 398). In the end, as Ganley writes, "for Veblen the substantial foundation of the industrial corporation is its immaterial assets" (Ganley, 2004: 398).

Therefore, the primary concern of capitalists at this stage became the accumulation of immaterial capital and reputation rather than making production more efficient. That explains why "pecuniary capital," which is all about financial data, became more important than production and technological issues at the beginning of the 20th century compared to early capitalism. Similar to daily consumption, financial data could be easily observed and serve as a signal of status for the other players. Veblen explained this transformation as the domination of finance or business over industry, (Hunt & Mark, 2015: 327-331) and in this process, the capitalist became a businessperson, someone working to influence the perceptions of others (Veblen, 1901: 205).

At this point, we can say something about the nature of the flow of information we defined above as a necessary condition to sustain the division of labor. The information broadcast, received, and processed by firms in a capitalist economy is not limited to the technical issues of production. This kind of information is essential and shared among the firms taking part in the division of labor, for example, between the main firm and its suppliers. But at the same time, there is a flow of "personal" information among the firms, which they use to draw conclusions about one another's reputation, social background, values, and qualities. As long as financial facts like prices and the pecuniary value of capital assets influence this reputation, they can also be used and manipulated by businessmen to accumulate immaterial capital. Thus Veblen viewed the information circulated in the market much differently than Hayek. For Hayek, the data collected and shared by the market mechanism is impersonal, objective, and apolitical.[7] For Veblen, it can be personal, subjective, and political. It can include psychological factors and can be shaped by the "state of mind of the valuers." (Davanzati & Pacella, 2014: 1048). Unlike Hayek, Veblen did not see:

> *[...] the flow of financial information as a natural, unfettered river of financial facts. Managers of corporation finance were skilled in the manipulation and massaging of financial data. Acquisitions and mergers were the very vehicles needed by the capitalist system to sustain industrial growth. They provided the opportunities not only to alter*

[7] Fisher, who was involved in a polemic with Veblen over the nature of capital, had ideas similar to Hayek's. According to Fisher, "The preferred accounting techniques [in capitalism] were those that could be regarded as politically neutral tools for generating objective factual information in pursuit of efficiency."

> *the capital structure of businesses but to manipulate the value of capital assets. Veblen's financial world was not bounded by the flow of flawless information or rational decision makers with well-ordered preferences for risk. The captains of industry and finance were not just better decision makers; they controlled the rules of the game* (Ganley, 2004: 402).

According to Veblen, financial information could serve firms if it could create a positive impression about the firm's future. The better the image of a firm, the more credit it can obtain. Here, we should emphasize that in Hayek's framework the information transmitted was about the past while for Veblen's the signals were clues about the future of the firm. Therefore, the successful businessman is not the one who strives for technological leaps in production but the one who uses financial information to send these signals to creditors. But other institutional economists extending Veblen's approach showed that information can also serve as a signal in some other ways in business life. Rather than causing a real information exchange about technological capacity or ability to pay creditors, financial information (and reports) may be instrumental in *enabling* further information exchange about similar issues (information exchange in supply chains). It can do that by giving a hint about the social background and values of the firm, which can clear the way for effective communication. This is similar to the conspicuous consumption we can observe in social life. What we observe in business life is "conspicuous consumption of information," (Feldman and March 1981, 178) which has a symbolic value.

What kind of consumption can be regarded as conspicuous? In one of his early works, "Economic Theory of Woman's Dress," Veblen answered this question for consumption in general. He argued that novelty, ineptitude (that is, impractical features), and expensiveness could make a dress fashionable (Camic 2020, 270). The last two factors, ineptitude and expensiveness, were important because they were unnecessary costs or "waste" that demonstrated the consumer's financial power. This "costly signaling" approach can be used to explain why audit firms' reports are valuable symbols in global markets. As we will see, they yield a considerable cost. But secondly, these reports have a symbolic function inasmuch as they convey something about the firm's vision and values and those of its owner. A *willingness* to pay for the cost of these reports shows that the owner has a modern, secular, and broad worldview. If the desire to obtain the report represents rationality, it may also represent similar values in terms of reliability, labor-capital relations, etc.

An important characteristic of Veblen's ideas about the role of finance and auditing in business life is that the latter are used by businessmen, not by managers. In the classical agent theories, agents (namely managers, who are now separate from owners or shareholders) are responsible for disclosing financial information to prove that they act in the interest of the firm rather than their own narrow interests. In this context, finance and financial information regulate the division of labor between the firm's owners and managers, and they are an internal matter. But according to Veblen, financial information is also disclosed and manipulated by owners to build a reputation that could be important to forming partnerships with other firms. In other words, for Veblen, auditing is an external matter regulating the relations between the firm and third parties. And rather than the managers, shareholders (or businessmen, in Veblen's words) were responsible for discharging this information.

In sum, the consumption of information in business has a similar symbolic and instrumental function as the consumption of goods. For Veblen, every expenditure made for acquiring status was a waste and contrary to the interest of the society.[8] He believed that only investments in increasing production efficiency were good for society. In daily life, he viewed expenditures on status goods with an implicit contempt. In business life, he deplored emphasis on immaterial capital and deemed the activities of financiers industrial sabotage or "conscientious withdrawal of efficiency."[9] Jürgen Habermas, in *The Public and Private Sphere*, praised the bourgeoisie for being unconcerned with status signals, unlike the aristocratic class of feudalism. According to him, "The nobleman was what he represented; the bourgeois, what he produced" (Habermas, 1991: 13). But for Veblen, the bourgeoisie exceeded the nobility in their craving for status under late capitalism and used finance as a means to obtain it. Below, we turn back to the transformation of independent auditing and present our own perspective about this transformation. But before that, we discuss the integration of the Turkish economy to global markets and what happened at the micro-level during this process.

5. Turkiye's Experience with Globalization

Turkiye has never been a capital-abundant country. While determined to increase the national income through industrialization, the lack of capital resources, skilled labor, and technology was always a barrier to reaching the desired development rate. In the first decades after establishing the republic in 1923, governments relied mainly on internal resources and did not consider foreign capital or foreign credit as an instrument to increase the rate of industrialization. But after the first free election in 1950, that changed, and Turkiye expended a lot of effort to attract foreign investors.

It would not be an exaggeration to say that the primary concern behind nearly all of the macroeconomic reforms made by Turkiye after 1950 was to attract foreign capital. For example, the purpose of the "Planned Period" at the beginning of the 1960s was to persuade foreign investors and lenders that the Turkish economy was a safe haven for their investments. The latter could observe how their money would be used in the next few years thanks to the declarations of five-year plans. Therefore, international investors and financial institutions supported these macroeconomic policies and institutions like the State Planning Organization (DPT) (Kepenek, 2012: 139).

Similarly, when Turkiye experienced a severe shortage of foreign currency and economic difficulties partly due to the global economic crisis at the end of the 1970s, the first reaction was to reorganize macroeconomic institutions. Again, the main goal was to attract foreign capital in addition to increasing exports. For this purpose, the Istanbul Stock Exchange was founded in 1985, followed by the interbank money market in 1986 and the foreign currency and gold markets under the supervision of the Central Bank in 1988 and 1989, respectively (Kepenek, 2012: 207-214). And perhaps more importantly, the capital accounts of Turkiye were fully liberalized in 1989, which abolished all barriers against capital inflow to and outflow

[8] A similar idea can be found in Kennett Arrow's words: "These expenditures ... can be regarded as wastes; they yield indeed a competitive advantage but no social advantage" Quoted by Davazati, p. 1053.
[9] Engineers and Price System, p. 4. Veblen also used this term to describe the strikes of labor unions.

from the country (Ozatay & Sak, 2002: 6). Other measures followed in the next decades: the European Union— Turkiye Customs Union entered into force in 1996, and in 2001, Turkiye launched an ambitious economic program under Kemal Dervis, a former president of the United Nations Development Programme (UNDP). The Turkish parliament experienced one of the most active periods of its history making the necessary institutional and legal amendments to implement this program. The object was similar to that of the policies implemented in previous decades: "the stimulation of foreign investments in an economy fully integrated with the global market" (Savaşkan, 2015: 80).

Turkiye's success in attracting foreign capital in the 20th century was mixed. There were some periods when Turkiye received an especially large amount of short-term speculative capital, but they didn't cause a positive transformation in the economy (Yenturk, 2005: 61). But after 2000, integration of the Turkish economy into global markets intensified, and institutional transformations followed.

The first evidence for this is found the tremendous increase in net capital inflow after 2000. While this inflow was more or less the same from 1985 to 2000, it increased more than tenfold between 2000 and 2006. The ratio of net capital inflows to GDP in 2000 was 0.358% whereas it was 3.624% in 2006. Although there was a sharp decline during the Great Recession, the net capital inflow/GDP ratio was still considerably higher than it was in 2000 (2.229%) (https://data.worldbank.org/indicator/BX.KLT.DINV.WD.GD.ZS?end=2019&locations=TR&start=1970&view=chart Access Date: August 24, 2021). In addition to the success of Dervis's program, developments in the global economy also supported this trend. Low interest rates in the developed countries and corporate malpractice scandals by large Western companies like Enron, Worldcon, Xerox, and General Electrics, which caused a slowdown in direct foreign investment in these countries, directed foreign savings to emerging markets like Turkiye.

In addition to the impressive capital inflow to Turkiye, it is possible to observe an intense relationship between Turkish and international firms after 2000. An indicator for that is the increasing number of mergers and acquisitions of Turkish firms by foreign companies (or vice versa). According to Akdogdu, mergers or acquisitions were very rare before 1988, with most occurring between 2000 and 2008 (Akdogdu, 2011: 141). And we should note that the intense inter-firm relations were not unidirectional. For example, in the case of mergers and acquisitions, the buyer was not always a foreign company, or they were not always the one who gained control of the new company after the merger. But on many occasions, a Turkish firm was both the buyer and leader of the new company. Still, the percentage of foreign buyers among total mergers and acquisitions began to rise after 2000, one of the reasons for the increase in foreign capital inflow (Akdogdu, 2011: 146).

In addition to the increase in mergers and acquisitions, short-term capital inflow to Turkiye also soared rapidly during the 2000s. The most important sign of this is stock market capitalization. This indicator for Turkiye increased from a minimum of 20.77 billion USD in 1995 to a maximum of 315.2 billion USD in 2012. Even if Turkiye's stock market was shallow in the 2000s compared to the world average, this 15-fold increase is remarkable (https://www.theglobaleconomy.com/Turkey/stock_market_capitalization_dollars/ 24 Temmuz 2021).

As expected, Turkiye's firms tried to take advantage of the availability of foreign capital in the new period described in the figures above. As a result, the indebtedness of the Turkish private sector skyrocketed in the new period. The total foreign debt of Turkiye in 2001 was 113.6 billion USD. It peaked in 2018 by increasing to 454.5 billion, a fourfold increase. If the depreciation of the Turkish lira throughout the period is taken into account, the increase is even more dramatic. Additionally, the private sector's share of total debts increased during the period (https://www.hmb.gov.tr/duyuru/30-eylul-2020-tarihi-itibariyla-turkiye-brut-ve-net-dis-borc-stoku, 21 Agustos 2021).

All of this information about the Turkish economy shows that the firms' relations with third parties such as other firms, banks, foreign investors, and the government changed considerably. First, it changed qualitatively, in that that these relations were now more intense and frequent. And second, there was a quantitative change, as these relations were no longer limited to a handful of economic agents as they were before globalization. We elaborate on this difference in the next section.

6. Partnerships before Globalization

As we have said, Turkiye always lacked the necessary savings and technology for rapid economic development, and the reflection of that at the firm level was a lack of credit and a desire to form partnerships with foreign firms. That was true even during the post-war years. Firms were desperate to take credit from banks (and mainly from state banks before the 1980s) to grow their business, and the competition for credit became even more intense when the government somehow found an extra foreign fund. In a developing economy like Turkiye, which lacked the formal institutions that could evaluate the ability of debtors to pay the credit back, it was almost impossible for many small businesses to obtain credit. Banks had strict preconditions like co-signers, mortgages, and material compensation. During the 1940s and 50s, they experimented with offering credit to groups of artisans, with one artisan serving as guarantor for another (Karaomerlioglu & Balikci, 2013: 189). A few other measures were tried in following years, but getting money back from debtors remained a big problem for banks (Sanayi Tarihi Uzerine Roportajlar, Uretenlerin Oykusu 2017: 77) Therefore, banks offered credit to large capitalists such as Koc, Sabanci, and Eczacibasi, as they found it less risky, while other businesses sought to strengthen their personal relations with banks by sending gifts and organizing social events in order to raise their reputation and credibility. Thus business before globalization in Turkiye was largely conducted among people who knew each other or shared the same social circles in the absence of the institutions facilitating information flow among strangers.

In addition to gaining some credit, Turkish firms had long sought to establish partnerships with foreign companies. Especially during the 1960s and 1970s, import substitution industrialization policies provided many advantages to domestic firms if they could produce the formerly imported goods within the country. But doing so required a certain technological expertise and capital which many Turkish companies did not have. To compensate, Turkish businesses tried to persuade foreign companies like Ford, General Motors, and Tesla to forge partnerships. In the mid-20th-century environment, this was possible primarily through personal relationships, and therefore the big capitalists of Turkiye invested heavily to expand their connections. In his memoir, Vehbi Koc, one of Turkiye's most prominent entrepreneurs, wrote that he often traveled to Istanbul to meet big, and especially non-Muslim merchants who had strong ties to global markets (Kirac, 1995: 35). And Koc always had warm relations with government officials who were instrumental not only in helping him do business with the state or access cheap credit from state banks but also to have a guarantor to their investments they could do with the foreign companies. In his partnership with international firms, Koc managed relations with the government to ensure certain privileges and arranged the transportation and market channels of the product in the domestic market while foreign companies were expected to "provide the know-how, material capital and continuous flow of the intermediate goods." (Nahum, 1988: 85). Koc cites a personal letter he received from Prime Minister Adnan Menderes promising government support for a future partnership with Koc, as playing a considerable role in Ford Motor Company's decision to invest in Turkiye (Nahum, 1988: 89). What Koc and others suggest about business life in Turkiye during the 1950s and 1960s is that entrepreneurs were mainly responsible for organizing the relationships and image of their company rather than production.[10]

While business partnerships in Turkiye was mainly based on personal relations before the 1990s, Veblenian symbols also played a role, especially in forming relations within the country. For example, demonstrating a commitment to the values of the new republic and its ideology, Kemalism, was the most critical component of the "symbolic capital" of Turkish businessmen (Behar, 2012: 76). The commitment to early Republican values served as a sign of the social background of the businessmen, which was the ultimate determinant for the state when deciding with whom to do business prior to the conservative AKP government. In addition, possessing a good education and advanced degrees, especially from prestigious Western universities, helped facilitate contact with government officials, probably because of the positive image of Western countries in Turkiye during those decades (Bugra, 1997: 99-100). Thus signals can advertise the potential for a partnership indirectly, a point emphasized by Veblen in his writing on conspicuous consumption. That is, while having Western values says nothing directly about, say, the competitiveness or reliability of a firm, it is assumed that these symbols are a proxy for ability in business life. And the meaning of these value-loaded symbols is socially determined and can change very rapidly.

In addition to these value-laden symbols, other signals provided by certain institutions could also be demanded. For example, Asim Kocabiyik, another important businessman of the time, recalled that the Turkish Industrial Development Bank once requested that his company obtain a feasibility report from a state institution before it would grant a line of credit. The report, which cost 15,000 USD (which the firm could not afford), would persuade the bank that the credit would be used for a well-planned investment. But beyond the "hard facts" the report would provide, its considerable cost and the fact that it came from a "state institution" would also serve as a signal of the firm's wealth and credibility (Kocabıyık, 2004: 132).

[10] Maybe this can explain why the social background of the most successful entrepreneurs in Turkiye mainly was not related to artisanship which is defined with a deep interest in the production process but to trade. Contrary to Greece and Pakistan, a transition from small industrialists or craftsmanship to big industrialists is nearly non-existence (Soral, 1974: 41).

While the various forms of signals, such as cost, symbolic meaning, or hard facts, are essential, the means of transmitting them is also critical. More precisely, as Ayse Bugra stated, any hard information about the market, like a new investment opportunity, partnership potential, etc., came not through the impersonal channels of the price mechanism, as argued by Hayek, but from the advice of state officials, (Bugra, 1997: 267) or any other reliable institution or person. And as we saw above, this kind of information flow between state officials and businessmen is possible only through personal contact (e.g., via social gatherings) and signals. Bugra, rightfully, thinks that this is a real counterargument to the assumptions of mainstream economics about information. Secondly, Turkiye observed the emergence of business associations during the 1980s whose primary purpose was not to influence public policy but to expand business networks both in Turkiye and other countries. MUSIAD, one of the most influential of these associations, strengthened ties among its members by emphasizing common values (conservatism) and organizing social gatherings like picnics, breakfasts, and so on. The presidents of MUSIAD thought that this collective spirit could be used to establish economic ties with Middle Eastern countries whose businessmen had similar values. As one of its former presidents, Erol Yarar, remarked at a conference, MUSIAD was established to open up the "introvert" industrialists of Turkiye, to collect information related to production technology and global markets, and to solve potential problems in his relations with other industrialists. To do so, the association organized trips to other countries and encouraged its members to attend trade fairs to meet potential partners face-to-face (Ozdemir, 2006: 171).

7. Relations with Third Parties and Auditing

After the Turkish economy's integration into the global economy, partnerships between strangers became more common, and face-to-face interactions were no longer sufficient to establish them. Therefore, entrepreneurs undertook a new role in the new era, which was pursuing status and reputation, as Veblen observed in 19th-century America. Rather than involving themselves in the managerial tasks of their companies and interacting with their immediate social circles[11], entrepreneurs after the 1980s in Turkiye were mainly busy differentiating themselves by disclosing their conspicuous leisure and lifestyle (Bali, 2002). Similarly, the increase in corporate social responsibility spending or investment in sports clubs in the same period was another way to signal the quality of companies indirectly, which can be analyzed with the costly signaling concept. In addition to these methods, accounting and auditing also became a signaling institution and played an important role in facilitating the division of labor among strangers, as we have argued throughout this paper. Starting in the 1980s but especially after the 2000s, with the change in the economic context, the functions of accounting and finance underwent a considerable transformation that has been experienced in different periods in the West. Before the 1980s in Turkiye, accounting and financial reporting mainly recorded past transactions and informed the government about the activities of the business. Interviewee 3 stated, all financial reporting activities were tax- and state-centered, and the main focus was on tracking the past. Another function of accounting

[11] As one of us shows elsewhere, the pictures of and interviews with Turkish businessmen during the 1950s and 1960s described them as "inventors" and heavily involved in production issues (Emre Balikci, 2014).

that also persists today was assuring the rational use and allocation of resources, as defined by Max Weber and Werner Sombart. During these years, financial reporting and accounting were tools for rational management, instruments for summarizing past performance in order to shape and predict future practices. Additionally, there were no incentives to disclose this financial summary to potential partners outside the firm. In other words, these tools were not initially used to represent unobservable qualities of firms and entrepreneurs, including their possible performance in the future, which is an essential input for partnership decisions. But as firms became more dependent on partnerships with other players, these inputs became vital, and accounting and financial reports took on a new purpose. To put it differently, financial reports in the new era were prepared mainly to increase the credibility and reputation of the firms and entrepreneurs rather than to find past mistakes in the reporting process (Heang & Azham: 2008, 5). Actually, as Jonathan Barron Baskin has noted with respect to Britain and the US, only after this evolution in accounting and other signaling mechanisms could the economy in Turkiye progress from personal to arm's-length transactions, a process that continues to intensify today with increasing globalization (Baskin, 1988: 201).

There are not many sources about the history of this transformation and auditing in Turkiye. But according to our interviewees and limited sources on the subject, auditing and reports for third parties were nearly nonexistent in Turkiye before the 1980s. These kinds of services were so unknown in Turkiye that even payments to international auditing firms were not defined as an expenditure item in the national accounting system, which made their activities in the country impossible. Laws enabling the activities of auditing firms were first enacted in 1987 and were elaborated step by step until 2006. The Association of Independent Auditors was founded in 1987 and pushed the government to determine and update auditing standards in Turkiye. The industry leaders known as the Big Four (Deloitte, Ernest & Young, PricewaterhouseCoopers, and Klynveld Peat Marwick Goerdeler [KPMG]), opened their offices in the early 1980s[12] and became very popular during the 2000s. The positive correlation between the demand for auditing and the intensity of globalization is striking. Today, there are 84 auditing firms at the national and international levels recognized by the government.

Another aspect that should be emphasized about auditing is that it solves the information asymmetry problem, which refers to a situation when one party in the transaction has more information than the other. Asymmetric information is usually referred to as an internal problem between the shareholders and managers, but in fact, it exists in all kinds of division of labor and inter-firm relations, as long as some tasks are also delegated to another firm by a principal firm. It is assumed that accounting solved this problem by disclosing more and more financial data to the principals. Although auditing reports have become more extensive and inclusive in the 21st century, they still cannot provide perfect information about the past and potential success of the firm in the future. Interviewee 3 cited many barriers to perfect information in financial reports: ideally, they should be completed several times a year, which is not always feasible; it is difficult for firms to share all their financial information in the desired format, and sometimes the information is manipulated; and it is impossible to measure, analyze, and summarize all financial data, "as there are millions of [pieces]". Even if

[12] Deloitte in 1986, Ernest & Young in 1983, PricewaterhouseCoopers in 1981, and KPMG in 1982.

financial reports could give a perfect picture of the firms' past and future, it would be impossible for their readers to absorb every detail.[13]

It is important to underscore that auditing reports convey more than strictly financial information. That is, they include some “hard facts,” which helps to solve the asymmetric information problem to some extent, but at the same time, they have a symbolic meaning that says something about what has *not* been included. This is what makes auditing reports a signaling instrument. They provide a shortcut to the financial as well as nonfinancial information necessary to make sound business decisions.

The most obvious example is the positive impression generated by a report published by one of the Big Four on a firm being evaluated for a possible partnership. Interviewee 1 and Interviewee 4 claimed that even if a Big Four company performed the same job as a small, local auditing company, its report would give a positive signal independent from the content of the report itself. This can be explained partly by the reliability of the service they provide. (Namely, one can trust in the information in the report.) But at the same time, a firm that chooses to buy the auditing service from a Big Four company is assumed “to be disciplined, well-managed and [to] ha[ve] a particular investment scale.” The impact of this choice can be so significant, especially on international firms, that interviewee 4 compared it to a passport or visa that enables a company to do business in global markets. According to the same interviewee, one international company that asked for its Turkish partner's financial data even canceled its request after learning that the firm is audited by Deloitte.

In seeking to explain the reasons for the “better reputation” one can acquire thanks to the reports prepared by Big Four companies, we should consider that these firms' services are considerably more expensive. This tells something about the firms working with Big Four companies: They are willing to pay these costs in order to demonstrate their financially strength and they see this as an important investment that proves that the firm has long-term plans and is managed by a farsighted vision.

Analyzing this indirect, symbolic meaning of information and disclosing it in business life, Martha Feldman and James G. March note that firms continue to collect information at a great cost even if the information has no direct bearing on the decision-making process. In their article, they showed that the information collected in various ways is most of the time unrelated, untimely, or hard to process. But still, information is helpful in that it signals that firms collecting it are “good decision-makers.” After calling this practice “conspicuous consumption of information,” Feldman and March state, “Even if information contributes nothing directly to the quality of decisions, better decision-makers would invest more in information, and decision-maker quality could be estimated accurately by monitoring information practice” (Feldman & March, 1981). Following the terminology of Veblen and Ayres, the authors call this the “symbolic function” of information. As we define auditing as an information and signaling instrument, we think this perspective can also be applied to it.

[13] This last statement of our interviewees is in line with what Kahneman taught us: People lack the necessary cognitive capacities to process all the information they have.

A few examples show how information represents more than its content. Baskin, focusing on the development of corporate finance markets in the US and Britain, observed that some critical pieces of data became representative of others that were difficult to collect and observe but still crucial for investors. For example, the deepening of financial markets in the US resulted in steady or increasing dividends. Accepting that they would never be able to collect all of the data relevant to the health of a company, investors perceived the dividend "as an informative and trustable symbol." As a result, to raise capital in financial markets, managers prioritize declaring dividends rather than improving what these dividends represent. This even caused the collapse of many firms at the end of the 19th century in the US (Baskin, 1988: 234).

8. Conclusion

In this paper, we have tried to show the significant role of auditing as an information system and costly signaling instrument in economic relationships and partnerships in our modern economies. As we have seen, when the division of labor is limited to a small number of parties who knew each other closely, the flow of information flow is easy, less costly, and direct. But when the division of labor involves numerous firms/people, then face-to-face relations are not enough to guarantee the necessary information flow between parties. Under these conditions, some information and signaling instruments are needed.

Mainstream economists claim that price mechanisms are sufficient for collecting and distributing the necessary information between parties involved in the division of labor. In this way, the argument goes, partnerships could be established thanks to the indirect relationship through the market and prices anonymously. But we think that the division of labor is a social phenomenon so long as the participating parties are people. The price mechanism can inform parties about the past transactions and decisions of a firm, but it includes less information about what to expect in the future. At this point, economic agents are looking for clues to predict behavior, which explains why signaling is as vital as it is in social life. Signals help us predict the trustworthiness, abilities, and vision of other firms in economic life. We explained the signaling concepts with references to Veblen's writing on the topic itself and on finance.

We claimed that economic relations and division of labor became complicated in different countries at different moments in their economic history. In the West, this occurred first in financial markets after the separation of ownership and management. In Turkiye, this happened mainly after globalization during the 1980s. With reference to interviews with top officials of auditing companies operating in the country, we showed how financial reports are perceived and used by Turkish firms to find global partners and access global financial capital.

Veblen was critical of all economic activities that don't contribute directly to production. All the conspicuous activities which serve only to the signaling process are unproductive for him. For Veblen, accounting was also unproductive, and accountants fell under the "pecuniary employment category". We don't share Veblen's view and think that as long as this signaling process alleviates the division of labor, it is productive, although indirectly. But the signals used in the economy really must represent the companies' health and strength. If socio-economic values overemphasize financial signals, then a shift in interest from production, technology, sustainability, etc., to financial performance can undermine the performance the signals supposedly represent.

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