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Case Study on Outward Foreign Direct Investment by Enterprises from Turkey

Contents

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I. Introduction

1.During the last 15 years, outward foreign direct investment (OFDI) flows from developing countries have grown faster than those from developed countries . These outflows have also risen significantly relative to the Gross National Income of the source countries . Moreover, many developing countries have directed their OFDI flows increasingly to other developing countries . The pressure to accumulate a portfolio of locational assets to increase competitiveness, facilitated by improved regulatory environment, had led to the increase in OFDI flows from developing countries. Turkey had contributed to this development.

2.OFDI from Turkey had increased significantly, especially in recent years. The bulk of Turkish OFDI is in the neighbouring countries. Most of the Turkish firms that have invested in the neighbouring regions are small and medium-sized enterprises (SMEs) although large enterprises account for most of the total OFDI value. A combination of "push" and "pull" factors were responsible in driving Turkish OFDI. New markets in the neighbouring countries such as in the European Union, Middle East, Caucasus and the Russian Federation, and in Central Asia as well as in North Africa and the United States were important factors. The ability of Turkish firms to exploit these market opportunities also played a role. The recent domestic economic crises, including high taxes and rising labor costs encouraged Turkish enterprises to go abroad. The improved policy environment had also facilitated the OFDI process. Geographical proximity and cultural affinity play an important role in the OFDI spread.

3.This paper examines a number of key issues on OFDI by SMEs from Turkey. It provides an analysis of the current trend of OFDI from Turkey, the drivers and motivations, market entry strategy, obstacles and policy environment. The paper also examines the extent in which OFDI has helped increase the competitiveness of Turkish enterprises, and the prospects and challenges for OFDI by Turkish SMEs. Policy options to increase the internationalization of Turkish enterprises, particularly SMEs, through OFDI, are offered.

II. The Conceptual Framework

4.The methodology used for this study is descriptive and institutional, relying on original documents, reports, tables, including interviews conducted in the second half of April 2005. Turkish private and public sector decision-makers were interviewed. The conceptual framework draws from Dunning's eclectic Ownership-Location-Internalization (OLI) paradigm and its dynamic version of the Investment Development Path model (as well as from the Industrial Organization based FDI theory , especially for large enterprises. It also relies on the insights from the Uppsala internationalization model , especially for SMEs. This study builds on an earlier one that was first published in 2003 .

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5.According to the Investment Development Path model, based on the eclectic OLI paradigm , a country passes through five development stages in its evolution from a host to a source country for FDI.[2] According to this model, Turkey appears to be in Stage 3 in which OFDI rises, inward FDI (IFDI) falls, but net OFDI is negative. Either the negative or the positive role of the state in the rise and strategies of emerging economy TNCs has been particularly important . Turkey's evolution as a source country seems to have been accelerated over its evolution as a host country not only by deliberate policy discouraging IFDI (as in Japan and Korea) but also by the chronic macroeconomic and political instability over more than three decades to which especially the large Turkish companies have adapted remarkably well. This adaptation to instability and risk has enabled them to evolve into TNCs by developing ownership specific assets, reacting to the eroding location-specific advantage of their home country by internalizing those ownership specific assets through OFDI. Another driver of their OFDI has been the increasing competition they expected to face at home from imports resulting from the Turkish economy's outward orientation in the 1980s through international trade, especially in anticipation of the Customs Union (CU) with the EU in 1996. OFDI enabled them to increase their geographical diversification, against systemic and specific market risk, as they decreased their product diversification at home to benefit from scale economies and quality improvements. OFDI became for them an essential strategic move for greater international competitiveness. Many Turkish SMEs, on the other hand, used OFDI opportunistically, especially by taking advantage of privatizations in the Balkans and the Turkic Republics in Central Asia, to increase their geographical as well as product diversification. This enabled them not only to increase their competitiveness but in some cases to survive as going concerns.

6.According to the Uppsala model, based on behavioral theory, internationalization is incremental, sequential, and learning based, occurring in stages, based on cumulative market knowledge and commitment. It is not optimization based but "… the consequence of a process of incremental adjustments to changing conditions of the firm and its environment ." The major constraint on international expansion is knowledge and resource availability, especially for SMEs. International expansion is evolutionary and gradual in terms of not only the successive stages of rising international involvement but also the entry into markets with increasingly greater psychic distance in order to avoid uncertainty. The successive stages are (1) no international involvement, (2) indirect exports, (3) direct exports, and (4) OFDI. Psychic distance refers to all factors that prevent or disturb the flow of information between the firm and its markets, including language and culture. Psychic distance, which changes over time slowly, often, but not always, reflects geographical distance. The Uppsala model also implies a periphery strategy of international expansion, entering peripheral developing foreign markets before the central advanced triad markets of the United States, Western Europe, and Japan. The Uppsala model helps us to understand the incremental and peripheral nature of the internationalization by large Turkish enterprises such as Koc Holding and Sabanci Holding, two of the nine cases presented in the Appendix. It also sheds light on the gradual internationalization in terms of the increasing psychic distance of successive foreign markets, and their progression from peripheral to triad markets, for all the nine cases. Its prediction of evolutionary and gradual internationalization through successive stages of the establishment chain, however, does not fit the experiences of many Turkish firms, including most of the seven SME cases in this study, especially those in the services sector.

7.There is huge and growing literature on emerging economy TNCs. A recent OECD study on South Korean OFDI found that Korean TNCs in the electronics industry in the 1990s have integrated OFDI into their business strategies, especially in searching for new markets in both developing and developed countries . The study supported that Korean firms have pursued OFDI in developed countries not only for new markets and to bypass import restrictions but also to acquire advanced technology, modern R&D facilities and highly skilled labor. OFDI from developing countries can be divided into four categories, on the basis of different market and technology conditions (Lee 2002, pp. 56-59; table 1).

[2] The Extended Product Life Cycle hypothesis, with seven phases, is an alternative model for the conceptualization of outward FDI from developing countries .

8.Horizontal integration takes advantage of closeness to foreign markets and scale economies. Vertical integration takes advantage of factor cost differences and scale economies. Delocalization is the transfer of production abroad and the complete or partial closure of domestic facilities. Horizontal integration is divided into two subcategories, voluntary (offensive) and involuntary (defensive) depending on whether it is based on proactive rationalization strategy or reactive response to domestic and foreign challenges. Overall, vertical FDI is offensive but delocalization FDI is defensive. The effects of OFDI on the source country, depend on the type of FDI: Vertical integration has the strongest complement (positive) effects and delocalization has the strongest substitute effects on both domestic production facilities and exports, with the effects of horizontal (voluntary as well involuntary) expansion falling in between .

III. Trends and Features of OFDI from Turkey

9. The internationalization of enterprises from Turkey through OFDI has become more visible since the early 1990s. After the country's economic crisis in 1994, Turkey's OFDI accelerated (table 2).[3] The economic crises in 2000-2001 provided further push for Turkish enterprises to go abroad, contributing to an increase in the country's share of the world and developing country OFDI flows. UNCTAD's Outward FDI Performance Index, measured as the ratio of a country's share in world FDI outflows to its share in world Gross Domestic Product (GDP), for Turkey rose from -0.004 in 1988 to 0.104 in 2003 (table 3). The ranking has also improved, from 87th position to 64th out of 128 countries. The rising index reflects the strengthening of ownership-specific advantages of Turkish firms and their desire to exploit these advantages abroad for strategic reasons or the weakening of the relative locational advantages of Turkey for both national and foreign firms . Both of these factors played important roles in the rise of the index for Turkey according to the cases presented in the Appendix A.

10.Turkish OFDI flows as a percentage of gross fixed capital formation (GFCF) and Turkish OFDI stock as a percentage of GDP are below those for the world and developing countries. This statistical indication, however, would have to be interpreted with care as the official OFDI data are likely to be under reported (box 1).

Box 1. Turkey: statistical issues on OFDI

Underreporting of FDI outflows is a serious problem in developing countries . The relatively small stock of Turkey OFDI ($157 million) in the Russian Federation suggests under estimation of actual situation. On the basis of interviews with large enterprises such as Koc Holding, Enka Holding and Anadolu Holding, and based on information provided by the , it is estimated that at least $2 billion Turkish OFDI is in the Russian Federation. Enka Holding alone had invested about $1 billion in the Russian Federation, according to its founder. Further, the number of Turkish firms in the Russian Federation (87) (table 4) contrasted significantly with the number (some 600) reported by Russian sources .

Based on interviews with executives of Turkish firms and Turkish experts for this paper, OFDI situation appeared to have been grossly understated by official statistics. A number of reasons are

[3] The UNCTAD as well as the OECD data on the Turkish annual outward FDI flows are those reported by the Turkish Central Bank in the Balance of Payment statistics (http://tcmbf40.tcmb.gov.tr/cbt.html). The Turkish Central Bank collects these data on a monthly basis from the foreign exchange position reports filed by Turkish banks. These data reflect currency transfers only and do not include in kind transfers that are supposed to be included in the Turkish Treasury statistics. (Where is Footnote 4?)

associated with this development. First, official statistics do not include financing component of OFDI in host or third countries through foreign banks or international capital markets. Second, they exclude transactions under $5 million. Third, they do not include reinvested earnings of the foreign affiliates. Fourth, they do not include funds transferred abroad illegally, for example through over-invoicing of imports. It was estimated that cumulative Turkish OFDI is at least $15 billion, more than double the official figure given by the Turkish Treasury .

Source: Author.

11.Some 1,500 enterprises from Turkey invested $7 billion abroad in 1991-2004 (table 4). Most Turkish OFDI were to the Netherlands. Part of the OFDI activities was transshipped through the Netherlands to a third country. Financial motives such as benefits of favourable taxes offered to foreign investors played a role for Turkish OFDI to the Netherlands (section IV). Bilateral double taxation treaty concluded between the Netherlands and Turkey, in 1986, provides several benefits to Turkish firms incorporating holding companies in the Netherlands .[4]

12.Azerbaijan was the second most preferred destination, led by significant OFDI from the Turkish Petroleum Corporation (TPAO) in the Azeri energy sector in the early 1990s. TPAO, a state-owned petroleum enterprise, has many OFDI activities in other countries in the Caucasus, Central Asia, the Middle East, and North Africa.[5] It alone, in the same period, accounted for about $2 billion of total Turkish OFDI. TPAO's objective is to participate, mainly through the Turkish Petroleum International Company Ltd. (TPIC), in international oil and natural gas activity that helps Turkey meets its energy demands, and in line with the general policies of the Turkish government in accessing to natural resources.[6]

13.The Russian Federation is another important OFDI destination. Most Turkish OFDI to the Russian Federation concentrated in retail services, durable and non-durable consumer goods, real estate and property development activities. Market access and geographical diversification were the two main motivations.

14.The energy sector accounted for more than a quarter of the total OFDI in 1991-2004 (table 5), dominated by TPAO's investment in Azerbaijan. Manufacturing and banking each accounted for about a one-fifth share, while the Netherlands accounted for most of the manufacturing OFDI, and together with Germany accounted for most of the banking OFDI activities.

15.The case studies presented in the Appendix A and information reported in the Turkish press suggest that both the large enterprises and SMEs have relied on mergers and acquisitions (M&As) in their internationalization process. For instance, Koc Holding and Sabanci Holding, Turkey's two largest conglomerates and two of the nine cases studied, have pursued acquisitions aggressively in both developed and developing host countries. Many Turkish SMEs have invested in the neighbouring countries to take advantage of investment opportunities offered by privatizations in the Balkans and in Central Asia. They acquired state-owned enterprises in these host countries. The case studies highlighted

[4] For instance, participation income arising from dividends and capital gains received from subsidiaries can be exempt from Dutch corporate income tax in the hands of the holding companies. When a Dutch holding company distributes its participation income to its Turkish individual and corporate shareholders, they would be subject to 20% and 5% dividend and withholding tax, respectively, in the Netherlands but would be exempt from additional taxes in Turkey. This encourages Turkish companies to have intermediary holding companies in the Netherlands for corporate OFDI purposes.
[5] http://www.tpao.gov.tr/defaultt.asp
[6] TPIC was incorporated in 1988 in Jersey Channel Islands.

that Turkish firms prefer majority-owned joint-venture with local partners initially in order to minimize uncertainty and start up costs, cope with host country bureaucratic obstacles, and to gain access to superior technology. They eventually acquired full ownership and control of their foreign affiliates after having exhausted the initial benefits from joint-venture.

IV. OFDI drivers and motivations

16.Turkish enterprises are investing abroad for various reasons and they differ according to size of firms (tables 6 and 7). Each of the nine cases indicates that there were more than one reasons for OFDI and the relative importance of the factors varies across the different cases (table 7, Appendix A). Liberalisation, escape from constraints in home economic environment and privatization in neighbouring countries were key drivers of Turkish OFDI. Saturated home market had encouraged Turkish enterprises to venture abroad to diversify risk, improve competitiveness and expand markets. Other important motivations include access to new markets, natural resources, technology and brand names. While cost motive is an important factor but is not the overriding reason, particularly for efficiency-seeking OFDI. The rise in Turkish TNCs belongs to the "Second Wave" of third-world TNCs whose "…globalization is less driven by cost factors per se, but more by a search for markets and technological innovations to compete successfully in the global economy" .

- **Liberalization and improved policy environment**

17. As the Turkish economy became more outward-oriented since the 1980s, the government started to liberalise the country's OFDI regulatory environment. The improved policy environment was a key factor driving Turkish enterprises to internationalise through OFDI. Competition at home and from abroad (through imports and inward FDI) contributed to internationalization of Turkish enterprises. In all the nine cases, liberalization of the home regulatory environment ranks a priori factor for OFDI.

18.The first important regulatory reform that has spurred OFDI is the liberalization of the foreign exchange regime. Turkey's regime governing foreign exchange transactions and capital movements is based on Law 1567 for the Protection of the Value of Turkish Currency, which was enacted in 1930.[7] This draconian law, which initially and severely restricted Turkish foreign exchange transactions and capital movements were subsequently amended in 1936, 1942, 1950, 1954, 1966, 1985, 1989, and 2003, which relaxed the restrictions.

19.The most important legislation to liberalize Law 1567, however, was Decree 32, issued by the Council of Ministers in 1989.[8] Prior to this decree, the Turkish currency was inconvertible for both current account and financial account transactions. Under this Decree, Turkish residents are allowed to transfer, without seeking permission, up to $5 million, in either currency or in kind, such as machinery, for OFDI purposes. Transactions exceeding $5 million would require the permission of the Undersecretariat of Treasury's Banking and Exchange General Directorate. Turkish banks are required to report all currency transfers by Turkish residents, executed for commercial purposes, to the Treasury. The values of in kind transfers are certified by the Turkish Customs administration. All Turkish residents are required to file detailed reports on their OFDI activities to the Turkish Treasury. The officials of the Banking and Exchange General Directorate stated in interviews that very few applications for OFDI exceeding $5 million under Article 13 of Decree 32 were rejected. The few that were rejected were mainly because of the lack of proper documentation.[9] This was confirmed in interviews with representatives of private sector organizations and company executives, who described the regulatory process more as registration

[7] http://www.tcmb.gov.tr/yeni/mevzuat/DISILISKILER/TPKKhakkinda1567Sayilikanun.htm
[8] http://www.tcmb.gov.tr/yeni/mevzuat/DISILISKILER/32sayilikarar.htm

than screening of OFDI. Several of these officials and executives argued that even as registration, the regulatory process was ineffective and burdensome, and hence should be eliminated.

20.Along with the liberalization of the foreign exchange controls, Turkish foreign trade regime has also been progressively liberalized, as a result of both the Uruguay Round and the Turkey's customs union (CU) with the EU, allowing much greater competition from imports. Turkey's inward FDI regime has also been liberalized although not to the same extent as the import regime . The increasing competitive pressure from imports and inward FDI on domestic firms has forced them to seek foreign markets through both exports and OFDI.

- **Escape from home economic environment**

21.A key driver of Turkish OFDI is the desire of its enterprises to escape from the constraints of home economic environment. The business environment in Turkey in the past decades has been a challenge for SMEs. "An inflationary economic climate and increasing public sector debt have led to a lack of confidence, a series of financial crises, a sharp rise in real interest rates and marked depreciation of the Turkish lira. GDP has fluctuated widely, punctuated by recessions, and average growth has been modest given the Turkish economy's growth potential and its needs." . Since 2003, the business environment has improved substantially, with low inflation and higher real economic growth rates, and significant regulatory reform . However, many of the problems that burden SMEs remain.

22. "Surveys of business executives attribute not only a below average ranking to the legal and regulatory environment in Turkey, but the score has to date been substantially worse than that of other lower-income OECD countries…Rigid employment protection legislation and substantial labour tax and social contribution wedges hinder companies in responding flexibly to changing market conditions" . These wedges account for 70% of the net wage of a worker earning the minimum wage, the highest in the OECD . "High labour tax and social security charges are also among the causes of the very significant size of the informal sector in Turkey. Estimates about the extent of unregistered activities exceed 50% of total employment." . The informal sector could well account for 50% of the SME activities .

23.Exit costs are also very high for unsuccessful businesses. It takes several years of costly litigation to liquidate an unsuccessful company. Some SME owners find it less costly to pay year after year the commercial registry fees for their out-of-business companies than to seek their legal liquidation after they establish new companies. Since such exit costs are much less burdensome for Turkish companies with OFDI in their host countries, especially for entrepreneurial SMEs, these exit costs act as a push factor for them.

[9] The proper documentation includes specific financial and operational information about both the Turkish parent firm and its foreign affiliate. After receiving permission for OFDI, the Turkish parent firm is expected to file periodic reports on the financial and operational activities of its foreign affiliates. The form that is expected to be filled out by Turkish parent firms consists of 17 questions. The first 15 questions ask for detailed data on the financial and operational characteristics of the affiliate. The last two questions are qualitative and subjective, asking about the "Problems Encountered," and "The Reasons and Expectations that Led to the Realized Investments." The officials of the Banking and Exchange General stated, however, that they receive relatively few such reports and very few of them are completed satisfactorily for any use. They also revealed that since they are short of qualified personnel they would not be able to process and analyze the reports even if they were completed satisfactorily. In other words, the Turkish government has very limited financial and operational data, which can be used for either academic or policy research, on the OFDI activities of Turkish firms. This is also true of the IFDI activities of foreign firms in Turkey.

24. Another important push factor has been the increasing competitive pressure from rising imports, especially as a result of the Customs Union with the EU since 1996. This pressure has forced many firms to seek foreign markets through OFDI.

25.High corporate and personal income tax rates in Turkey have also encouraged Turkish OFDI. The corporate income tax rate in Turkey is 30%, compared with 15% and 16% respectively in Bulgaria and Romania. Turkish tax laws and regulations, which have become increasingly complex over the years even for specialists, also change frequently and unpredictably. The tax laws have been changed by eight times since 1980 . These changes have generated hundreds of revisions annually in regulations and circulars issued by the Ministry of Finance. All these changes and revisions have created financial uncertainty and complexity, especially for SMEs in their long-term planning and investment decisions. Most of the Turkish business executives interviewed regard Turkey's tax system as a major obstacle to increasing their companies' competitiveness - a point that has been made forcefully also by a Turkish tax specialist . They also hold it responsible for Turkey's unregistered economy, which is estimated to account for 55% of the total employment . Fiscal motives (avoidance of high tax rates) have been cited a significant OFDI driver for all but one of the nine cases interviewed.

26.Escape from the home economic environment was cited as a powerful OFDI driver in five of the nine cases surveyed. This is especially true for Koc Holding and Sabanci Holding, which was due to increasing competitive pressure from imports. The two enterprises used OFDI as a means to increase their geographical diversification and enhance their competitiveness. In three of the seven SME cases (Ener Holding, Emsas, and Aksan Kalip), escape from the home economic environment was the dominant OFDI driver.

- **Attractive foreign investment environment abroad**

27. A major change in the foreign environment is the restoration of capitalist regimes in several countries close to Turkey, in terms of either physical or psychic distance. The opening of these countries (e.g. former USSR and Balkans) to inward FDI, especially through the privatization of state-owned enterprises, has enabled Turkish firms to increase their presence in these countries. Of the nine cases interviewed, all but one (Sabanci Holding) have exploited this regime change in the foreign environment to either initiate or increase their OFDI to these countries.

- **Access to Natural Resources**

28.Access to natural resources has been an important motive for resource-seeking OFDI. Resource rich neighbouring countries such as Azerbaijan witnessed strong Turkish OFDI. The significant OFDI by TPAO in the Azeri energy sector is an example. Among the nine cases, OFDI by Haznedar Refrakter, an SME, was driven by the acquisition of high quality dolomite deposits in Macedonia.

- **Access to Markets**

29.Accessing new markets is a key motivation of Turkish OFDI. Saturated domestic market and competition from imports and IFDI were the prime reasons for Turkish market-seeking enterprises to venture abroad. Koc Holding and Sabanci Holding and SMEs such as Borova, Ener Holding, and Oynurden Kimya (see respective case studies) went abroad to access to new markets. In addition, many Turkish firms, especially SMEs, have resorted to OFDI in the Balkans, the Russian Federation, and the Turkic Republics in Central Asia for trade supporting motive. The motivations included avoiding high tariffs, rising transportation costs, overvaluation of the Turkish currency, and bureaucratic obstacles to imports from Turkey in these regions. In all nine cases, access to markets and as a means for geographical risk diversification has been cited a key OFDI driver.

- **Access to Technologies**

30.Sabanci Holding has benefited technologically from its joint-venture with DuPont. Koc Holding has also gained access to new technologies, including hundreds of patents, through its acquisition of international brands such as the German electronics brand Grundig. Among the seven SMEs, Aksan Kalip illustrated that the company's initial internationalization was driven by its determination to overcome its technological shortcomings. On the other hand, Oynurden Kimya, another SME, indicated that access to technology was not initially an OFDI driver but later became the dominant one.

- **Access to Brand Names**

31.Both Koc Holding and Sabanci Holding used OFDI to acquire international brands in their quest to strengthen their global presence. In order to facilitate its expansion in consumer durables in Europe, Koc Holding bought initially several brands, such as Blomberg in Germany, Elektra Brengez and Tirolia in Austria, the bankrupt appliance maker Brandt group of France, and the Flavel and Leisure brands in England. Koc Holding purchased later, in a 50-50 joint venture with an English firm, Alba, the much better-known consumer electronics Grundig brand, along with Grundig's 717 patents. This took place after Grundig, for which KH had been an original equipment manufacturer (OEM), went bankrupt.

32.Sabanci Holding became the sole licensee of DuPont technologies, patents, and trademarks in its businesses in Europe, the region of the former USSR, and Africa, after buying out DuPont in their joint venture DuPontSA, the largest polyester company in Europe. In both cases, accessing foreign brands through OFDI has increased the competitiveness of these two Turkish TNCs both at home and abroad.

33.Another example of a major Turkish TNC, although not one of the nine cases analyzed in this study, that has benefited from access to local (host country) as well as international brands through OFDI is Turkey's largest beer producer Efes Pilsen. Besides its own international brand Efes Pilsen, it produces the host country local brands such as Stary Melnik, Beliy Medved, Sokol, and Amsterdam Navigator in the Russian Federation; Karagandinskoe in Kazakhstan; Caraiman in Romania; Vitanta, Chisinau, and Arc in Moldova; Weifert, Standard, Pils Plus, and Zajecarsko in Serbia-Montenegro. It also produces the leading international brands Warsteiner and Zlatopramen under license in the Russian Federation.[10]

V. SMEs and OFDI

34. According to a recent survey, only three percent of SMEs in Europe have OFDI but with wide variation among countries. In Korea, however, SMEs increased their share in OFDI from 16 percent in 2000 to 38 percent in 2002 . Little is known empirically as to why SMEs choose OFDI and even less is known about the extent to which they realize their OFDI objectives. No national data on the OFDI by SMEs exist in Turkey. In fact, no reliable statistics exist on Turkish SMEs. "Turkey does not currently carry out an exhaustive statistical census of SMEs on the basis of homogeneous definitions and criteria" . Many, if not most, SMEs are suspected of operating in Turkey's unregistered economy.

35.The special services that Istanbul Chamber of Industry (ISO) provides to support its SME members do not include facilitation of OFDI. Neither the ISO nor the Ankara Chamber of Industry could tell the author which of their SME members had OFDI, either for the lack or the sensitivity of the data. In short, SMEs in Turkey do not receive any specific direct and proactive support from any public organization for OFDI.

[10] http://www.efesbev.com/our_group/beer_brands.aspx

36.The ISO surveys its 11,000 members, of which 98 percent have fewer than 250 employees, for their planned investments and the realization of those plans. Its latest published survey reveals that both large companies and SMEs have begun to view OFDI as increasingly critical to their competitiveness and profitability . It reports that its members had planned to increase their OFDI by 17 percent during the first half of 2004 but only three percent had realized those plans. During the second half of 2004, 15 percent had planned to increase their OFDI but four percent had realized those plans. As for 2005, 25 percent of all its members plan OFDIs. Among them, 22 percent of small-scale members, 18 percent of medium-scale members, and 33 percent of large-scale members plan OFDI for 2005. The ISO states that its members find it increasingly more attractive to invest abroad than at home due to rising intermediate input prices and declining profitability in Turkey .

37.In the absence of adequate proactive support from the Turkish government and the Chambers of Industry for OFDI, the Foreign Economic Relations Board (DEIK)[11], a private non-profit Turkish business association established in 1986, has played the major role in promoting OFDI from Turkey. The primary objective of DEİK is to improve Turkey's international economic relations through the activities of bilateral business councils (BBCs) formed between Turkey and countries that have significant trade and investment ties with Turkey. Each BBC has two sections, one in Turkey and the other in DEIK's counterpart institution in each respective partner country. DEIK provides the operational services for the Turkish section, which consists of companies that either already have or intend to develop business relations in the respective country. The BBCs, which meet regularly, aim not only to improve the conditions of existing bilateral trade and investment ties, but also to provide a forum for the development of new ones by collecting and exchanging information on potential business opportunities in and outside Turkey. As of June 2005, there were 67 BBCs operating under DEIK's umbrella, with 476 companies and 1,205 representatives. Many of Turkish companies that are BBC members are SMEs. For example, Yalcin Egemen, the owner and CEO of Oynurden Kimya, one of the seven SME case studies presented in the Appendix, is chairman of the Turkish section of the Turkish-Bulgarian Business Council. Haznedar Refrakter, another of the seven the SME case studies, is a member of the Turkish-Macedonian Business Council.

38.DEIK has developed close ties with international organizations such as the World Bank, the European Bank for Reconstruction and Development (EBRD), Multilateral Investment Guarantee Agency (MIGA) and the Asian Development Bank in order to assist Turkish companies interested in OFDI in their search for international funding and foreign partners. DEİK also collaborates with the Black Sea Economic Cooperation (BSEC) Business Council in the promotion of investment projects that are either bilateral or multilateral. In short, the privately financed and managed DEIK promotes not only Turkish OFDI but also IFDI in Turkey.

VI. OFDI and Enterprise Competitiveness

39.OFDI has improved the competitiveness of the enterprises studied in all but one of the nine case studies in several different but significant ways. The two large-scale enterprises, Koc Holding (KH) and Sabanci Holding (SH) have learned to do business under very different conditions in different markets and have benefited from scale economies. They have diversified their business and country risks and they have improved the quality of their products for domestic and foreign markets by having to compete with their foreign rivals in foreign markets. OFDI has also led to increase in their R&D and in-house technology development. Their Turkish managers who had worked in foreign subsidiaries have come back home with valuable international experience in doing business under different conditions. KH and SH have increased their geographical diversification as they decreased their sectoral diversification at

[11] http://www.deik.org.tr/default_eng.asp

home. All seven SMEs viewed OFDI as a way to reduce their risk from over dependence in the home market. In all but one of the nine cases, it was revealed that enhancing market access through OFDI has enabled Turkish enterprises to increase their competitiveness through either geographical or product diversification. Several of the SMEs not only improved their competitiveness through OFDI but also ensured their survival. The more specific effects of ODFI on competitiveness are detailed below.

40. KH recorded, in 2004, 37 percent of its total sales from combined exports and foreign affiliate sales, which rose from $1 billion to $7 billion during 2000-2004. Its target is to push this to 50 percent. In order to facilitate its expansion in Europe, KH's Arcelik, whose foreign sales accounted for 44 percent of its total sales in 2004, bought in 2002, several brands, such as Blomberg in Germany, Elektra Brengez and Tirolia in Austria, of the bankrupt appliance maker Brandt group of France, and the Flavel and Leisure brands in England. In 2003, Arcelik established in England an R&D and marketing subsidiary, Fusion Digital Technologies, of which it owns 50 percent shares. This joint venture, which is developing digital technologies, aspires to establish the Beko brand as the leader in Europe's TV market. In 2004, KH purchased, in a 50-50 joint venture with an English firm, Alba, the much better-known consumer electronics Grundig brand, along with Grundig's 717 patents. This happened after Grundig, for which Arcelik had been an original equipment manufacturer (OEM), had gone bankrupt. The acquisition lessened Arcelik's dependence on OEM manufacturing through the exploitation of the premium Grundig brand in Europe. Since its acquisition by Arcelik, Grundig's market share in Germany has tripled from 3 percent to 9 percent. In Romania, Arcelik acquired Arctic, a refrigerator manufacturer established in 1970. Arcelik, after modernizing Artic and doubling its productive capacity, began to make significant profits. Arctic, which also makes washing machines and ranges, now has 50 percent domestic market share in refrigerators and exports close to 40 percent of its output. Arcelik's combined exports and foreign affiliate sales led to 29 percent increase in its total revenues and the 70 percent increase in its net income in 2004. In retail services OFDI, KH's Migros group has been expanding overseas faster than at home with higher profitability than at home. Its foreign affiliate sales, in the Russian Federation, Kazakhstan, Azerbaijan, and Bulgaria, accounted for 16 percent of its total sales of $1.7 billion but 39 percent of its total profits in 2004. Although the sales in the Russian Federation alone accounted for only 15 percent of the Migros sales in Turkey, the net income in the Russian Federation accounted for 50 percent of the Migros net income in Turkey.

41. SH's case fits closely the model of latecomer industrialization in which international expansion is directed toward establishing ties with advanced country firms in order to gain access to their knowledge, technologies, and market connections. SH's entered into a first joint venture with DuPont in 1987. The second joint venture was established in 1999. SH's major initial objective in these joint ventures was to access DuPont's technologies. In later years, SH's dependence on DuPont technologies in particular, and on foreign technologies in general has been reduced through SH's own R&D. The evolution of SH's joint ventures with DuPont is almost identical to that of Korean firms' joint ventures with Japanese firms in the electronics sector, where the Korean firms were able to buy out their Japanese partners after gaining all the knowledge they needed in order to stand on their own feet. SH has improved its international competitiveness significantly through its OFDI. In 2003, SH relocated its major R&D center for industrial nylon in Chattanooga, Tennessee to Izmit, Turkey, as its in-house R&D capabilities reached global standards. The fact that SH has been able to buy out its major foreign partner, DuPont in both of its major fields of activity in a short period, to stand on its own feet in global markets, shows that SH has become a major TNC in the world in polyester and industrial nylon businesses. In the interview with the author, Celal Metin, the CEO of Sabanci Holding summarized the crucial effect of OFDI on SH's competitiveness as follows: "Through becoming a major TNC, SH has extended its domestic reputation, trustworthiness, and leverage, as one of Turkey's largest enterprises, to the international level. As a major TNC, based on our international experiences, we are able to move more quickly, with greater confidence and decisiveness, to take advantage of new investment opportunities, and even without relying on foreign partners, with our own resources. This is the most important power that SH has gained from its emergence as a major TNC."

42.Among the seven SME cases, Haznedar Refrakter (HR), whose OFDI was driven by the acquisition of high quality dolomite deposits in Macedonia, enhanced its competitiveness significantly both at home and abroad by increasing its product range and vertical integration. Its Macedonian plant, Vardar Dolomite, built close to high quality dolomite deposits, far superior to those found in Turkey, exports almost all of its output to HR for further processing into dolomite bricks, used primarily in the steel and cement industries. As the products of Vardar Dolomite are not produced by HR in Turkey, they increased HR's product as well as geographic diversification, making HR more competitive both at home and abroad. According to HR, the first Turkish refractory industrial bricks producer to invest abroad, "… the new plant in Macedonia will not only introduce high quality dolomite to Turkey, but also it will make HR much more competitive among European suppliers, with its ISO 9002 certificate as the symbol of its proven quality." HR's access to high quality dolomite deposits of Vardar Dolomite has enabled it increase its refractory industrial brick exports, due their improved quality, from Turkey to markets in Europe and the Far East.

43.Oynurden Kimya (OK), a family-owned and -managed manufacturer of industrial glues, under the internationally known Denlaks trade mark, primarily for the shoe manufacturing sector, had intended its OFDI in Bulgaria to develop a market for its industrial glues. Fortuitously, however, as explained in the case analysis (see Appendix), it decided to exploit OFDI opportunities in the Bulgarian agricultural sector. Its successful wine grape nursery OFDI enabled it to transfer the wine nursery technology, which had been developed in Bulgaria since the 1950s with French technical assistance, to Turkey. OK's wine nursery OFDI, an unintended but successful sectoral diversification that has resulted in an important technology transfer from its host country to its home country, has enabled OK to acquire the dominant competitive position in an entirely new business in Turkey.

44.In the SME cases of Ener Holding and Emsas, OFDI has served as a means of survival in the harsh economic conditions at home. Ener Holding's Majestic Hotel in Bucharest has enabled the parent firm to survive during the back-to-back economic crises of 2000-2001 when its construction and tourism businesses in Turkey almost collapsed. Emsas's OFDI, an opportunistic one capitalizing on accumulated host country experience in Kazakhstan, as an unintended sectoral diversification into hotel services that has enabled this company to maintain its financial viability in light of the unfavorable conditions it faces in construction services, its core business at home. Emsas, which finds its construction business in Turkey too competitive and not very profitable, considers its OFDI highly successful and profitable, which provides a steady cash flow.

45.Aksan Kalip (AK), the manufacturer of electro-mechanical metal parts for the final products of the Turkish consumer electronics industry, primarily TV sets, has relied on its wholly-owned Bulgarian affiliate, Mikroak, to make the plastic molds for its metal products. Mikroak has enabled AK to increase its production of the electro-mechanical parts with greater flexibility and reliability through in-house production of the molds required to make those parts. Mikroak, which exports all of its output, three quarters to Turkey and the rest to Western Europe, has contributed significantly to AK's international competitiveness through both product and geographical diversification.

VII. Policy Issues: Legal and Institutional Developments and Policy Implications

46. The liberalization of Turkey's regulatory environment, especially the relaxation of restrictions on foreign exchange and financial account transactions, has spurred OFDI (section IV). By promoting exports of goods and services to the former communist countries in the former USSR and the Balkans, the Turkish government has paved the way for many Turkish enterprises to enter these markets first as exporters and then as direct investors.

47.The Turkish government does not have specific policies promoting OFDI and the public perception of OFDI is mostly negative as OFDI is seen as replacing investment and export of employment. It is viewed as a delocalization process that might benefit the investing firms but hurt the national economy. The requirement that capital transfers greater than $5 million must be authorized by the Turkish Treasury does not seem to have been a serious deterrent to OFDI. Turkey has bilateral tax treaties on avoidance of double taxation with 60 countries[12] and bilateral investment treaties to promote and protect FDI with 79 countries.[13] These bilateral tax and investment treaties can be viewed as indirect encouragement of OFDI although they were initially and primarily aimed at facilitating IFDI.

48. The Turk Eximbank, a state-owned bank founded in 1987, played a very important role in the initial wave of OFDI into the Balkans, the Russian Federation, and the Turkic Republics in Central Asia. It provided various types of export credit facilities, guarantee, and insurance programs to Turkish enterprises, most of them SMEs. Since 1989, Turk Eximbank has provided under its Country Credit/Guarantee Program financial support to Turkish firms investing overseas. During 1989-2004, some of the $2.2 billion in total credits and guarantees provided have supported Turkish OFDI in 21 countries, mostly in the Balkans, Eastern Europe, and Central Asia. Since 1996, Turk Eximbank has provided finance to Turkish OFDI projects in shopping malls and chain stores through the Overseas Chain Stores Investment Credit Program. It extended this program in 2003 to investments for establishing Turkish brands and promoting Turkish designer goods abroad, with a minimum fixed investment of $200 thousand and a lending ratio of 85 percent of the invested amount. Eximbank has considered but not yet implemented an Overseas Investment Insurance Program to provide cover to outward Turkish FDI firms against political risks.[14]

49.In the interviews it was noted that the Turkish embassies and consulates in the host countries of the nine case study OFDI firms had been, on the whole, quite helpful, especially to SMEs, in providing information and intermediation. In the case of Aksan Kalip, one of the seven SMEs, the intervention of the Turkish government at the highest level may have arguably saved its OFDI from extinction after its host country government threatened to shut down its foreign affiliate.

50.Turkey's customs union with the EU in 1996 and prospect of full EU membership have created opportunities for Turkish SMEs that are interested in OFDI in the EU. Ankara European Information Center (AEIC), founded in 2002, is a joint project of the Small and Medium Industry Development Organization (KOSGEB) of the Ministry of Industry and Trade and the Ankara Chambers of Commerce and Industry. It is financially supported by the Commission of the EU. One of AEIC's objectives is to enable Turkish SMEs and EU enterprises that are interested in starting joint ventures in either Turkey or the EU to make contact with each other. On AEIC's website Turkish SMEs can search for the profiles of EU enterprises that are potential joint venture partners.[15]

51.Turkey does not have an investment promotion agency (IPA) for either inward or outward FDI. Although the establishment of an IPA to promote IFDI was considered by the present Turkish government in recent years, no steps have been taken yet to realize it. Instead, an Investor Relations Office (IRO) was established in the Turkish Treasury "… to provide timely and useful macroeconomic data on economic situation, which may be of primary importance while undertaking an investment in Turkey. Nevertheless, IRO does not provide specific information pertaining specific investment opportunities present in Turkey."[16] If an IPA were to be established, it might be able to serve as a catalyst

[12] http://www.gelirler.gov.tr/gelir2.nsf/CifteVergilendirme?OpenPage
[13] http://www.yased.org.tr/page.asp?PageID=1230
[14] http://www.eximbank.gov.tr/html_files/kisaeximbankpg.htm
[15] http://www.abmankara.gov.tr/default.asp
[16] http://www.hazine.gov.tr/iro_files/fqa.htm

for OFDI, especially by SMEs, in providing information and enabling contacts between Turkish and foreign enterprises.

VIII. Policy recommendations

52.In the absence of proactive support for OFDI from the Turkish government and the Ankara and Istanbul Chambers of Industry, the Foreign Economic Relations Board (DEIK), a private non-profit Turkish business association established in 1986, has played the major role in promoting OFDI from Turkey through its Bilateral Business Councils. SMEs that are not already DEIK members can join this organization to take advantage of its services in developing bilateral investment ties with foreign enterprises in 67 countries in all over the world.

53.The Turkish government can play a much more significant role in facilitating OFDI, especially by SMEs. The establishment of an Overseas Investment Insurance Program under the aegis of the Turk Eximbank would be an important step in that direction. The responsibilities of the Small and Medium Industry Development Organization (KOSGEB) of the Ministry of Industry and Trade, which provides a wide range of services, such as export promotion, to industrial SMEs, should expand to include provision of not only information on the Internet but also individual and customized advice on OFDI opportunities and ways to realize those opportunities. The Chambers of Industry should also do the same and promote a better understanding of internationalization of enterprises through OFDI, including the challenges and how such internationalization process can help improve enterprise competitiveness. The Turkish government should also channel the required resources into the collection and analysis of the data on OFDI activities of Turkish enterprises so that both academic and policy questions on the causes and effects of OFDI can be better answered.

54.The Turkish government could consider promoting OFDI as an important activity to improve the international competitiveness of both large Turkish enterprises and SMEs. The government agencies responsible for helping the formation and development of SMEs could add to their portfolio of services for SMEs the facilitation of OFDI. Turk Eximbank could implement an Overseas Investment Insurance Program to provide insurance cover against political risks.

55.Given that OFDI is becoming an increasingly important phenomenon relative to total economic activity in Turkey, the government could consider allocating resources for studying the causes and effects of OFDI, especially by SMEs,. The starting point for this could be the formation of a reliable database on OFDI.

56.Requiring Turkish OFDI to be authorized by the Turkish Treasury, especially when such authorization requirement has been recently abolished for IFDI, does not seem to serve any useful purpose. Instead, the Treasury could consider more effective ways of collecting data on the financial and operational data on the activities of OFDI affiliates.

57.The Turkish government could implement a fundamental tax reform to lower the personal and corporate income tax rates and broaden the tax base in order to not only help SMEs but enable the Turkish economy to realize its fuller potential.

IX. Summary and Conclusions

58.This study analyzed the Turkish OFDI trends, causes, and effects on enterprise competitiveness, based on macro data and primary case studies, with an emphasis on SMEs. It had reviewed the drivers and motivations of Turkish OFDI, including economic, legal, and institutional factors. The following key points need to be highlighted:

- Most of the Turkish firms that have invested in the neighbouring countries are SMEs although large enterprises such as Koc Holding and Sabanci Holding account for most of the total value of OFDI transactions.
- The motives of large enterprises are mainly strategic, which relates to long-term planning. However those of SMEs are entrepreneurial, innovative, idiosyncratic, and opportunistic, based on their attempts to exploit unique circumstances, to stay competitive, and even to survive in reaction to the various challenges they face in home market environment.
- The drivers and motivations for rising OFDI vary but the more important factors appear to be liberalization of the home regulatory environment, home economic environment as push factors, fiscal motivations, and access to markets. High taxes, rising unit labor costs and trade supporting factors have also encouraged OFDI. "Pull" factors such as access to technologies, brand names and natural resources played a significant role as well.
- Turkish construction companies paved the way, as pioneers, in the 1970s for the rest of the Turkish private sector to enter into international markets, first as exporters and later as direct investors, beginning in the 1980s. This process accelerated in the early 1990s, following the collapse of the USSR and the communist regimes in the Balkans, which has acted as a powerful pull factor for Turkish OFDI. Large Turkish construction companies have significant investment abroad.
- Turkish enterprises, as later comers to industrialization, have used different linkages, such as joint venture and original equipment manufacturer (OEM) relationship, with foreign enterprises in initiating and expanding their OFDI activities. Joint venture appears to have been a common initial strategy to minimize risk and to access technologies of foreign partners.
- Both large enterprises such as Koc Holding and Sabanci Holding and SMEs seem to have used OFDI as a source of cumulative learning as predicted by the Uppsala model toward more intensive as well as extensive internationalization.
- The case studies suggest that OFDI has strengthened the competitiveness of both large Turkish enterprises and SMEs in different ways. Geographical risk diversification against both systemic and specific risks and market access, appears to have benefited most of them in terms of scale economies and quality standards improvement. Access to technologies and brands appears to have benefited the large enterprises. For some SMEs, OFDI is seen not just as a means to improve competitiveness but to ensure survival in light of home market environment and economic crises.
- It seems that the widespread concern in Turkey about OFDI as delocalization is more justified about SMEs than about large enterprises. This implies that any effort to stem such delocalization OFDI by SMEs should address the problems they face in investing and growing at home.

Appendix A: Case Studies

59.Two sets of case studies are presented. The first set includes two conglomerates, Koc Holding and Sabanci Holding, listed in the Forbes Global 500, which are Turkey's first and second largest TNCs, respectively. The second set includes seven SMEs that the author was able to study based on the availability of their owners or managers for interviews during the second half of April 2005.

60.Before examining the case studies, in order to set the background, it should be noted that Turkish construction companies, such as Enka, paved the way, as pioneers, in the 1970s for the rest of the Turkish private sector to enter into international markets, first as exporters and later as direct investors, beginning in the 1980s.[17] This process accelerated in the early 1990s, following the collapse of the USSR and the communist regimes in the Balkans. In fact, large construction companies such as Enka, Tekfen, and Gama themselves have significant OFDIs. Enka's OFDI in the Russian Federation, in retail services and commercial real estate, is about $1 billion. Tekfen owns construction companies in Germany, Azerbaijan, and Georgia. Gama owns a power station in Ireland. Several smaller construction companies such as Okan and Emsas also have OFDIs resulting from their earlier presence overseas as contractors. Many of these OFDIs are in sectors other than construction. The critical role played by construction companies in the internationalization of the Turkish private sector cannot be overstated.

Case 1 - Koc Holding

61.Founded in 1963, but its origins dating back to 1926, Koc Holding A. S. (KH) is the largest private enterprise in Turkey. Controlled by the Koc family, it is an industrial and financial conglomerate consisting of 106 companies, with total assets of $14.2 billion, consolidated sales of $16.2 billion, exports of $5.7 billion, and 62 thousand employees in 2004.[18] KH companies produce a very wide range of goods and services. KH had become highly diversified in Turkey during the closed economy-import substitution regime that began to disintegrate in the 1980s and ended after the CU with the EU in 1996. The strategy of KH, which had anticipated the CU with the EU since the early 1990s, has been to reduce its sectoral diversification in Turkey as it increases its geographical diversification outside Turkey, in order to benefit from scale economies and quality improvements and to reduce its risky dependence on its often unstable and increasingly saturated Turkish markets.

62.KH aims to become internationally competitive through both cost minimization, based on R&D, state of the art technologies, and scale economies, and product differentiation, based on brand name development, in all of its core businesses through OFDI. KH recorded, in 2004, 37 percent of its total sales from combined exports and foreign affiliate sales, which rose from $1 billion to $7 billion during 2000-2004. Its target is to push this to 50 percent.

63.KH has chosen, on the basis of its strategic planning dating back to the early 1990s, two regions for its international expansion: Western Europe and the regions surrounding Turkey, namely, the Balkans, the Russian Federation, the Middle East, and North Africa. Western Europe is where the major competitors of KH are located and where the most advanced products and processes first emerge. It is also the region with the highest per capita income and most sophisticated consumers. It is not, however, a growing market. KH wants to learn how to compete and survive in such a mature market. The regions surrounding Turkey are relatively underdeveloped and unstable, but they have great growth potential, which KH counts on for its own growth. They also resemble Turkey in their social and cultural characteristics more than the Western European markets. KH sees in particular great potential in Iraq, Iran, and Syria for its

[17] The initial internationalization of Turkish construction companies has been studied elsewhere .
[18] http://www.koc.com.tr

future OFDI if and when these countries gain greater political stability and open themselves to foreign business. KH regards, however, the Russian and Chinese markets as its major international opportunities for OFDI based on its core businesses and core competences developed in Turkey. That is how KH distinguishes its OFDI strategy from the entrepreneurial or opportunistic approach of SMEs and individuals who enter into foreign markets without much experience gained in Turkey. KH's successful adaptation to the CU with the EU after 1996 has enabled it to view foreign expansions with greater confidence.

64.KH has its major OFDIs in two sectors: Retail services and electrical appliances (white goods and TV sets). Its Migros and Arcelik companies have respectively pioneered OFDI in these sectors. KH's two relatively minor FDIs outside of these sectors are its automotive joint venture in Uzbekistan and the recently established subsidiary, Opet/Aygaz, in Bulgaria for liquefied petroleum gas (LPG) and fuel-oil distribution.

65.KH's initial OFDI in the 1980s was in consumer durable goods distribution and marketing subsidiaries in Western Europe. After the collapse of the USSR, it shifted its attention to the Russian Federation and the Newly Independent States of the former USSR, benefiting from the Turkish government's political support and Turk Eximbank's credits. One of its initial OFDI projects, based on its experience in the Turkish automotive sector since the 1960s, was a commercial vehicle plant, in Uzbekistan, in a joint venture, named SamKoc Auto, with the Uzbek Automotive Ministry. This project, begun in 1996 and completed in 1999, has not been very profitable for Koc due to problems in doing business in Uzbekistan.

66.In 1996, KH began, on the basis of the long experience of its Migros[19] group in the Turkish retail sector, to develop supermarkets and hypermarkets, called Ramstores, and shopping centers, in Azerbaijan, Bulgaria, Kazakhstan, Macedonia, and in the Russian Federation, with International Finance Corporation (IFC) financing. Ramstores, especially those in the Russian Federation, have become the major OFDIs of KH. The 32 Ramstores in Russia are owned by a 50-50, $350 million joint venture, founded in 1997, called Ramenka, with Enka Holding, another major Turkish conglomerate whose flagship is Turkey's largest construction company. Ramenka generated $400 million in sales with 3,500 employees in 2004. KH has a minority local partner in its Kazakhstan Ramstores. All other Ramstores are wholly-owned by KH.

67.KH first chose to invest in the Turkic Republics in Central Asia. It has not been satisfied with its progress in these countries. The major problem is the unfavorable business environment in these countries even compared to that of Turkey. Nevertheless, KH has gained valuable experience in these countries. KH was one of the first major direct foreign investors in the Russian Federation when it decided to establish the Ramstores. KH owes its ease of entry and initial success in the Russian Federation to Enka Holding, which had gained experience and knowledge about the Russian construction and real estate markets through several years of contracting services, especially in and near Moscow. Through its 50-50 joint venture Ramenka with Enka, Koc now has several major shopping centers (hypermarkets and malls) and many Ramstores, primarily in the Moscow region, that have been very profitable, in fact, much more profitable than KH's Migros stores in Turkey. As it faces increasing local and foreign competition in the Moscow region, Ramenka has begun to expand into other regions in Russia, for example, St. Petersburg and Siberia. In retail services OFDI, the foreign sales of KH's Migros group accounted for 16 percent of its total sales of $1.7 billion but 39 percent of its total profits. KH's greenfield OFDI in the retail sector can be viewed as primarily voluntary (offensive) horizontal expansion.

68.KH's white goods producer Arcelik[20], founded in 1955, with 2004 consolidated sales of $3.5 billion, one third of which was derived from foreign markets, primarily in Europe, accounts for the second largest

[19] http://www.migros.com.tr
[20] http://www.arcelik.com.tr

OFDI after Migros. For a large Turkish company such as KH's appliance maker Arcelik, whose long term objective is to become one of the world's largest appliance companies, the domestic market is too small. It has also been extremely volatile due to the severe macroeconomic instability of recent years. Moreover, producing in developed countries, especially in the EU, enables a company such as Arcelik to overcome the perceived liability of the "Made in Turkey" label. Having a production presence abroad can also improve the international image of a Turkish company, helping it in various ways, e.g., in raising funds and attracting investors in international capital markets. Arcelik's OFDI, which appears to be a mixture of involuntary (defensive) horizontal expansion and delocalization FDI, has been primarily in the form of either brownfield or greenfield wholly-owned subsidiaries.

69.In Western Europe, Arcelik's first beachhead in durable consumer goods was England where it now has its major presence with a significant market share through its Beko brand of white goods and TV sets. The Beko brand, although not yet a premium brand, is now also widely known in France, Germany, and Spain. In order to facilitate its expansion in Europe, in 2002, KH's Arcelik bought several brands, such as Blomberg in Germany, Elektra Brengez and Tirolia in Austria, of the bankrupt appliance maker Brandt group of France, and the Flavel and Leisure brands in England. In 2003, Arcelik established in England an R&D and marketing subsidiary, Fusion Digital Technologies, of which it owns 50 percent. This joint venture, which is developing digital technologies, is aimed at establishing the Beko brand as the leader in Europe's TV market.

70.In 2004, KH purchased, in a 50-50 joint venture with an English firm, Alba, the much better-known consumer electronics Grundig brand, along with Grundig's 717 patents. This happened after Grundig, for which Arcelik had been an original equipment manufacturer (OEM), had gone bankrupt. This acquisition was aimed at enabling Arcelik to lessen its dependence on OEM manufacturing through the exploitation of the premium Grundig brand in Europe. Since its acquisition by Arcelik, Grundig's market share in Germany has tripled from 3 percent to 9 percent.

71.In Romania, KH acquired Arctic, a refrigerator manufacturer established in 1970. KH, after modernizing Artic and doubling its productive capacity, began to make significant profits. Arctic, which also makes washing machines and ranges, now has 50 percent domestic market share in refrigerators and exports close to 40 percent of its output. Arcelik had established a joint venture in Tunisia in the late 1990s, which was shut down after proving unsuccessful. Now KH's Arcelik is expanding into the Russian Federation to produce ultimately a wide range of electrical appliances. Its new Russian plant will begin to produce initially washing machines and later add refrigerators and TV sets to its production line. Arcelik believes it must develop and establish more international brands of its own such as Beko. It wants to reduce its OEM role, especially in making TV sets for better-known European and Japanese companies, by using its own brands increasingly.[21]

72.KH has set its sight on China, which it regards as the most promising market in the world for FDI and where it already has a small joint venture. This joint venture, named Chung Mei, between the HK's Demir Dokum company and a partner from Hong Kong, produces electrical residential radiators. KH is considering a major expansion in the Chinese market for white goods, TVs, construction materials, and even in the Chinese automotive sector. Its aim is not, however, to use China as an export base as have many TNCs done from developed countries. On the contrary, it wants to produce primarily for the

[21] Among Turkey's global brands, besides Beko, we can list the jeans *Mavi Jeans* brand, developed by Turkey's largest denim producer Erak, the designed men's wear *Damat-Tween* brand, developed by the Orka Group, the *ViatrA* seramics brand, developed by Eczacibasi Holding's Karo Seramik, which has an OFDI in Ireland, the *Efes* beer brand developed by Anadolu Holding's Efes company, which has OFDIs in several countries, most important of which is in the Russian Federation.

Chinese market. Finally, KH is hopes to enter the U. S. market, in the next five years, initially on a small scale in order to learn the market and gain experience before making a major commitment.

73.Almost all KH foreign subsidiaries produce for either local or other foreign markets, exporting very little to Turkey. KH has not yet resorted international specialization by locating the production of specific goods or processes to different host countries based on the comparative advantages of these countries. In other words, its OFDI is not primarily efficiency-seeking or vertical-integration oriented.

74.KH sought local joint venture partners initially in the former USSR countries mainly to benefit from their political connections and familiarity with the business environment. Later it began to view these partnerships as unnecessary and in some cases even burdensome. Its joint venture, Ramenka, with Enka Holding, another Turkish enterprise, in the Russian Federation, however, has been very helpful in its success in that country.

75.KH believes that its OFDI has contributed significantly to its competitiveness. It has learned to do business under very different conditions in different markets, it has benefited from scale economies, and it has diversified its business and country risks. It has improved the quality of its products for domestic and foreign markets by having to compete with its foreign rivals in foreign markets. OFDI has stimulated KH to increase its R&D and in-house technology development. Its Turkish managers who had worked in foreign subsidiaries have come back home with valuable international experience in doing business under different conditions.

76.According to KH, the Turkish government has no specific direct policy to either encourage or discourage OFDI. However, the Turkish government's initiatives to further develop commercial ties, mainly through international trade, and especially with Turkey's neighbors, have indirectly benefited KH in its OFDI activities. KH also believes that the Turkish government can help Turkish companies further in their OFDI by encouraging R&D, especially through increasing subsidies for basic R&D. KH believes that OFDI, especially by large Turkish companies, will continue to affect Turkey's international image positively as the names of those companies, and their brands, become better known globally. As for host country policies affecting its OFDI, KH neither expected nor received any major FDI incentives from the host countries in which it has invested. It has encountered difficulties in some of its host countries outside Western Europe in intellectual property protection, obtaining work permits for its Turkish personnel, in particular, and bureaucratic delays and obstacles, in general.

77.The cumulative OFDI by made KH totaled $1.1 billion by 2004 year end. The sales of KH foreign subsidiaries accounted for 11 percent of total KH sales, 8 percent of total KH assets, and 10 percent of total KH employment, resulting in a Transnationality Index of 10 percent, which is the average of these three percentages .

Case 2 - Sabanci Holding

78.Haci Omer Sabanci Holding A. S. ("Sabancı Holding"), founded in 1967 but its origins dating back to 1932, is the parent company of the Sabancı Group, Turkey's second largest industrial and financial conglomerate (in terms of sales and employment), consisting of 66 companies, organized under nine strategic business units that produce a very wide range of goods and services.[22] Controlled by the Sabanci family, Sabanci Holding (SH) had in 2004, total assets of $32.3 billion, consolidated sales of $8.6 billion, exports of $0.9 billion, and 34 thousand employees. Like KH, SH had diversified across many sectors during Turkey's closed economy-import substitution regime until the early 1990s, often in domestic joint ventures with major foreign TNCs. Since then it has, like KH, emphasized geographic diversification

[22] http://www.sabanci.com.tr/

abroad over sectoral diversification at home. SH has foreign subsidiaries, which produce either polyester or industrial nylon yarn and tire cord fabric, in eight countries. Some of these subsidiaries were greenfield and others brownfield. SH expanded internationally after establishing itself as Turkey's market leader in both polyester and industrial nylon. Determined to become the world leader in both these product groups, SH has the widest global reach in its OFDI among all Turkish enterprises.

79.SH has established 18 joint ventures with foreign partners in Turkey since the 1970s. Most of these joint ventures not only brought new technologies, products, and processes to Turkey but also enabled SH to boost its R&D activities.[23] SH has made a distinction between "Manufacturing Territory" and "Marketing Territory" in the way it has approached these joint ventures. Initially the manufacturing territory was always Turkey and the marketing territory included besides Turkey only the close regions around Turkey, such as the Balkans, the Middle East, and North Africa. SH's initial struggle was to expand its marketing territory beyond Turkey. Its foreign partners, which limited the manufacturing territory to Turkey, also resisted SH's efforts to expand the marketing territory. In short, the foreign partners did not favor the inclusion of their joint ventures with SH in their global manufacturing and marketing networks. They preferred establishing separate joint ventures with other local partners in other countries. Ultimately, this led SH to separate from its foreign partners in order to expand its production and marketing territories globally on its own. SH's OFDI has been motivated primarily by this objective. In its joint ventures with DuPont since the 1980s, SH was able to expand globally but ultimately it found it more beneficial to end these joint ventures by buying out DuPont.

80.SH has decided to expand, for strategic reasons, regionally in some sectors and globally in others, regardless of the economic conditions in Turkey and the economic policies of the Turkish government. Its regional expansion, in sectors such as cement, is directed toward East Europe, the Balkans, the Caucasus, North Black Sea, and North Africa where it aims to be the market leader. In sectors such as tire cord fabric, an intermediate input for tire production, which is driven by the rapidly expanding automotive sector, SH's strategy is to expand globally in the Far East, especially in China, to follow its customers. In short, SH's OFDI is driven primarily by pull factors abroad to expand either regionally or globally, not push factors in Turkey. It has not made any opportunistic investments, avoiding, for example, privatization offers in the Balkans and elsewhere. Its OFDI can be viewed as primarily voluntary (offensive) horizontal FDI.

81. Like KH, SH considers the Middle East, especially Iraq, Iran, and Syria as potentially very attractive host countries for its OFDI, once those countries achieve political and economic stability and open up to international business. Unlike KH, however, SH, which established an enterprise-wide integrated risk management system, has thus far avoided the Balkans, the Russian Federation, and Central Asia due to the relatively low risk adjusted returns and the troublesome business environment in these regions. It is, however, watching the Russia Federation's progress closely for future possible projects especially in raw or industrial materials, given that country's great economic potential. SH has not made any opportunistic investments in the Balkans, which it has considered like the Russian Federation too risky and unstable.

82. SH and DuPont cooperation dates back to the mid 1970s. Their joint venture negotiations, which began in 1981, concluded successfully 1986 with the formation of the first joint venture in 1987. The second joint venture, DuPontSA, was established in 1999. SH's major initial objective in these joint ventures was to access DuPont's technologies. In later years, SH's dependence on DuPont technologies in particular, and on foreign technologies in general has been reduced through SH's own R&D. SH has also several technology exchange and patent sharing agreements with several foreign companies such as BASF and Hoechst. SH's value chain in polyester is longer, and value added ratio higher than that in

[23] In a recent article, I analyzed the R&D activities of such joint ventures in Turkish manufacturing .

industrial nylon. SH's master strategy is to supply Europe from Turkey, the Far East from China, and North America from Latin America.

83.In 2000, SH and DuPont merged their polyester fiber, resin and intermediates operations to result in the formation of DuPontSA (DuPont Sabanci Polyester Europe) B.V., based in the Netherlands, the largest polyester company in Europe. SH and DuPont were equal partners in this joint venture with a capital of $1.4 billion, annual sales exceeding $1 billion, and 4,500 employees. In November 2004, SH bought out DuPont to become the sole owner of DupontSA, which was subsequently renamed Advansa.[24] Advansa remains the sole licensee of DuPont technologies, patents, and trademarks in its businesses in Europe, the region of the former USSR, and Africa. This firm develops, makes and sells polyester filament, staple, resins and intermediates throughout Europe, the Middle East, and Africa. It owns, besides several operations in Turkey, the following ones outside Turkey: the pure terephthalic acid and resins businesses at Wilton, UK, and dacron filament and staple businesses at Pontypool, United Kingdom, and Uentrop, Germany as well as SH's texturizing plant in Garforth, United Kingdom.

84.DuPont-Sabancı International LLC (Dusa), headquartered in Wilmington, Delaware, began to manufacture industrial nylon in January 2001 as a 50-50 joint venture between SH and DuPont. In April 2005, SH bought out DuPont to become the sole owner of Dusa International, which was subsequently renamed Kordsa International.[25] This company is the world's largest supplier of industrial nylon yarn and tire cord fabric. It accounts for 40 percent of total nylon and 66 percent of total yarn and cord fabric production of the world. It serves the tire, mechanical rubber goods, webbing and cordage markets. It is the market leader for heavy decitex industrial nylon for use primarily in the tire industry. Its principal customers include all leading manufacturers of tire and mechanical rubber goods. Major products manufactured by Kordsa include industrial nylon yarn, single-end treated cord, greige and dipped tire cord fabric. Its products are used in a vast number of applications; however, the most common usage is in tires, hoses, conveyor belts, V-belts, fiber optics and paper felt. It operates nine manufacturing sites in seven countries. Its eight manufacturing facilities outside Turkey are: DuPont Sabancı Dusa (Brazil), DuPont Sabancı Dusa (Argentina), Interkordsa (USA), DuPont Sabancı (USA), Kordsa (USA), Interkordsa GmbH (Germany), Nile-Kordsa Co. (Egypt), and Kian Kordsa (Iran). With a capital of $592 billion, and sales of $ 520 billion in 2004, Kordsa International has 2,300 employees worldwide. Nile-Kordsa (Egypt), Interkordsa (Germany), and Kian-Kordsa (Iran) are majority-owned subsidiaries. The others are wholly-owned. SH's Advansa and Kordsa foreign subsidiaries combined account for 17 percent of total SH sales, 7 percent of total SH assets, and 15 percent of total SH employment, resulting in a Transnationality Index of 13 percent.

85.The SH case fits closely a model of latecomer industrialization in which international expansion is directed toward establishing ties with advanced country firms in order to gain access to their knowledge, technologies, and market connections. The evolution of SH's joint ventures with DuPont is almost identical to that of Korean firms' joint ventures with Japanese firms in the electronics sector, where the Korean firms were able to buy out their Japanese partners after gaining all the knowledge they needed in order to stand on their own feet.

86.SH has improved its international competitiveness significantly through its OFDI. The fact that it has been able to buy out its major foreign partner DuPont in both of its major fields of activity in a short period, to stand on its own feet in global markets, shows that SH has become a major TNC in the world in its two businesses. SH wants drastic tax reform in Turkey to bring Turkey closer to the Netherlands. Tax rates, both direct and indirect, are too high in Turkey, which leads to serious capital flight as well as widespread tax evasion. It is also the major reason for Turkey's huge unregistered economy. It also finds the Turkish foreign exchange regime that requires permission for OFDI burdensome and ineffective. It is

[24] http://www.advansa.com/home.html
[25] http://www.kordsa.com.tr/

also critical of the Turkish government's industrial incentives system which it finds to be highly politicized and economically wasteful.

87.Some of the other large OFDI private firms besides Koc and Sabanci are Enka Holding in property development and real estate, Anadolu Holding in beer and beverages, Eczasibasi Holding in ceramics, Sisecam in flat glass and glass products, Zorlu Holding in textiles, white goods, and consumer electronics, Calik Holding in textiles and apparel, and Yasar Holding in food and industrial paints. Due space restrictions, discussion of their OFDI activities is omitted. Attention now turns to seven SMEs with OFDI.

Case 3 - Haznedar Refrakter

88. Haznedar Refrakter Sanayi A. S., ("Haznedar Refrakter") founded in 1967 and listed on the Istanbul Stock Exchange (ISE), manufactures highly heat resistant bricks ("fire bricks") for industrial use primarily in the iron and steel and cement sectors.[26] It had total assets of $20 million, total sales of $19 million, and 134 employees in Turkey. Haznedar Refrakter (HR) has a single brownfield OFDI in Gosdivar, Macedonia. HR acquired, in July 2003, one of the plants of the bankrupt Silika Enterprise, which had been built as a state-owned enterprise in 1965, modernized twice in 1988 and 1994. The plant, Vardar Dolomite, built close to high quality dolomite deposits, far superior to those found in Turkey, had manufactured sinter dolomite and dolomite bricks. HR had to streamline the plant, which it had acquired through privatization, so that it could to restart production in February 2004 after being idle for prolonged periods for more than a decade. All the attempts to revive the plant through earlier privatization efforts had failed. HR was the only bidder in an international bidding.

89.Vardar Dolomite, valued at $6.5 million, with 46 employees, exports almost all of its output to HR for further processing into dolomite bricks. As the products of Vardar Dolomite are not produced by HR in Turkey, they increased HR's product as well as geographic diversification, making HR more competitive both at home and abroad. HR plans to soon manufacture dolomite bricks in its foreign subsidiary to save on transportation costs for its European markets and to take advantage of subsidized fuel oil in Macedonia. Its OFDI was motivated by access to natural resources, not negative factors in Turkey, such as high taxes or high unit labor costs. The combination of high quality dolomite deposits and a plant that could be restarted in a short period after a relatively small investment was the deciding factor. HR's successful OFDI was neither encouraged nor discouraged by the Turkish government. Vardar Dolomite accounts for 29 percent of HR's total sales, 25 percent of HR's total assets, and 26 percent of its total employment, resulting in a Transnationality Index of 27 percent. HR's opportunistic OFDI can also be viewed as efficiency-seeking through voluntary vertical integration.

Case 4 - Borova

90. Borova Yapi Endustrisi A. S. ("Borova"), founded in 1979 and listed on the ISE, is a construction services company, with assets of $33 million and 117 employees at home.[27] Borova's only OFDI is a Do-It-Yourself retail store, Master Tibot, constructed by Borova itself, in Baku, Azerbaijan. Borova had first entered Azerbaijan as a construction company. Borova invested $6.5 million in 1997 in this greenfield operation through its Turkish subsidiary Tibot Yapi Market Sanayi ve Ticaret. It has one Turkish and two Azeri partners in this joint venture. Master Tibot, with 65 employees, operates as a franchisee of the French chain Mr. Bricolage. Borova's motive for its OFDI was to capitalize on its knowledge of the Azeri

[26] http://www.hazref.com/
[27] http://www.borova.com/

economy whose consumers it believed would soon prosper thanks to expected substantial oil and natural gas production. Borova received encouragement for its OFDI from the Turkish government in the form of Turk Eximbank credits. Master Tibot accounts for 10 percent of Borova's total sales, 20 percent of Borova's total assets, and 36 percent of Borova's total employment, resulting in a Transnationality Index of 22 percent.

91.Borova has been disappointed with its OFDI whose performance has fallen far short of the expectations. Azeri consumers have not yet become prosperous enough to generate sufficient demand for the services of Master Tibot. Borova is still waiting for that to happen, eight years after its OFDI. That will depend on future increases in Azeri oil and natural gas production, which Borova believes are coming soon. Another reason for the disappointing performance of Master Tibot is that it pays tariffs on its imports, most of which are from Turkey, but most Azeri stores that compete with it do not. This unfair competition, which the Azeri government is either unwilling or unable to prevent, results in about 40 percent price disadvantage for Master Tibot. The only consolation for Borova is that the land on which Master Tibot stands is now worth the original amount it had put into its OFDI. It now has the option to sell that land to recoup its investment. In the worst scenario, Borova will dismantle Master Tibot and move it to another country with better conditions, to operate it more profitably with the valuable experience it has gained in Azerbaijan. Borava's OFDI can be viewed as an opportunistic and speculative venture that has not yet produced the expected results although it has not been a financial failure.

Case 5 - Ener Holding

92. Ener Holding (EH) is a privately held company, which does not have a web site of its own, active in the construction and tourism sector. It has only one brownfield OFDI, a hotel, valued at $15 million, with 200 employees, in downtown Bucharest, Romania. EH acquired, with its own funds, the four-star Majestic Hotel[28], built in the 1930s, when it was privatized in 1993. The Romanian Privatization Administration is a minority and passive partner. EH itself renovated this old hotel at a cost of $10 million, during 1993-2002. Majestic Hotel, which opened in 1996 and with a new wing added in 2003, caters mostly to an international business clientele. EH operates and manages Majestic Hotel itself based on its experience in hotel ownership and management in Turkey. EH's strategic reason for OFDI was geographic diversification outside of Turkey, which it had perceived increasingly unstable and risky in both economic and political terms for its business in the early 1990s. It chose to invest in Romania because of its physical and cultural closeness to Turkey. The Majestic Hotel accounts for 50 percent of EH's total sales, 15 percent of EH's total assets, and close to 100 percent of EH's employment since EH has leased its hotel, a holiday resort, in Turkey to a French company. EH's Transnationality Index is 55 percent. For EH operating its hotel in Romania is easier and more profitable compared to operating its hotel in Turkey. In particular, it finds labor costs and taxes lower and bureaucracy less burdensome in Romania. EH's OFDI was neither encouraged nor discouraged by any specific Turkish government policies. EH's OFDI, an opportunistic venture that has been very successful, can be viewed as primarily horizontal involuntary (defensive) FDI.

Case 6 - Oynurden Kimya

93. Oynurden Kimya (OK), founded in 1974, is a family-owned and -managed manufacturer of industrial glues, under the internationally known Denlaks trade mark[29,] primarily for the shoe manufacturing sector. It has in Turkey annual sales of $35 million and 150 employees, most of whom are skilled workers. OK entered the Bulgarian market in 1990 through exports. Shortly after that OK's owners visited Bulgaria where they perceived a huge potential demand for their products. Bulgaria, the largest producer of shoes in the former Soviet Bloc, had developed a strong comparative advantage in

[28] http://www.majestic.ro/
[29] http://www.denlaks.com/

making shoes for a huge market. OK's first step was to establish in 1991 a distribution center in Plovdiv. This was a 50-50 joint venture with a private Bulgarian partner. OK ended this joint venture in 1995 to establish a new venture on its own, Denbul, to start production in Plovdiv, Bulgaria. This new venture included the purchase of the land on which Denbul's plant were to be built. OK was able to finance this venture with the funds it had accumulated in Bulgaria from its export profits.

94.Before Denbul's plant could be constructed, however, the political situation in Bulgaria took a turn for the worse during 1995-1997, leading OK to drop its plan to start production in that country. After the political situation improved, OK, instead of returning to its plan to produce industrial glues, decided to explore investment opportunities in the agricultural sector. It made this switch because the Bulgarian shoe sector's recovery proved to be too slow and the agricultural sector, with Bulgaria's anticipated EU membership in 2007, showed greater promise. In 1998, OK entered into a majority-owned joint venture, Agroden, a wine grape nursery, capitalized at $450 thousand, with a Bulgarian partner experienced in this business. The nursery occupied the land that OK had bought earlier for its Denbul plant. After the nursery's annual sales rose to $2 million, from a harvest of 1 million grapevines, in 2004, OK bought out its Bulgarian partner.

95.In 2005, OK began to transfer the wine nursery technology, which had been developed in Bulgaria since the 1950s with French technical assistance, from this venture to Turkey. As a first step, it started a wine nursery in Catalca, near Istanbul, with initial capacity of 500 thousand grapevines that will soon expand to 2 million. This modern wine nursery is the first of its kind Turkey. OK considers as the major benefit from its presence in Bulgaria the wine grape nursery technology, along with the experience and know-how, it has acquired. In short, OK's OFDI served to transfer a new technology from its host country to its home country. Bulgarian wine grape nursery accounts for 10 percent of OK's total sales, 3 percent of OK's total assets, and 10 percent of OK's total employment, resulting in a Transnationality Index of 8 percent. OK's OFDI, a highly unusual case, can be viewed as unintended but successful sectoral diversification that has resulted in an important technology transfer from its host country to its home country.

Case 7 - Emsas

96. Emsas Construction and Tourism ("Emsas"), founded in 1982, is a privately held medium-sized company that has completed turnkey projects in Germany, Belarus, Kazakhstan, and Uzbekistan, specializing in hotel renovations.[30] It was one of the first Turkish companies to enter Kazakhstan in the early 1990s, encouraged by the Turkish government. Emsas executives accompanied then Turkish president Turgut Ozal who visited the newly independent Turkic Republics to develop political and economic ties. As a result of this exposure, Emsas entered Kazakhstan where it renovated and managed two three-star hotels, Medeo and Alatau, with Turk Eximbank credits. When these two hotels were subsequently privatized in an international bidding during 1997-1999, Emsas bought the Alatau Hotel[31], built in 1974, in Almaty.

97.Emsas still owns and manages "Premier International Alatau Hotel" profitably, catering primarily to an international business clientele, mostly from Turkey, who uses the hotel as a business center. Alatau Hotel, which is now valued at $30 million, accounts for 90 percent of its total sales, 90 percent of its total assets, and 35 percent of its total employment, resulting in a Transnationality Index of 72 percent. Emsas, which finds its construction business in Turkey too competitive and not very profitable, considers its OFDI highly successful and profitable, which provides a steady cash flow. It is now considering similar

[30] http://www.emsas.com.tr/
[31] http://alatau-hotel.kz/

ventures in Belarus and Uzbekistan based on its favorable experience with Alatau Hotel. Emsas's OFDI, an opportunistic one capitalizing on accumulated host country experience, can be viewed as unintended sectoral diversification that has enabled this company to maintain its financial viability in light of the unfavorable conditions it faces in its core business at home.

Case 8 - Aksan Kalip

98. Aksan Kalip (AK), a privately held medium-sized company with assets of $4 million, annual sales of $15 million, and 280 employees in Istanbul, was established by two partners in 1977. It manufactures electro-mechanical metal parts for the final products of the consumer electronics industry, primarily TV sets. As the Turkish economy began to open up in the early 1980s, AK decided to explore potential export markets by visiting industrial fairs abroad. Its initial exposure to international competition through these fairs made AK realize its technological shortcomings. These shortcomings were responsible for the internationally substandard specifications and tolerances of its products. It tried to rectify these shortcomings toward the end of the 1980s by installing state-of-the-art CNC (computer numerical control) equipment, from Japan and Western Europe, used to make the plastic molds for its metal products. In order to speed up its technological catch up, however, it decided to import its molds and focus on making the metal parts until it could master making the molds itself. At an industrial fair in Istanbul, it discovered that a Bulgarian state-owned electronics company, Microelectronica, could manufacture these molds. After placing an order, AK owners visited the manufacturing facilities of this large vertically integrated company, with six thousand employees, which offered to start a joint venture with AK. Microelectronica provided the plant and equipment (as its share) as well as the work force for this joint venture which went into effect in 1993 with 85 employees.

99.

100.This joint venture, Mikroak[32], located in Botevgrad near Sofia and capitalized at $2 million, was owned initially 54 percent by AK and 46 percent by Microelectronica, following long negotiations on the ownership structure. Microelectronica had wanted a 50-50 ownership but AK had insisted on majority ownership to maintain managerial control. As a result of the political and economic upheaval in Bulgaria during 1995-1997, Mikroak was shut down in mid-1997 for two months by the Bulgarian government, which had obtained a court order stating that since the joint venture had been illegally established, it had no right to exist. The basis for the court order was that the document authorizing the establishment of Mikroak had been signed by the Deputy Industry Minister while the Industry Minister was out of the country. AK sought the help of the Turkish government during the official visit of the Bulgarian president to Turkey shortly after Mikroak was shut down. The Turkish government brought the matter to the Bulgarian president's attention. Subsequently, a Bulgarian appeals court threw out the lower court's order, allowing Mikroak to reopen with financial compensation for the losses suffered during its closure. Toward the end of 1997, AK bought out its Bulgarian partner to become the sole owner of Mikroak whose performance improved significantly as a result. Since then AK has been pleased with the business environment in Bulgaria, which it prefers in many respects to that in Turkey, especially in terms of Bulgaria's lower tax rates and fewer bureaucratic obstacles. Mikroak, now valued at $3 million, has annual sales of $9 million and 270 employees. It also employs 150 Bulgarian families as contractors to do assembly work at home. Mikroak exports all of its output, three quarters to Turkey and the rest to Western Europe.

101.Mikroak accounts for 38 percent of AK's total sales, 43 percent of its total assets, and 49 percent of its total employment, resulting in a Transnationality Index of 43 percent. Mikroak has contributed significantly to AK's international competitiveness through both product and geographical diversification. It has also enabled it to increase the production of the electro-mechanical parts with greater flexibility and reliability through in-house production of the molds required to make those parts. AK's OFDI can be

[32] http://www.mikroak.com/

viewed as primarily vertical offensive (voluntary) integration that has increased the length of its value chain and value-added.

Case 9 - Turkuaz

102. Turkuaz[33] is a group of companies established, beginning in 1992, by the Turkish entrepreneur Ismail Kavuncu, who received for his success in international business the World Young Business Achiever Award in 2004, given annually since 1993 to an entrepreneur under 40. Kavuncu, trained as an agricultural engineer, went to Kazakhstan in 1992, when he was 27 to start Turkuaz International Trade Company with $10 thousand given to him by his retired banker father. He began to distribute and market the consumer nondurables of Western companies in Kazakhstan. He accumulated capital from his Kazak business to expand his activities to other sectors and countries. The Turkuaz Group today consists of 13 companies, all greenfield OFDIs, in Kazakhstan, Kyrgyzstan, Tajikistan, and Uzbekistan, with total sales of $130 million, total assets of $40 million, and 1,500 employees. Most of these companies are active in distribution and marketing of food, cleaning supplies, personal care products and cosmetics, automotive products, and construction machinery and materials. One company manufactures edible vegetable oils. The others are active in cellular telecommunications, tourism, construction, and property development. Most of these activities are concentrated in Kazakhstan. Turkuaz has a small company in Istanbul which employs a few people and arranges for exports to the other Turkuaz companies in Central Asia. It is an independent company, not the parent company of those in Central Asia. Kavuncu, with his three Turkish partners, owns all these companies that were established separately at different times. Effectively, Turkuaz has a Transnationality Index of 100 percent. Kavuncu and his partners plan to enter into business in Turkey as a result of the experience and wealth they have accumulated abroad. The Turkuaz and Ismail Kavuncu case although intriguing is not that unique. It illustrates that Turkish entrepreneurs can become very successful investors abroad without first proving themselves and accumulating capital at home.

References

[33] http://www.turkuaz.kz/

Table 1 - Outward FDI Types, Major Characteristics, and Critical Determinants

	OUTWARD FDI TYPE			
	Voluntary Horizontal FDI	Involuntary Horizontal FDI	Vertical FDI	Delocalization
Corresponding FDI	Offensive horizontal expansion	Defensive horizontal integration	Vertical integration	Delocalization
Performed Function	Assembly, high-tech parts	Assembly, parts	R&D, high-tech parts, labor-intensive parts	Assembly, common parts
Local Market Characteristics	Increasing competitive pressure	Threatened	Increasing competitive pressure	Increasing competitive pressure
Major Motives	Exploitation of market potential	Exhortations to increase output	Increasing fragmentation of process	Response to high domestic production cost
Distributed Function	Extension of domestic operation	Extension of domestic operation	Acquisition of new function	Complete or partial domestic plant closure
Critical Determinant Factor of FDI	Magnitude of marketing potential	Threatening market security	Labor cost, technology bottleneck	Labor cost

Source:

Table 2 - Turkey's Outward FDI Trends

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
FDI outflows ($ millions)	27	65	14	49	113	110	251	367	645	870	497	175	499
% of World FDI Outflows	0.013594	0.032247	0.005729	0.017052	0.031544	0.027689	0.052219	0.053402	0.059051	0.073304	0.068884	0.029338	0.081509
% of Developing Countries FDI Outflows	0.227034	0.257172	0.035288	0.103247	0.214343	0.175517	0.312557	0.686778	0.854439	0.879415	0.830255	0.397648	1.402038
FDI outward stock ($ millions)	1,184	1,249	1,263	1,312	1,425	1,535	1,786	2,153	2,798	3,668	4,581	5,047	5,546
% of World FDI Outward Stocks	0.060783	0.060974	0.056338	0.051347	0.049179	0.047833	0.049418	0.050857	0.055403	0.061304	0.072313	0.070004	0.067660
% of Developing Countries FDI Outward Stocks	0.838789	0.759294	0.621083	0.515755	0.461726	0.426665	0.338470	0.394571	0.401176	0.462374	0.574306	0.633645	0.645874
Outflows as % of GFCF (Turkey)	0.1	0.2	0.0	0.2	0.3	0.2	0.5	0.7	1.6	2.0	1.9	0.6	1.4
Outflows as % of GFCF (World)	4.1	3.9	4.7	5.2	5.8	6.3	7.5	10.7	16.1	17.1	10.8	9.0	8.4
Outflows as % of GFCF (Developing Countries)	1.0	2.0	3.1	3.8	3.5	3.9	4.3	3.3	3.8	6.1	3.6	3.0	2.1
Outward stock as % of GDP (Turkey)	0.8	0.8	0.7	1.0	0.8	0.9	0.9	1.1	1.4	1.8	3.0	2.7	2.3
Outward stock as % of GDP (World)	9.0	8.2	9.3	9.8	10.0	10.8	12.2	14.4	16.6	19.1	20.4	22.6	23.0
Outward stock as % of GDP (Developing Countries)	4.0	3.3	4.9	5.5	5.7	6.1	8.5	9.4	11.8	12.4	12.6	12.6	12.2

Source: UNCTAD (http://stats.unctad.org/fdi/eng/TableViewer/wdsview/dispviewp.asp)

Table 3 - Turkey's Outward FDI Performance Index

	1988-1990	1989-1991	1990-1992	1991-1993	1992-1994	1993-1995	1994-1996	1995-1997	1996-1998	1997-1999	1998-2000	1999-2001	2000-2002	2001-2003
A*	-0.004	0.002	0.017	0.024	0.028	0.033	0.047	0.064	0.073	0.086	0.096	0.113	0.107	0.104
B**	87	81	76	80	81	79	83	70	72	68	56	57	60	64

* Turkey's Outward FDI Performance Index. ** Turkey's Ranking of Outward FDI Performance Index among 128 Countries.
Outward FDI Performance Index is calculated as $OND_i = [(FDI_i / FDI_w)/(GDP_i / GDP_w)]$ where OND_i = Outward FDI Performance Index of the ith country; FDI_i = FDI outflows in the ith country; FDI_w = World FDI outflows; GDP_i = GDP in the ith country; and GDP_w = World GDP.
Source: UNCTAD (http://www.unctad.org/Templates/WebFlyer.asp?intItemID=3241&lang=1)

Table 4 - Distribution of Turkish FDI by Host Country (1997-2004)

	1997*		1998		1999		2000		2001	
Host Country	No. of Firms	Exported Capital $1,000	No. of Firms	Exported Capital $1,000	No. of Firms	Exported Capital $1,000	No. of Firms	Exported Capital $1,000	No. of Firms	Exported Capital $1,000
Netherlands	16	554,794	11	50,979	11	49,415	6	743,490	11	463,356
Azerbaijan	86	68,675	13	43,880	6	18,040	2	16,475	3	417,691
England	41	232,128	4	5,648	2	199,273	5	70,873	3	11,544
Germany	85	203,325	5	78,088	8	36,468	7	32,346	10	112,756
Kazakhstan	46	45,420	7	26,679	4	40,852	3	13,814	3	302,304
Luxembourg	9	64,694	1	5,100	5	115,407	1	40,041	1	8,532
U. S. A.	33	54,919	3	5,179	9	42,139	7	67,371	8	2,564
Russian Federation	58	91,260	4	7,938	1	45,400	0	2,523	3	12,596
Romania	81	61,890	9	13,551	3	1,284	4	21,445	9	34,393
Virgin Islands	0	0	2	43,850	0	0	2	768	1	64,505
France	16	33,294	1	44	2	10,367	3	47,729	5	1,793
Switzerland	31	70,994	1	9,374	0	3,183	0	0	0	0
Northern Cyprus	79	44,337	1	1,427	10	13,883	5	16,484	9	1,503
Bulgaria	16	419	4	11,337	6	10,004	3	19,484	5	2,132
Turkmenistan	17	18,870	3	8,068	1	4,271	3	7,286	1	6,026
Belgium	13	50,459	0	323	1	29	0	1,452	0	0
Hungary	5	3,119	0	0	1	40,000	0	0	1	0
Austria	6	17,696	0	0	2	11,054	1	10,954	0	2
Bahrain	3	18,750	3	5,485	2	1,057	3	13,500	0	402
Ireland	6	5,594	3	12,315	6	5,042	2	4,080	0	1,799
Georgia	8	7,841	3	3,760	1	7,673	0	10,200	4	1,113
Malta	5	14,342	3	2,320	0	0	2	8,302	0	0
Algeria	1	20	1	0	0	0	2	74	0	0
Kyrgyzstan	14	18,600	1	4,038	0	346	0	0	0	728
Uzbekistan	47	11,382	3	766	1	845	2	5,624	1	608
Others	94	42,168	25	46,789	14	15,620	23	34,126	17	13,105
Total	816	1,734,992	25	386,936	96	671,653	86	1,188,440	95	1,459,455

Table 4 - Distribution of Turkish FDI by Host Country (1997-2004) (Continued)

	2002		2003		2004		Cumulative Total	
Host Country	**No. of Firms**	**Exported Capital $1,000**	**No. of Firms**	**Exported Capital $1,000**	**No. of Firms**	**Exported Capital $1,000**	**No. of Firms**	**Exported Capital $1,000**
Netherlands	10	157,706	10	42,469	7	181,632	82	2,243,841
Azerbaijan	2	177,374	4	298,687	1	580,742	117	1,621,565
England	3	196	2	4,529	0	18	60	524,209
Germany	12	3,760	10	2,738	2	4,483	139	473,965
Kazakhstan	3	593	5	1,664	3	3,901	74	435,228
Luxembourg	0	2,000	1	12,938	0	0	18	248,712
U. S. A.	10	6,477	4	932	2	859	76	180,439
Russian Federation	6	-3,201	7	-1,697	8	2,173	87	156,990
Romania	6	-10,034	10	7,774	7	4,721	129	135,024
Virgin Islands	4	8,904	1	821	0	0	10	118,848
France	0	0	2	57	4	163	33	93,448
Switzerland	2	151	2	1,175	0	0	36	84,877
Northern Cyprus	12	2,524	18	810	25	294	159	81,263
Bulgaria	6	9,299	3	4,950	0	4,943	43	62,568
Turkmenistan	0	7,879	0	4,976	0	60	25	57,437
Belgium	2	59	0	0	1	55	17	52,377
Hungary	0	0	1	15	1	9	9	43,144
Austria	0	734	0	0	0	0	9	40,440
Bahrain	0	188	0	0	0	0	11	39,381
Ireland	1	1,828	0	1,550	0	1,218	18	33,427
Georgia	0	0	0	36	0	0	16	30,622
Malta	0	0	2	1,500	0	0	12	26,464
Algeria	0	25,808	2	232	1	209	7	26,342
Kyrgyzstan	0	0	0	248	0	0	15	23,961
Uzbekistan	2	497	0	541	2	507	58	20,770
Others	17	20,409	18	11,947	25	23,559	233	207,724
Total	98	413,149	102	398,893	89	809,548	1,493	7,063,066

*Cumulative since 1992 as of the end of 1997.
Source: Turkish Treasury (http://www.hazine.gov.tr/stat/finansal.htm)

Table 5 - Cumulative Distribution of Turkish FDI by Sector ($1,000) (31 December 2004)

Host Country	Energy	Manufac turing	Banking	Other Financial Services	Trade	Telecommu nications	Tourism	Construction	Mining	Transpor tation	Insurance	Others	Total
Netherlands	6,412	739,468	324,826	880,966	128,052	158,518	5,540	0		0	0	58	2,243,841
Azerbaijan	1,552,576	28,641	3,560	0	11,084	23,200	0	6	2,067	0	432	0	1,621,565
England	0	210,799	111,575	7,218	169,419	0	3,012	0	0	44	0	22,142	524,209
Germany	0	45,114	369,512	0	20,610	0	16,028	21,510	0	208	909	74	473,965
Kazakhstan	287,673	40,988	32,309	555	17,126	12,883	38,771	1,724	0	3,000	0	201	435,228
Luxembourg	0	0	89,500	25,616	121,850	0	0	11,746	0	0	0	0	248,712
U. S. A.	0	55,700	63,408	15	50,800	1,500	935	5,834	0	500	0	1,748	180,439
Russian Federation	50	40,923	65,340	0	47,516	0	98	2,958	0	0	0	105	156,990
Romania	0	72,107	10,002	2,113	28,017	0	7,112	2,931	12,550	56	77	59	135,024
Virgin Islands	0	0	0	65,231	44,713	0	7,117	1,787	0	0	0	0	118,848
France	0	199	17,312	0	14,671	56,677	3,755	0	0	834	0	0	93,448
Switzerland	0	16	51,966	9,333	10,318	0	0	13,116	0	41	29	57	84,877
Northern Cyprus	0	914	67,838	2,429	1,051	2,031	5,539	255	30	59	1,092	25	81,263
Bulgaria	158	11,430	22,791	120	27,770	0	225	68	0	5	0	0	62,568
Turkmenistan	0	41,695	2,885	0	500	0	2,804	995	8,557	0	0	0	57,437
Belgium	0	3,528	0	0	47,008	0	1,683	0	0	159	0	0	52,377
Hungary	0	40,529	2,601	0	5	0	0	9	0	0	0	0	43,144
Austria	0	2,997	35,104	0	2,302	0	37	0	0	0	0	0	40,440
Bahrain	0	0	37,958	1,423	0	0	0	0	0	0	0	0	39,381
Ireland	0	4,947	50	26,050	44	0	215	2,120	0	0	0	0	33,427
Georgia	0	9,459	3,796	0	6	16,762	0	600	0	0	0	0	30,622
Malta	0	0	300	11,145	13,519	0	0	0	0	1,500	0	0	26,464
Algeria	25,808	67	0	0	348	0	0	100	0	20	0	0	26,342
Kyrgyzstan	0	16,594	2,048	0	5,319	0	0	0	0	0	0	0	23,961
Uzbekistan	0	10,717	2,379	0	7,619	0	50	0	0	5	0	0	20,770
Others	11,768	52,326	33,832	2,033	51,932	29,691	638	19,424	3,111	1,420	0	1,550	207,724
Total	1,884,445	1,429,158	1,350,893	1,034,246	821,599	301,262	93,559	85,184	26,314	7,849	2,538	26,018	7,063,066

Source: Turkish Treasury (http://www.hazine.gov.tr/stat/finansal.htm)

Table 6 – OFDI Characteristics of Case Study Parent Enterprises

PARENT	OFDI CHARACTERISTICS

ENTERPRISE									
	Host Countries	Major OFDI Activity	Names of Foreign Affiliates	Greenfield vs. Brownfield	Joint Venture vs. Full Ownership	Foreign Affiliate Assets as Percentage of Total Assets	Foreign Affiliate Employment as Percentage of Total Employment	Foreign Affiliate Sales as Percentage of Total Sales	Transnationality Index
Koc Holding	Russia China Bulgaria U.K. Germany Romania Netherlands Uzbekistan Azerbaijan Kazakhstan Macedonia Austria	Retail Services, Consumer Durables Consumer Durables Retail Services, Oil & Gas Distribution Electronics Consumer Durables Consumer Durables Holding Company Automotive Retail Services Retail Services Retail Services Consumer Durables	Ramenka Beko Chung Mei Ramstore Opet/Aygaz Fusion Digital Blomberg Werke Arctic Ardutch SamKocAuto Ramstore Rambutya Ramstore Elektra Brengenz	Greenfield Greenfield Greenfield Greenfield Greenfield Greenfield Brownfield Brownfield Greenfield Greenfield Greenfield Greenfield Greenfield Brownfield	Joint Venture Full Ownership Joint Venture Full Ownership Full Ownership Joint Venture Full Ownership Full Ownership Full Ownership Joint Venture Full Ownership Joint Venture Full Ownership Joint Venture				
						8%	10%	11%	10%

Sabanci Holding	Egypt Iran Germany U.S.A. Netherlands U.K. Brazil Argentina	Industrial Nylon Industrial Nylon Industrial Nylon Polyester Holding Company Industrial Nylon Industrial Nylon Industrial Nylon Holding Company Polyester Industrial Nylon Industrial Nylon	Nile-Kordsa Kian-Kordsa Interkordsa Advansa Kordsa International Dusa Kordsa Interkordsa Advansa Advansa Dusa Dusa	Greenfield Brownfield Brownfield Brownfield Greenfield Brownfield Brownfield Brownfield Greenfield Brownfield Brownfield Brownfield	Joint Venture Joint Venture Joint Venture Full Ownership Full Ownership Full Ownership Full Ownership Full Ownership Full Ownership Full Ownership Full Ownership Full Ownership				
						7%	15%	17%	13%
Haznedar Refrakter	Macedonia	Industrial Bricks	Vardar Dolomite	Brownfield	Full Ownership	25%	29%	26%	27%
Borova	Azerbaijan	Retail Services	Master Tibot	Greenfield	Joint Venture	20%	36%	10%	22%
Ener Holding	Romania	Hotel Services	Majestic Hotel	Brownfield	Joint Venture	15%	100%	50%	55%
Oynurden Kimya	Bulgaria	Wine Nursery	Agroden	Greenfield	Full Ownership	3%	10%	10%	8%
Emsas	Kazakhstan	Hotel Services	Alatau Hotel	Brownfield	Full Ownership	90%	35%	90%	72%
Aksan Kalip	Bulgaria	Industrial Electronics	Mikroak	Brownfield	Full Ownership	43%	49%	38%	43%

Turkuaz	Kazakhstan	Retail Services Food	Turkuaz	Greenfield	Full Ownership				
	Kyrgyzstan	Retail Services	Turkuaz	Greenfield	Full Ownership				
	Tajikistan	Retail Services	Turkuaz	Greenfield	Full Ownership				
	Uzbekistan	Retail Services	Turkuaz	Greenfield	Full Ownership				
						100%	100%	100%	100%

Source: Interviews conducted by the author.

Table 7 – OFDI Drivers of Case Study Parent Enterprises

PARENT ENTERPRISE	OFDI DRIVERS							
	Liberalization of Home Regulatory Environment	Home Environment as Push Factors	Foreign Environment as Pull Factors	Fiscal Motives	Access to Natural Resources	Access to Markets	Access to Technologies	Access to Brands
Koc Holding	X	X	X	X	-	X	X	X
Sabanci Holding	X	X	-	X	-	X	X	X
Haznedar Refrakter	X	-	X	X	X	X	-	-
Borova	X	-	X	X	-	X	-	-
Ener Holding	X	X	X	X	-	X	-	-
Oynurden Kimya	X	-	X	X	-	X	X	-
Emsas	X	X	X	X	-	X		-
Aksan Kalip	X	X	X	X	-	X	X	-
Turkuaz	X	-	X	-	-	X	-	-

Source: Interviews conducted by the author.