Interaction of the Business Environment and Multinational Enterprises in Turkey

A Study based on an Example of
the Automotive Industry

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C o n t e n t s

A B B R E V I A T I O N S

A

ACM	Anden Common Market
A.O.S	Anatolian Otomotiv Sanayii
APEC	Asean Pacific Economic Group
ASEAN	Malaysia, Singapur, Indonesien, Phillipinen, Thailand und Brunai

B

BM	Black Market
B.M.C	British Motor Company
BPS	British pound sterling
BSEC	Black Sea Economic Co-operation

C

CIS	Commonwealth of Independent Countries

D

DEIK	Foreign Economic Relations Board
DIM	Dis ticaret müstesarligi (Ministry of foreign affairs)
DC	Developing Countries

E

EU	European Union

I

IBS	IBS Research & Consultancy
IC	Industrialized Countries
ICOC	Istanbul Chamber of Commerce
IMF	International Monetary Found

M

MBT	Mercedes-Benz Türk A.S.

N

NAFTA	North American Free Trade Area
NIC	Newly Industrialized Countries

O

OECD	Organization of Economic and Co-operation development
OSD	Automotive Manufacturers‘ Association

S

SIS	State Institute of Statistics

T

TL	Turkish Lira

I n t o d u c t i o n

In late 1978 the Turkish government decided to leave the classical path of import-substitution industrialization (ISI) in favor of outward orientation and international competitiveness. The decision was a consequence of a severe economic disequilibria Turkey witnessed towards the end of the 1970s and resulted in a major adjustment program in January 1980. The resolution was accompanied by an 'orthodox' International Monetary Fund (IMF) type program and basically aimed at the gradually correction of the Republic's insolvency through the attraction of foreign direct investment (FDI) and a boost in exports.

Along with the liberalization measures in foreign trade activities, the new economic strategy aimed at decreasing both the scale of public sector activity as well as the degree of state intervention in the operation of the market. From the change towards an outward orientation Turkey did not only expect a considerable increase in FDIs but also the solution of its three major macroeconomic problems: galloping inflation, unequal distribution of income and a high rate of unemployment. Drastic changes in the global environment in the second half of the 1980s stimulated foreign investment in Turkey, such as the enormous political and economic changes taking place in the former Soviet Union and Eastern Europe and the impressive rise of Japan as a world power and as a major source of foreign investment. Consequently, Turkey was on the verge to play an important part in the region as an export base and a point of entry into markets of the European Union, the Middle East as well as the emerging markets of the former Soviet Union and East Europe. Such factors are additional advantages to Turkey's large internal market, low labor costs and the absence of European Union-style rigorous technological regulations.

Turkey's adjustment program is characterized by three different phases: a phase of stabilization and structural adjustment in the years 1980 to 1983, followed by a period of liberalization and acceleration of growth which lasted until 1987 and a third phase of stabilization and slow growth as a consequence of a political crisis in the aftermath of the general elections in 1987. The adoption of an outward oriented policy led to a boost in both, the manufacturing industry and the service sector leaving the agricultural sector behind. Whilst agriculture, forestry and fishing accounted for 42 percent of GNP at current producers' prices in 1960, it was only 16.6 percent in 1996. For the industrial sector it was 16 percent in 1960 and 24.8 percent in 1996. The most significant increase was reported in the service sector with a rise of 15.5 percent from 1960 (36 percent) to 1996 (51.5 percent).

The Republic's determination to join the EU in the 1990s witnessed several setbacks in this decade despite its efforts to correct the Republic's macroeconomic instability and thus be part of a strong economic and political association granting financial and administrative assistance to its member states. The country's determination to become a "component" of the Union is reflected in the Republics economic strategy of the 1990s, modelled on the requirements for an EU accession.

Liberalization of markets and privatization of state-owned enterprises are nowadays a global phenomena, hence the Turkish experience is not unique. Several countries have been undergoing similar types of transformation as part of a more general process in the restructuring of the world economy during the 1980s stemming from a debt crisis that hit the LDCs in late 1970s resulting in a decrease of 25 percent in foreign direct investment.

Another phenomenon of the past two decades next to the liberalization and privatisation in some countries, is the increasing significance of investments in the form of foreign direct investment as a type of regional and international expansion of companies. Whereas FDIs are intended to secure natural resources for the production, to ease the entering of new outlet markets and thus extend the product cycle of goods from the firms point of view; national governments see in FDIs a source of capital inflow and technology transfer. FDIs have to be seen in the context of the interplay between multinational enterprises and less developed countries, an aspect that got a new turn in the 1980s. Slow economic growth, low levels of capital accumulation in the 1980s and a constant widening of the technological gap vis-à-vis the industrial countries forced countries like Turkey to revise their attitude towards FDI. In addition, a heavy debt burden limited the funds available for capital formation.

FDI in the pre-1980 period was extremely limited in Turkey due to a multitude of restrictions and bureaucratic constraints. In the course of the 1980s these restrictions were gradually eliminated and made way for comprehensive incentives and tax exemptions to attract foreign companies. The results, however, were marginal. It was in the first place small and middle-size enterprises that entered the Turkish market, the expected market-leaders stayed away, despite new investment laws that provided a liberalized business climate. The foreign investment code was made consistent with the Organization for Economic and Cultural Development (OECD) norms. Therefore, foreign investors became entitled to the same investment incentives and allowances as their domestic counterparts. Moreover, foreign investors could transfer their profits without any restrictions to their home countries.

Turkey's pre-liberalization period was determined by *"mutual distrust between the government and foreign investors, a regime that was clearly not conducive to the goal of attracting large inflows of foreign investment."*[1] Therefore, prior to the liberalization, multinational enterprises (MNE) preferred institutional arrangements involving little or no investment of capital such as joint-ventures, licensing agreements or subcontracting, enabling the companies to economic presence without running the full risks associated with direct investment. Turkey's structure of the automotive industry verifies this assumption. Upon their foundation in the 1960s or 70s most enterprises in this sector started either as licensing agreements or joint-ventures. After the Republic's change to an export-oriented industrialization companies like Mercedes-Benz Turkey turned from a licensing agreement into a subsidiary. Others who intend to enter the market are also thinking about the establishment of a subsidiary, such as the Japanese car maker Mazda.

The high degree of sectoral concentration of foreign capital in the pre-1980s era, in particular in the manufacturing sector, namely the automotive industry, chemicals, rubber, electrical and electronic products is remarkable. These factors accounted for more than 2/3 of the total stock of foreign capital. Clearly, foreign capital played a crucial role in the development of important branches of the manufacturing industry in Turkey oriented towards the domestic market.

I picked the automotive industry as an example to demonstrate the manufacturing sectors' development in a changing business climate. In the course of my studies at the Hochschule Bremen I had the opportunity to serve a three-month internship at Mercedes-Benz Turkey (MBT) in Istanbul. The vehicles' producer who specializes in the production and sale of commercial vehicles in Turkey, has been on the Turkish market since 1967, at first as a licensing agreement known under the name "Otomarsan". In 1990 Otomarsan was renamed in Mercedes-Benz Turkey when the shareholder structure changed and the Daimler Benz AG in Stuttgart increased its shares to 55.65 percent. It is the study's aim to illustrate the development

[1] Önish, 1998:309

of MBT in a changing business environment from 1967 to 1998 embedded in the general development of the automotive sector since 1980.

MBT’s activities were basically aimed at the domestic market, even though exports to the Middle East started in 1970. Later West and East Europe as well as the former Soviet Union as trading partners were added. Their export activities increased slightly after 1980 and got momentum during the 1994 economic crisis compensating a considerable decrease in domestic sales. In course of the decision to turn the licensing agreement into a subsidiary of the Daimler Benz AG, the enterprise further expanded its production facilities in Turkey with the construction of a second bus plant in Hoshdere, a district of Istanbul. Since its foundation MBT has become one of the most successful foreign companies in Turkey: it ranked second largest exporter of the automotive industry in 1995, it ranks fourth in terms of turnover achieved (1997) and holds fourth position in sales from production from all automotive manufacturers.

With the initiation of liberalization methods in 1980 Turkey exposed itself and its local manufacturers to the powers of a globalized market. Therefore the liberalized market structure did not only change the working conditions for MNEs but also Turkey’s position within the global economy. In addition to the prevailing macroeconomic problems of the country, the government also has to fight the negative effects of the European Customs Union it joined in 1996. The impact of a liberalized market structure on both, national governments and MNEs is manifold. A comprehensive reflection on the development and the current situation of a foreign company in Turkey as well as of the government’s attitude towards FDI must include the background of direct and indirect factors of influence on a changing business environment.

I therefore divided the study into five chapters. In chapter one I will present the theoretical framework of the study including the classical hypothesis by Ricardo and Smith on the advantages of international trade as well as the modern approach by Dunning on the increasing significance of FDIs. Next to the explanation of macro- and microeconomic factors determining the motivation for worldly trade activities, this chapter will also include a short review of the development of the automotive industry since World War (WW) II.

Chapter two is a more focused consideration of the particular case of Turkey and the development of its industrialization policy after WW II which has been determined to a great extend by Turkey’s legacy as a semi-colonized country in the late Ottoman Empire. The chapter will also deal with the new investment law introduced post 1980 as well as with the Republic’s current integration problems into the European Union and the establishment of the Black Sea Economic Cooperation (BSEC), as a possible alternative to the EU. As a supplement to chapter two, chapter three will give a thorough insight into the foreign investment structure in Turkey as far as principle investors, affected sectors and participating companies are concerned. To provide a complete perception, section 3.1. also gives an outline of the country’s trade structure which is closely connected to its investment structure as to the investing countries. Global influences on the business climate in Turkey such as the Gulf crisis in 1990/91 when Turkey lost one of its most important trading partners, the Iraq, and the Republic’s geopolitical position which grants the country an ambiguous advantage in the region as a trade hub for Europe and Asia are subject of the third chapter.

Having illustrated the conditions MNEs have to work under in Turkey and the situation the government faces within the country, I would like to introduce the auto manufacturer Mercedes-Benz Türk A.S. (MBT). I will firstly concentrate on the general thrust of the auto industry in Turkey, its development and the effects the trade liberalization had on the industry. MBT will thereby serve as a pragmatic model that profited from and grew with the changing business environment of Turkey which has become more favorable over the years.

In chapter five, I shall illustrate the provisional results of the liberalization period post 1980 classifying the changes of an amended market structure and the possibilities offered to MNEs. Moreover, I will bring up the complex issue the impact of MNEs market power in the host country and will conclude with an outlook on the prospects of FDI in Turkey.

Owing to the lack of relevant literature on the situation of foreign companies in Turkey, I decided to explain the situation by presenting the example of MBT. By choosing this method I take a limited generalization of the model into account. The results of my study are based to a great extend on experience gained during my internship in Turkey as well as on the case study chosen. In order to clearly separate the empirical analysis from the theoretical framework and the literature review I inserted quotes from interviews conducted with staff-members of MBT and business experts in Turkey as a proof for my findings. The interviews have all been taped and transcribed in Turkey.

Abstract:
The Interaction between the Business Environment and Multinational Companies in Turkey: The Case of the Turkish Automotive Industry

International trade has witnessed some major changes within the last 40 years. Whereas literature on business in the 1950s and 1960s regarded cross-border trade as a 'cultural-free phenomenon'[2], a shift to the recognition of country-specific differences became obvious in the 1960s and 1970s. Those decades were followed by a third phase of organizational development, which took into account regional integration, technological development and geographical diversification of companies operating world wide, which were given the name of multinational enterprises. The 1980s saw another, significant change: old philosophies were questioned and firms realized the need for an adoption of new strategies to meet particular and specific needs of the countries in which they operate. A further step has been taken by the taking over of the "globalization-concept" which has emerged as one of the most frequently used and widely discussed terms of this decade.

Companies on the whole, and multinationals in particular, will engage in business activities outside their national boundaries, whenever they wish to acquire assets of value to maintain or improve their global competitive position and when they find it profitable to create or add value to their assets in a foreign location.

As a legacy of colonization, enterprises from certain countries tend to reside in 'former colonies' of their home country, i.e. France in North Africa or Great Britain in India. Even though this phenomenon is about to fade, a certain distribution of the world's markets among the dominant powers can still be observed.

Even though Turkey has never been colonized, the Republic does, and will play an important role in the globalized world and the strategic interests of both, nations and multinational enterprises, because of its geopolitical position between Europe and Asia.. There is plenty of literature on Turkey's function as a bridge between the two continents, a phenomenon the country however could not come up to.

Turkey's absence from the 'world stage' for almost sixty years is the legacy of the Republic's experience in the late Ottoman Empire and its participation in World War II: two events where the Turks were dominated by and dependent on the Western World. Almost sixty years later it was again the West that brought Turkey back to world trade in the form of a reform program by the International Monetary Fund (IMF) in 1979.

Twelve years before, Mercedes-Benz Türk (MBT) – at that time under the brand name 'Otomarsan' - started to operate in Turkey, firstly only for the domestic market due to the policy of import substitution of the regime, but after liberalisation in 1980 also for exports to the neighbor countries.

Today, the Turkish state and MBT are embedded in the globalized world. With the demise of the USSR in 1992 MBT could expand to a new, promising market and Turkey thought to have found a new ally and possible substitute for the rejection to join the European Union (EU).

The impact and the structural changes globalisation caused is displayed by a "two-phase-model": on a national level – the Turkish side – and on a multinational enterprise' level – Mercedes-Benz Turkey (MBT). The study shows that whereas MBT could take advantage of

[2] see also: Dunning, J, "The Globalization of Business", Routledge, London 1993, p. 9-10

the gradually opening of the Turkish market, the nation had to face problems which are due to the difficult process of a re-orientation for a nation which is searching an identity between Europe and Asia. The domestic rivalry between the two leading business association TÜSIAD which represents the business community of Istanbul and MÜSIAD which represents the Anatolian businessmen makes this clear.

The role of multinational enterprises in Turkey is an ambivalent one: companies bring prosperity and wealth for a certain part of the country but leave behind the ones that do not dispose of a qualifying education or the necessary language skills. Foreign language skills are not very wide-spread in Turkey – a fact due to the non-colonization of the country. The share of foreign direct investment (FDI) is still after the liberalisation quite marginal and is concentrated in key industries, such as the automotive industry. Companies' engagement in key industries like automotive, electronics or pharmaceuticals enables them to influence the economic and partly political development of the host-country because of the financial dependency on such firms.

The following expression of a Turkish manager at MBT emphasizes the unequal power distribution between foreign investors and local shareholders (MBT holds 55,65 % of MBT's shares):

"Okay, I mean, there is a board (of directors – the author), an executive committee and so on, they (the Turkish' shareholders – the author) are always represented over there...when it is increasing the capital and all these things, of course, the financial power is in DB AG (Daimler-Benz AG – the author), Daimler-Chrysler hands today. Therefore it happens, that the increase is so high that the Turkish shareholder is not able to pay instantly, so you see it is always financed by the Germans."