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Whither Turkish Capitalism?

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Recent years have seen investor confidence in Turkey improve, after the financial crisis of 2001, with the US and EU contributing tens of billions of FDI in Turkey every year. However, many of the largest conglomerates and holding companies in Turkey remain family-run affairs. The status quo looks set to change, however, with family members likely to cede their controlling interests in Turkey’s dominant holding companies in the coming decades.

Turkish families will likely cede their controlling interests in Turkey’s dominant holding companies in the coming decades as foreign investors clamour for a greater share of developing world profits and the country’s business dynasties enjoy the fruits of their oligopolistic labours.

From yabancı to Sabancı

Both financiers and industrialists have drawn closer to Turkey since the last crisis in 2001. The US and Turkey’s closest investment partners in the EU invested about $29 billion in 2009. However, direct investment from Turkey’s largest EU-based partners (Germany, the UK and the Benelux countries) totalled $54 billion in 2009, dwarfing the $8 billion invested by US partners. As shown in the map (Figure 1), Turkish companies tend to invest in countries that invest in Turkey. For example, the Netherlands represents Turkey’s largest investor (by far), with $25 billion in foreign direct investment in 2009. No one particular company dominates in these figures; the Dutch oil company Shell’s investment in Turkey’s highly lucrative oil sector is only about $830 million. Turkish companies reciprocated with $5.4 billion of investment of their own in the lowlands.

One cannot understand Turkish investment abroad (or vice versa) without understanding the conglomerates that have been pushing the Turkish economy forward. Turkey’s conglomerate-dominated economy has parallels in many other countries. These conglomerates, called “zirveti” and typified by names like MİT, Nokia, or Sabancı, pushed the Japanese economy forward (and onward) in the 1980s. Their South Korean cousins (“chaebol”), representing names like Samsung and LG, did the same thing for the Korean economy in the 1990s. The Russians (never to be outdone) have, in their own way, been pushing the Turkish economy forward.

from the Golden Twenty to the Global Twenty

The typical pattern of economic development. The story goes that foreigners (like Americans and Europeans) invest in an economy (like Turkey’s) to bring know-how and much-needed capital. Domestic companies take over, and in the third evolutionary stage expand in turn into foreign markets. The data seem to bear out this story — at least in part. FDI in the Turkish economy has risen steadily over the past 20 years in absolute terms, representing today about 15 percent of Turkey’s $735 billion of domestically produced goods and services. According to Turkey’s Capital Markets Board (SPK), foreign participation in the Turkish economy has remained relatively stable over recent years. Foreign participation in Turkish securities has increased during the last decade — hovering around 66 percent of all securities held in custody in 2010. Both figures point to a know-how which foreign investors bring to Turkish companies (and particularly their conglomerates).

And yet academics still debate whether foreign investment in Turkish companies has helped the Golden Twenty learn, adapt and grow to profit from Turkish and foreign business opportunities. In a recent article in the Eurasian Journal of Business and Economics, Prof. Yasar Vural and Assoc. Prof. Mahmut Zortuk found that foreign investment in Turkish companies since 1982 has resulted in the transfer of know-how and skills which helped Turkish companies like Sabancı and Koç export abroad (despite a hostile macroeconomic environment and appreciating Turkish lira). Anyone shopping in a CarrefourSA can appreciate the commercial fusion of French technical and organisational prowess and Sabancı’s local know-how. However, recent studies suggest that such foreign investment may not have been much help in Turkey’s becoming the 17th largest economy in the world. Prof. Erol
Investors in the global average — and roughly three times what they would have earned in the UK or US. Investors, both foreign and domestic, clearly use the shares listed on the IMKB to gain access to lucrative investment opportunities.

Taymaz and Assoc. Prof. Kamil Yilmaz, in a recent study, found (again using complex statistical analysis of Turkish productivity data) that FDI had only a nominal impact on Turkish productivity. The effect of foreign investment in the Golden Twenty’s foreign expansion still remains (somewhat) uncertain.

The growth prospects of these conglomerates (and thus the Turkish economy) seem far more certain. The Istanbul Stock Exchange (IMKB-100) Index provides a crude measure of how effectively Turkish companies use capital (and how effectively investors think they will use capital in the future). In 2010, the IMKB-100 outperformed most similar indices worldwide (as shown in Figure 3). Investors in the index would have earned twice the global average — and roughly three times what they would have earned in the UK or US. Investors, both foreign and domestic, clearly use the shares listed on the IMKB to gain access to lucrative investment opportunities.

Turkey conglomerates: funnelling funds into hard-to-reach markets?

Turkey conglomerates’ foreign investments probably represent the way an average Turkish investor buys foreign stocks and bonds. According to the previously cited Kadir Has University study, of the 19 multinational non-financial conglomerates surveyed, roughly 14 percent of their assets were foreign-owned, they derived roughly 18 percent of their sales abroad and employed about a 38 percent non-Turkish staff. Such figures exceed the roughly 2 percent to 5 percent range of foreign equity and debt that Turkish portfolio investors hold in foreign securities. Such a trend suggests that an investment in Sabanci Holding or Dogus Group is the way the average Turk invests abroad. Yet Turkish conglomerates do far more than use foreign investments to give the average middle-class holder of an equity account at Ak Bank a bit of foreign exposure.

Foreign markets serve as the arena in which Turkey’s competitive holding companies (and non-holding companies) compete. Three companies in particular which do not make the top-20 list of conglomerates by assets (Cağlı Holding, Limak and TAV) have expanded investments in the Balkans. In Albania, Cağlı Holding has invested approximately $40 million in Albania’s infrastructure and telecommunications projects. Another of the minor league holding companies (by volume of assets), Limak Holdings, recently won a contract to run Kosovo’s Pristina International Airport for 20 years in exchange for an $80 million euro investment in the airport’s infrastructure. TAV Construction — mostly known for work on airports around Europe — has recently completed a 100 million euro refit of Skopje and Ohrid’s airports in Macedonia. TAV has also won work (as part of a consortium) a 1 billion euro investment in the politically and religiously sensitive Medina airport development in Saudi Arabia.

These foreign investments’ exotic locales do more than increase the profits of companies. They provide shareholders of Golden Twenty conglomerates (and other companies not in this exclusive group) with exposure to markets in which they cannot invest directly. Azerbaijan represents Turkey’s most significant investment destination among neighbouring, developing countries, with over $4.2 billion in Turkish investments. Romania and Georgia basically tie for second place among Turkey’s FDI destinations, with roughly $2.65 billion in investments each. Yet not all these exposures to foreign risks (and returns) are open to equities investors. For example, the unlisted and untraded state-owned Turkish Pipeline Corporation (BOTAŞ) has significant interests in Iraq, Turkmenistan, Egypt and elsewhere.

Foreign investors can access these markets through Turkish funds listed outside of Turkey. For every TL 100 that the foreign investor places in MSCI Turkey Investable Market Index Fund, that investor will get about Kr 3 of exposure to markets in which Koc Holding operates and another Kr 3 of exposure to Sabanci Holding’s foreign partners. Who wants such exposure? The top holders of the fund include Barclays Global Investors (with investments of about $10 million), Harvard Management Company ($9.3 million), Wells Fargo ($8.2 million) and Morgan Stanley ($4.7 million). The City of London represents the largest institutional investor in the Morgan Stanley-managed Turkish Investment Fund, at about $17 million. Americans, Britons and other foreigners provide some of the funds that Turkish conglomerates use to expand abroad.

The major obstacle for investors — both Turkish and foreign — remains firm family control of many of the Golden Twenty conglomerates. Assoc. Prof. Pınar Mandal and Dr. Gülüzar Gümüş found that only about 33 percent of shares in the 203 companies they covered (including 37 listed and 78 unlisted companies) were available to the public. A recent study by Assoc. Prof. Mehsa Aztar and her colleagues at Sabancı University implied that foreign investors should not worry about their lack of access to Turkish equity (and Turkish boardrooms). Based on complex statistical analysis of Turkish corporate governance data, they found that external oversight does not necessarily discipline Turkish company boards and management in the same way it does in the West.
Closely held family-owned Turkish conglomerates raise shareholder value, so domestic and foreign investors should not go meddling with a good thing, Prof. Kader Sahin and his colleagues at the Karadeniz Technical University are less sanguine about the role of family dominance in some of the Golden Twenty conglomerates. They find (again using statistical analysis) that insider arrangements lead not only to worse financial performance, but also worse corporate social responsibility. If their view is right, releasing more shares to the public could increase these companies’ financial performance -- and make Turkey better off overall.

All of these perspectives miss the point. First, the investors placing $109 billion in FDI and roughly $70 billion in Turkish equity and debt will not carry on allowing the business patriarchs of Turkey to run multinationals like their personal fiefdoms. Second, investors placing roughly $500 million in the two funds previously mentioned will seek more placements (particularly if the Turkish market continues to outperform other world markets in the long run). The profits arising from Turkish companies’ foreign and domestic investments will be too good to “keep in the family,” at least in the long run. Third, as $22 billion in Turkish direct investment abroad turns into $222 billion in the coming years, the boards and shareholder patterns of Turkish conglomerates will increasingly look like those of Cola-Cola and Unilever. These global companies have board-level directors and investors that match the diversity of the markets Koc and Sabanci invest in.

Conclusion: return of the foreigners

What will the future hold for Turkish conglomerates (and their kin listed on the IMKB)? These conglomerates will probably provide a target for investors and high-street capital to access to investment opportunities in places like Kazakhstan, Albania, and Macedonia. They will also provide a more effective funnel for the savings of Turkey’s 50-million strong middle class. On average, these conglomerates’ largest shareholders hold about 50 percent of the conglomerate’s shares. Such a pie will be too tasty to pass up. The Sabanci and Koc families could profit by selling their shares (generating an estimated $125 billion for the families who hold these shares). The buyers of these shares profit by exposure to $22 billion in foreign investments (outside of Turkey). In short, family-run holdings probably do not represent the future of the Turkish conglomerate.