



Evolution of National and International Resource Constraints and Business Groups: The Historical Case of a Turkish Family Holding, 1950-1999

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In this study, we attempt to contribute to the literature on the evolution of business groups by providing a rich historical case study of a Turkish business group's evolution during the second half of the twentieth century. We emphasize the role of macroeconomic expenditure flows as well as of certain environmental and firm-level constraints in shaping the group's evolutionary pattern. When the level and direction of macroeconomic expenditure flows varied during the second half of the twentieth century in Turkey, the business group's investment strategy and structure also varied. Fit with the macroeconomic expenditure flows and environmental constraints resulted in better performance and growth, whereas misfit with environmental constraints and certain firm-level characteristics brought about below average performance and consolidation. Our case study also corroborates the earlier explanations of business group evolution based on asymmetric trade and investment flows and institutional voids.

Business groups have become a frequent topic among scholars, who want to understand how this peculiar form of economic organization has emerged, how it differs from other forms, and to what extent it has been sustained under particular conditions.¹ Although many explanations for

¹ Nathaniel H. Leff, "Industrial Organization and Entrepreneurship in the Developing Countries: The Economic Groups," *Economic Development and Cultural Change* 26 (July 1978): 661-75; Tarun Khanna and Krishna G. Palepu, "Why Focused Strategies May Be Wrong for Emerging Markets," *Harvard Business Review* 75 (July-August 1997): 41-51; Mauro F. Guillén, "Business Groups in Emerging Economies: A Resource-Based View," *Academy of*

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such questions have been proposed, empirical evidence derived from longitudinal case studies, which document when, how, and what type of decisions have been made by a business group throughout its evolutionary trajectory, are rare. The lack of evidence hinders further development of the theory on business group formation and evolution. In an attempt to rectify this shortcoming in the literature on business groups, we present a comprehensive case study of the evolution of a Turkish business group in relation to the changes that took place in Turkish economic policy during the second half of the twentieth century. This period, indeed, marks the very beginning of the emergence, and later, prevalence of “family holdings,” which have come to be the dominant economic actor in the Turkish business system. Among several different theories that attempt to explain firms’ structural characteristics and action patterns, we adopt an evolutionary perspective, which emphasizes international and national resource flows and constraints, national institutions and their historical evolution, and the path-dependent and idiosyncratic nature of agent (entrepreneur) choices. In this way, we attempt to contribute to the existing literature on business group evolution by accentuating how various characteristics of national expenditure flows, such as their instability, concentration, and authorization, shape business group formation and evolution. We not only propose a coherent economic framework to explain business group behavior, but also present empirical material to substantiate how macro-level resource flows and micro-level business group behavior interact under varying historical conditions.

This study comprises four basic parts. Initially, we briefly discuss theoretical treatments that examine how national evolutionary trajectories and economic forms of organization unfold concurrently. We then explain our evolutionary perspective that connects international and national expenditure flows, basic decision-making actors for such flows and their historical unfolding, which pave the way for entrepreneurial choices, which are bounded by and at the same time contribute to the patterning of such macro level coordination and control mechanisms. Following theoretical discussions and laying out the framework, we briefly discuss the characteristics of our focal business group, as well as the data and method that we employed during the study. The third part is composed of

Management Journal 43 (June 2000): 62-80; Tarun Khanna and Krishna G. Palepu, “Policy Shocks, Market Intermediaries, and Corporate Strategy: The Evolution of Business Groups in Chile and India,” *Journal of Economics and Management Strategy* 8 (Summer 1999): 271-310; Tarun Khanna and Krishna G. Palepu, “The Future of Business Groups in Emerging Markets: Long-run Evidence from Chile,” *Academy of Management Journal* 43 (June 2000): 268-85; Carl J. Kock and Mauro F. Guillén, “Strategy and Structure in Developing Countries: Business Groups as an Evolutionary Response to Opportunities for Unrelated Diversification,” *Industrial and Corporate Change* 10 (March 2001): 77-113; Daniel Maman, “The Emergence of Business Groups: Israel and South Korea Compared,” *Organization Studies* 23 (Sept. 2002): 737-58.

a fifty-year historical narrative of the business group under six consecutive time brackets, together with the historical evolution of Turkish economic and social policy. We conclude with an explanation of how this specific case contributes and is conducive to answering some basic theoretical questions about business group formation and evolution.

Development Trajectories and Business Group Evolution: Theoretical Arguments

An array of theories consider the behavior of firms in relation to a set of environmental conditions; among them the “economic theory of the firm” and sociological approaches mark the most prominent perspectives.² However, these theories almost uniformly deal with the firm as an integrated and freestanding entity, a view that represents the dominant perspective of the Anglo-American conception of the firm.³ Business groups, defined as “an organizational form of federation of legally independent firms, joined together by formal/informal mechanisms,” do not resemble the widely held, professionally governed, and integrated corporations of the advanced Western economies.⁴ Thus, many of the theories that have been developed until now by economists and sociologists do not adequately explain how these federations emerge and evolve.

A recently flourishing literature, specifically focused on business groups, has some interesting postulates about how these federations of firms emerge, become established, and evolve under particular contextual conditions. Some scholars dwell on specific contextual characteristics such as the role and authority of the state, regulatory frameworks, and socio-cultural traits to explain the formation of business groups.⁵ Although these contributions are remarkable, they are far from representing a coherent framework to explain the dynamic nature of evolution that business

² For comprehensive reviews see David E. Teece, “Economic Analysis and Strategic Management,” *California Management Review* 26 (Spring 1984): 87-110; Kenneth Dauber and Neil Fligstein, “Structural Change in Corporate Organization,” *Annual Review of Sociology* 15 (1989): 73-96.

³ Adolph A. Berle and Gardiner C. Means, *The Modern Corporation and Private Property* (New York, 1932); Randall Morck, Daniel Wolfenzon, and Bernard Yeung, “Corporate Governance, Economic Entrenchment and Growth,” *Journal of Economic Literature* 43 (Sept. 2005): 655-720.

⁴ Maman, “The Emergence of Business Groups,” 739.

⁵ Ayse Bugra, *State and Business in Modern Turkey* (New York, 1994); Mark Granovetter, “Business Groups,” in *The Handbook of Economic Sociology*, ed. Neil J. Smelser and Richard Swedberg (Princeton, N.J., 1994): 453-75; Alfred D. Chandler, Jr., *Scale and Scope: The Dynamics of Industrial Capitalism* (Cambridge, Mass., 1990); Granovetter, “Business Groups,” 466-67; Gary G. Hamilton and Nicole W. Biggart, “Market, Culture and Authority: A Comparative Analysis of Management and Organization in the Far East,” *American Journal of Sociology* 94 (Supplement 1988): s52-s94.

groups experience when contextual characteristics change. As a result, more recently, a dynamic view has been adopted in literature explaining business group formation and evolution in relation to variations in contextual characteristics.

A remarkable series of work in this dynamic view has been carried out by Tarun Khanna and his colleagues, mainly focusing on the effects of “institutional voids” on group formation and evolution.⁶ The institutional voids argument refers to the absence or imperfect functioning of various institutions, in developing or emerging economies, that usually operate in advanced economies as market intermediaries. Such voids are important because in the absence of intermediation, markets fail to function effectively and transaction costs significantly rise for agents.⁷ Capital markets, judiciary mechanisms, regulatory agencies, corporate governance practices, investment banks, and various other financial services act as intermediary institutions to make transaction costs for corporate diversification less feasible than the other alternative of focused integration. Thus, in countries where such intermediaries do not exist or do not function properly, entrepreneurs prefer diversified multi-unit organizational structures in order to internalize transactions and create externalities. As a logical consequence of this postulate, once institutional voids are surpassed, business groups in those emerging economies will decline and tend to refocus their activities to cope with the newly established transaction costs regime.⁸ Khanna and Krishna Palepu revealed, however, that business group affiliation did not decline dramatically, for example, in Chile, even in the face of a series of significant market deregulations.⁹ Thus, business groups seem to have a more path-dependent characteristic, which sustains group level identity and group-wide behavioral patterns even under conditions of diminishing financial benefits.

Another significant contribution, which in a way complements the findings of Khanna and his colleagues, came from Mauro F. Guillén and his associates. Guillén, like Khanna and his colleagues, prefers to undertake an institutional perspective rather than focusing on mere economic benefits in accounting for business group formation and evolution.¹⁰ However, he leans on a resource-based approach, thereby

⁶ Pankaj Ghemawat and Tarun Khanna, “The Nature of Diversified Business Groups: A Research Design and Two Case Studies,” *Journal of Industrial Economics* 46 (March 1998): 35-61; Khanna and Palepu, “Why Focused Strategies May Be Wrong for Emerging Markets”; Khanna and Palepu, “Policy Shocks, Market Intermediaries, and Corporate Strategy”; Khanna and Palepu, “The Future of Business Groups in Emerging Markets.”

⁷ Khanna and Palepu, “Policy Shocks, Market Intermediaries, and Corporate Strategy.”

⁸ Ibid.

⁹ Khanna and Palepu, “The Future of Business Groups in Emerging Markets.”

¹⁰ Guillén, “Business Groups in Emerging Economies.”

focusing more on the evolutionary dynamics and strategic capabilities. He asserts that, in different stages of the development path of an emerging economy, business groups need to display different set of capabilities in order to increase their chance of survival and earn profits.¹¹ More explicitly, Guillén emphasizes that business groups create rents over contact capabilities, which only can happen under certain economic policy regimes.¹² “Contact capabilities” refers to an ability to arrange and consummate successful business deals by mediating contacts with local and international entities that otherwise may not have access to each other.¹³ According to Carl Kock and Guillén, contact capabilities can become competitive only under asymmetric foreign trade and investment conditions, because those capabilities are geared to mediate and lever information asymmetries in a national economy, which usually emerge due to the exercise of protectionist policies.¹⁴ Testing his theory in Argentina, Spain, and Korea, Guillén found considerable support, especially when the long-term development trajectories of each country were analyzed in conjunction with the development of national intermediary institutions.¹⁵ As Khanna and Palepu in their studies of Chile, India, and South Korea, Guillén emphasized the role of the development of such intermediary institutions in accounting for the strategic choices and structural transformation of business groups.¹⁶ Yet, political choices over national development trajectories and the evolution of national institutions tend to form complex arrangements that require more case-based elaborations. Even though both theoretical and empirical findings support the idea that the globalization of markets increases the likelihood of the success rates of focused firms over business groups, there may be path-dependent characteristics unique to the context that may nullify, or at least diminish, the impact of such influence.¹⁷

Taken together, the current literature on business groups tends to emphasize certain contextual characteristics in order to account for how business groups emerge and evolve. Some scholars emphasize the role of

¹¹ Kock and Guillén, “Strategy and Structure in Developing Countries.”

¹² Guillén, “Business Groups in Emerging Economies”; Mauro F. Guillén, *The Limits of Convergence: Globalization and Organizational Change in Argentina, South Korea, and Spain* (Princeton, N.J., 2001).

¹³ Kock and Guillén, “Strategy and Structure in Developing Countries.”

¹⁴ Ibid.

¹⁵ Guillén, *The Limits of Convergence*.

¹⁶ Khanna and Palepu, “Policy Shocks, Market Intermediaries, and Corporate Strategy”; Khanna and Palepu, “The Future of Business Groups in Emerging Markets.”

¹⁷ Robert E. Hoskisson et al., “Diversified Business Groups and Corporate Refocusing in Emerging Economies,” *Journal of Management* 31 (Dec. 2005): 941-65; Kock and Guillén, “Strategy and Structure in Developing Countries”; Guillén, *The Limits of Convergence*.

state, regulatory frameworks, and socio-cultural factors as causes of business group formation, but generally they do not develop coherent frameworks to explain the dynamic evolution of business groups. The second strand of scholars, on the other hand, develops a more coherent framework to explain the dynamic evolution of business groups, based either on the severity of institutional voids or the restrictions placed on foreign trade and investments. Yet, we still believe that an evolutionary economic perspective, which takes into account both national demand and supply-driven factors, has considerable advantages to complement these dynamic frameworks in order to gain a better understanding of business group evolution.

Our framework suggests that national demand and supply-driven factors, once analyzed in a dynamic manner, impose significant constraints over entrepreneurial choices, thereby increasing the likelihood of the formation and survival of certain economic organization forms over others. Institutional voids, regulatory frameworks, and restrictions on international trade act as significant constraints, but indeed, they basically represent only parts, rather than the whole, of the explanatory framework. To identify and clearly analyze demand-driven and supply-driven factors at the national level, we suggest looking at both national and international expenditure flows to locate resource mobilization decisions. Decisions to mobilize resources not only explain constraints over demand and supply, but they also provide details about the availability, authorization, and concentration of resource flows, which act as indicators to signal opportunities for economic agents. The initial resources act as supply-driven enablers and constraints in this situation, shaping how local entrepreneurs decide on the type, timing, resource-capability composition, and organization-governance structure of their investments. As previously indicated, the presence and effective functioning of market intermediaries and restrictive policies applied to international trade and investments act as significant constraints on local entrepreneurial decisions. However, we believe that the initial stock of national resources and the presence and effective functioning of factor markets are even more central in shaping local entrepreneurial decisions to undertake business opportunities. Local regulatory frameworks and judicial institutions that exercise sanctions also act as important constraints on entrepreneurial decisions.

While these constraints taken together form externally driven constraints over entrepreneurial decisions, there are other significant constraints over the decision-making process of local entrepreneurs, related to the characteristics of the entrepreneur and the enterprise. An entrepreneur's background has a significant power to delimit choices, because such characteristics determine risk-taking attitudes and individual preferences. Also, once an enterprise becomes operational, routines embedded in operations and the initial resource composition of

the enterprise significantly shape prospective strategic choices.¹⁸ Thus, we propose the basic model described in Figure 1 to account for how macro-economic resource flows and micro-level investment decisions of local entrepreneurs are related, given the constraints on the decision-making process.

In an attempt to substantiate our framework, we analyze the formation and evolution of an exemplary Turkish family holding over its fifty-year lifespan in relation to the changes that occurred in the macro-economic resource flows in the Turkish economy. The next section discusses the details of our research methodology, emphasizing our sources of data and how we constructed our historical narrative in consecutive time brackets.

Methodology and Data

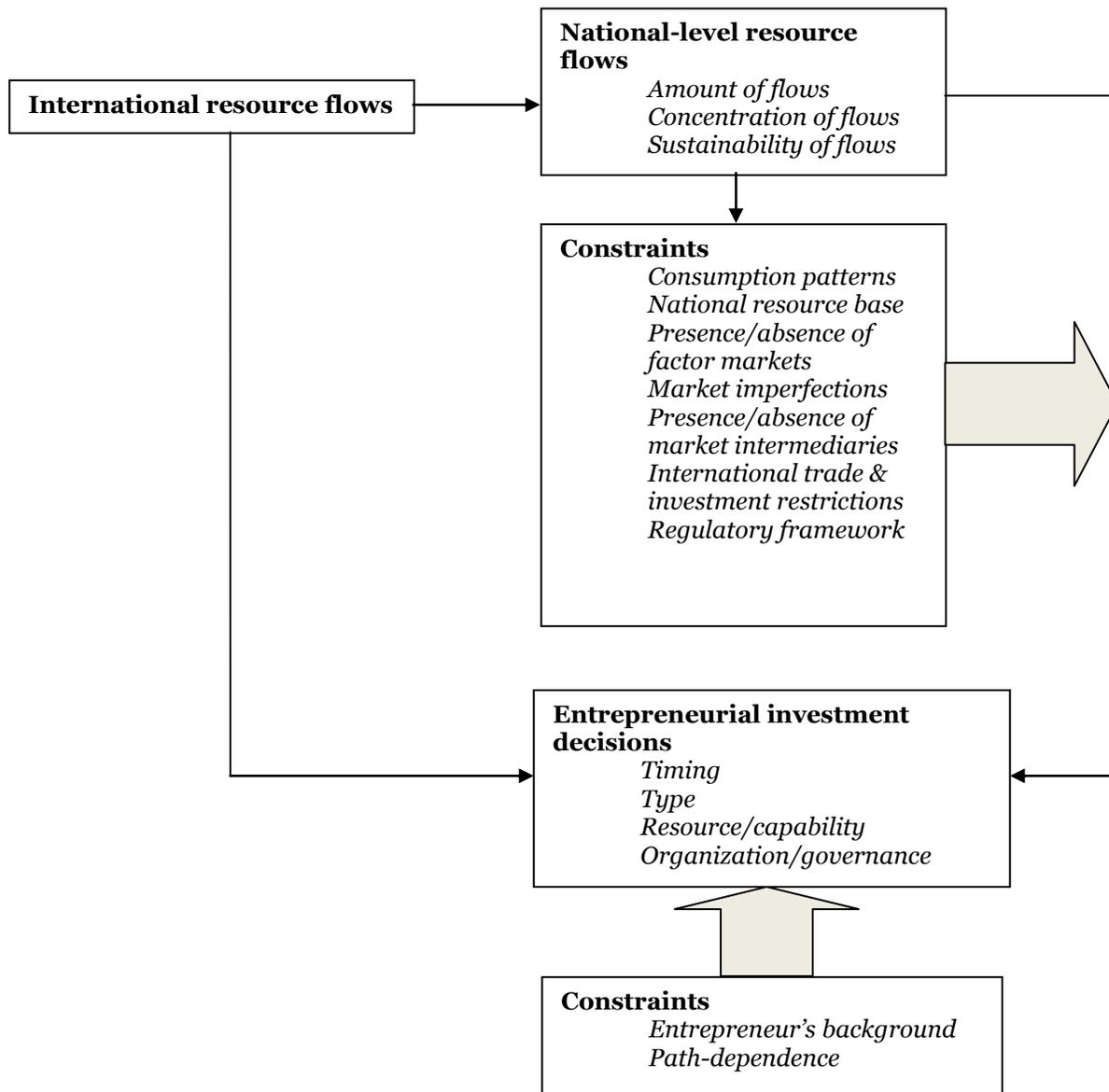
The Turkish business group that we have studied represents one of the most established business groups in Turkey. The founding of the business group goes back to the early 1950s, when the entrepreneur of the group first started his work life, initially as an employee, and a short time later as an entrepreneur. Ayşe Bugra in her seminal study of Turkish business tycoons reports that most of the business entrepreneurs in Turkey established their enterprises in the 1950s and that they represented a relatively more educated class compared to the average Turkish citizen in those years.¹⁹ Our case, in this sense, is completely in line with these findings. The core enterprise, which eventually diversified to form the family holding of our study, was founded during the 1950s. Also, both the founding entrepreneur and his brother, who soon joined the enterprise, were engineers who graduated from the most reputable engineering school in Turkey. However, the group is distinguished from other major groups in Turkey—comparable in size and establishment dates—by its keen focus on manufacturing and relatively weaker relationships with politicians and other external lobbying organizations. In this sense, our case can be interpreted as being more affected by internal constraints than other business groups operating in Turkey.

The data for the study were supplied by the group, which allowed us to search for all available archival records of the business group. There were three main archival sources, one of which belonged to the holding company and kept executive board decisions at the business group level. These data were generally composed of board meeting records, memos,

¹⁸ Arthur L. Stinchcombe, "Organizations and Social Structure," in *The Handbook of Organizations*, ed. James G. March (Chicago, 1965): 153-93; Michael T. Hannan and John Freeman, "The Population Ecology of Organizations," *American Journal of Sociology* 82 (March 1977): 929-64; Alfred D. Chandler, Jr., *Strategy and Structure: Chapters in the History of American Enterprise* (Cambridge, Mass., 1962).

¹⁹ Bugra, *State and Business in Modern Turkey*.

Figure 1. Macroeconomic Framework for Entrepreneurial Investment Decisions



and specially prepared reports that served as analytical components of important decisions. The archives of the holding company were systematic, clean, and went back to the late 1970s. For data before the 1980s, we looked at the archives of the business group's oldest company. In a different location, we searched for the archives, which dated back to the early foundation years. Because of the less than systematic structure of

the archives and the lack of some materials, we could gather only parts and pieces of data for the 1950s, 1960s, and 1970s in the second collection. To complete the historical picture, we had access to the personal collection of the entrepreneur in his private office. The data in the office were also disorderly, but they were very conducive to our study because they contained strategic reports, fact sheets, personal notes, memos, and copies of board decisions. Combining all three archives, we could pull together most of the data required to cover the chronological evolution of our business group. We limited our chronological time span for the study, starting from the initial business undertakings of the entrepreneur to his death in 1999. Considering that he started his business life in the early 1950s, our study covers roughly fifty years.

In order to make sense of the archival records, we also conducted retrospective one-to-one interviews with the former top managers of the business group, the entrepreneur's business contacts, his personal lawyer, and friends. There were a total of twenty-five such interviews, each of which were recorded on video tape and then transcribed. The length of the interviews varied considerably; some were conducted in two consecutive sessions, because the interviews took so long and the interviewees became exhausted. However, they provided rich data about motivations and linking of events that we had previously located in documents and thereby affirmation of causality between events and actors. As these were retrospective interviews, we tried to check for consistency and validity of the data by triangulating different interview data, documentary data, and our project group's interpretations.

We tried to use a hermeneutical pattern in constructing our narrative about the history of the business group. Even though we previously developed a theoretical framework, it was elusive at the beginning of the data collection and narrative construction process. We constructed and reconstructed our framework as the study unfolded and had lengthy discussions about the construction of the narrative and the theoretical framework that lasted approximately two years. We placed temporal brackets in the narrative to enhance understanding and readership as well as to distinguish analytically consecutive temporal periods, which differ considerably in critical national, international, and business group variables. We heavily referred to secondary sources on the Turkish economy, Turkish policy, industrialization strategy, and the history of business practices to frame our historical epochs.

The Narrative

Early Career, Start-up, and Accumulation of Capital: 1950-1957

The end of the Second World War represents a major turning point in Turkish history, as for many other countries in the world. The preceding statist period, during which the state's supremacy in Turkish social and economic life was prominent, had gradually transformed parallel to the international exigencies of the period. Being a neutral country during the

war, Turkey faced substantial threats from the Soviet Union right at the end of the war and sought help from the “Free World” then being formulated. However, dependent on a single-party rule, Turkey’s parliamentary regime was critically questioned in terms of its democratic stance, especially by policy makers in the United States.²⁰ Under these conditions, the Democrat Party (DP) was founded as an opposition party and entered elections in 1946 to signal to international society that a multi-party democratic regime was being established. Also, the ruling Republican People’s Party (RPP) declared a transition in its economic policy to leave room for private enterprises, as opposed to the previous policy, which had endorsed the state’s pioneering role in almost every economic undertaking.²¹ These changes in the Turkish economic and social demeanor proved to be successful, as Turkey was included in the Marshall Plan as of 1947. The Marshall Plan represented a significant event, marking the beginning of a long and relatively close relationship between the two countries. Even though there were ups and downs during the long history of the relationship, the role of the United States as the reference country for the transfer of modern practices and the country’s potential to shape resources and competencies in Turkey was established from that point.²²

From our perspective, this period represented a differentiated historical era in terms of the amount and variety of international resources coming into Turkey. Since the internal resources of Turkey at the time in terms of capital, labor, and knowledge were scarce, international inflow of such resources was crucial. Historical records showed that U.S. aid to Turkey between 1949 and 1961 totaled substantial amounts.²³ This aid was pivotal in financing Turkey’s trade deficits, and whenever they were not enough, additional borrowing capacity was made possible thanks to the U.S. alignment in international policy. Not all U.S. aid came in the form of money. Technical and military aid other than money created significant capabilities on the part of Turkish agents to learn modern practices and transfer technological know-how. Although the absence of markets created difficulties for effective transfer and utilization of inflowing resources, the

²⁰ Oral Sander, *Türk-Amerikan İlişkileri* [Turkish-American Relations] (Ankara, 1979).

²¹ İlhan Tekeli and Selim Ilkin, *Savaş sonrası ortamında 1947 Türkiye iktisadi kalkınma planı: Türkiye belgesel iktisat tarihi* [1947 Economic Development Plan during the Afterwar Era: Turkish Documentary Economic History] (Ankara, 1981).

²² Mehmet Erçek, “Çeviri, aktör ağları ve eksik/öncül kurumsallaşma: Türkiye’deki mesleki personel/insan kaynakları yönetimi söyleminin yeniden kurgulanması, 1960-1999” [Actor-Networks and Proto-Institutionalization: Reconstruction of Turkish Professional Personnel/Human Resources Discourse], *Yönetim Araştırmaları Dergisi* 4 (Oct. 2004): 129-96.

²³ Turkish Ministry of Finance, *Türkiye’ye Amerikan iktisadi yardımları* [American Economic Aid to Turkey] (Ankara, 1962).

inflow of resources from the United States, the expansion of world trade, and the 1950 domestic elections, after which the liberal DP became the ruling party, provided a significant impetus for Turkish economic growth. During the late 1940s and early 1950s, average annual GDP growth exceeded 10 percent.²⁴

Expansion in economic activities stimulated entrepreneurs to seize opportunities created by the increased national demand, and they sought for areas where expenditures were concentrated. Since the Turkish economy then was characterized by its underdeveloped state and was dependent to a large extent on agricultural products, all of the plans prepared by U.S. missions targeting Turkey's economic development strategy focused on increasing agricultural output.²⁵ To do that, however, significant investments were required for constructing transportation and communication networks to connect the vast lands of Anatolia with domestic trade hubs and international harbors. This rural development project was politically backed by the DP government and indeed served to increase its popularity, which was mainly dependent on votes coming from the rural parts of Turkey.

Thus, national demand conditions during the beginning of the 1950s were to a large extent determined by the rural development project, which in turn benefited infrastructural investments, agricultural production, and trade activities related to rural areas. It should also be noted that the state remained strong and mainly the sole actor in authorizing such investment decisions as well as in setting up the mechanisms of authorization. Therefore, entrepreneurs had to connect to the state and maintain their connections with the state to gain advantage over their rivals. Our case-based evidence and secondary sources confirmed that the influence of social networks and patronage relationships over the state's regulatory and investment decisions were prevalent.²⁶

Under these conditions, our entrepreneur (HEE), who came from a middle-class artisan family, started his career in a small contracting enterprise as an engineer. He graduated as a mechanical engineer in 1948 from the top engineering school of Turkey—Istanbul Technical University—and gained hands-on experience with contract work during his compulsory military service, which involved boiler projects for various military buildings. Indeed, his military experience provided the necessary connections to find his very first job. His discontent with that job escalated shortly after he found out that his superiors lacked the vision to grow the

²⁴ Yakup Kepenek and Nurhan Yentürk, *Türkiye Ekonomisi* [Turkish Economy] (İstanbul, 1997).

²⁵ See Max W. Thornburg, Graham Spry, and George Soule, *Turkey: An Economic Appraisal* (New York, 1949); Economic Mission to Turkey, *The Economy of Turkey: An Analysis and Recommendation for a Development Program* (Washington, D.C., 1951).

²⁶ See for example Bugra, *State and Business in Modern Turkey*.

company and that they did not trust him to delegate financial matters.²⁷ Thus, HEE decided to part ways with his job after a year and started a boiler contracting company with one of his military acquaintances in Ankara. As the capital of Turkey, Ankara provided advantages in learning of and consummating business deals: institutions connected to the state, which remained the sole authority over resource allocation decisions, resided in the town. The new company immediately bid on contracts related to expanding public postal services and agricultural credit banking services.²⁸ One after the other, boiler projects were contracted out by public institutions under the rural development project. The boiler company's expertise, which was rare and inimitable in the short run, provided them a significant advantage over the limited number of rivals. In the absence of markets and market externalities, the next step was to build their own boilers in Turkey to increase cost advantages. To build such boiler systems, the entrepreneur made a consultancy partnership with one of his university friends, who he knew had submitted a boiler project as a graduation thesis. This partnership worked; their domestically developed boilers performed sufficiently well and the company continued to win numerous contracts from expanding agricultural bank branches. It should be noted, however, that the controlled international trade regime, fixed exchange rates, and absence of markets caused transaction costs to escalate in Turkey. Thus, even their domestic boilers, which were far from creating a scale advantage and did not contain any major technological innovation, could gain above average profits.

Although the first enterprise that HEE initiated was performing well, his aspirations for the company were even higher. HEE wanted to grow his enterprise by bidding in more remote parts of Anatolia, realizing that branches of banks and other public organizations had started to spread in rural regions as a result of the rural development project. However, his partner decided to get married and his concentration on the business weakened. At this stage HEE decided to part ways with his partner, and the company closed down.²⁹ He then joined forces with his freshly graduated brother, CE, who had become a civil engineer, earning a degree from Istanbul Technical University as well. The two brothers started a new contracting company in 1953. This time their contracting services became more diversified to include infrastructural construction projects alongside heating and plumbing systems. They also based their company at Ankara to stay closer to the decision-making authorities of the state. The required project execution capability for the expanded enterprise was supplied by the brother. Yet, written memos from those years and archival records

²⁷ These accounts are based on an unpublished manuscript, which we have uncovered from the personal archives of the entrepreneur. The manuscript is entitled "Anılar" [Memoirs] and seems to be an unfinished autobiography.

²⁸ "Anılar."

²⁹ Ibid.

show that many other contractors emerged and rushed to create rents from the rural development project. Lack of regulatory control over entry and the prevalence of patronage relationships brought about increasing competitive threats for the new enterprise. Thus the two brothers devised a differentiation strategy, and focused on bidding for projects that were to be built on far eastern and southeastern parts of Anatolia. In that way, they avoided significant competition, but these projects created considerable challenges because of the difficult geographic and climatic conditions and the absence of skilled labor and other resources. These hardships were minimized because of their coordination and control capabilities related to the project work. In this way, the newly established family company thrived and grew rapidly until the mid-1950s. Because this expansion was the result of bigger projects, which required some foreign goods to be acquired and installed—such as radiators, fittings, some plumbing systems, and industrial pipes—the two brothers started a new company in 1954 to handle the import trade in these items. In this manner, they started to develop contact capabilities with foreign companies and began to learn new technologies and products available in relatively advanced economies, mainly in Germany and Italy.

After 1954, an important shift in macroeconomic expenditure flows occurred in the Turkish economy as a result of the expanding trade deficit and difficulties in finding new international credit to finance the ever-growing domestic demand for foreign goods.³⁰ Thus, import substitution—that is, domestic manufacturing of formerly imported goods—became more feasible given the domestic demand conditions and absence of markets. With his experience in contracting and his background as a mechanical engineer, HEE started to plan a manufacturing enterprise to gain advantage from the opportunities of the time. His initial idea was to produce electrolytic copper wires, but he soon learned that a plant was already being built.³¹ Then, from a two-page leaflet that he had found during his European journeys, he thought about producing faucets and valves, which were not being produced domestically at that time. The rural development project would soon lead to urban development, creating a huge demand for such products. Still, HEE had to configure the initial resource base for this enterprise. The idea was there, but there was a shortage of capital, no significant know-how in manufacturing technology and equipment, and no skilled work force to operate the factory. Then the two brothers began to divide their focus on different operating areas. While CE began to concentrate more on the contracting business, HEE started to become more focused on his new entrepreneurial manufacturing enterprise.

³⁰ Kepenek and Yentürk, *Türkiye Ekonomisi*.

³¹ “Anılar.”

Start-up of Manufacturing Business and Early Diversification: 1958-1966

The shift in macroeconomic expenditures and the restrictive international trade regime of the late 1950s rendered domestic import substitution projects feasible. At the same time, a rent-seeking opportunity for entrepreneurs who built connections with state politicians and bureaucrats had emerged because of the central control mechanisms over foreign exchange allowance to private agents. Through these centrally sanctioned and complicated controls, some agents could be granted allowances to foreign exchange, which was relatively cheap and scarce. Thus, resource flows authorized by the state favored import trade and import-substituting manufacturing projects in this era.³² Since trade deficits curbed the capacity for international borrowing, public expenditures on the rural development project became unpredictable and less attractive. Nonetheless, the populist policies of the DP government still allocated considerable resources for expansionary infrastructural investments, creating opportunities for private contractors.

Under these conditions, the two brothers set out to implement their plans concerning the manufacturing plant. Since they already had built considerable project execution and relational capability in the contracting business, which had become increasingly competitive, they used it to finance the initial stages of the manufacturing operation. Increasing competition in contracting business, however, curbed margins and increased the likelihood of losing bids, which made their cash flows even more unpredictable. They therefore started to focus on distinctive projects that required extensive project execution capabilities and coordination of numerous and geographically remote construction sites. Such projects were generally financed by international agents such as NATO (the North Atlantic Treaty Organization) and IBRD (the International Bank for Reconstruction and Development) and therefore had significant foreign exchange allowances and import rights. Once they managed to win the contracts, their cash flows and margins would be relatively above average. Documents revealed that the brothers faced fierce competition in these bids from other contractors with contact capabilities. There were cases when they were slandered, blackmailed and/or threatened by government bureaucrats or rivals.³³ Yet they managed to overcome these hardships and won the contracts, which provided them significant cash flow, project management know-how, and relational capital developed with the state agents. They also made use of their connections with the state, especially to recruit experienced professional staff from various public institutions. In this context it could be argued that one of the most important contributions of the statist period was the development of human capital

³² Çağlar Keyder, *State and Class in Turkey: A Study in Capitalist Development* (New York, 1987).

³³ "Anılar."

via the state's economic enterprises. The emerging private sector of Turkey capitalized considerably on this critical resource to build their capabilities. In our case, the two brothers concentrated their recruitment policy on engineers from their own university. This practice created in the latter stages, however, a strong engineering culture in their enterprise, cultivating production norms rather than economic effectiveness.

As the contracting business expanded with the NATO and telecommunications projects, HEE began to develop the plans for his manufacturing plant for faucets and valves. However, the archives and remarks of some interviewees disclose clearly that the preparation and installment of the factory required a distressing amount of paperwork and took more than two years. Because HEE realized that the cash flow from the contracting business might not suffice for financing the whole investment, he sought external investment financing options. Yet, financing investments in those days faced only limited capacity and very complicated bureaucratic processes because of the lack of market intermediaries and the state's lack of expertise in financing private enterprises. HEE benefited from a credit line opened to Turkey by the Italian government, originally created as an extension of the international political program for the security of the Mediterranean region. Also, he sought additional financial leverage from the newly established Turkish Industrial and Development Bank, which was founded with the aid of the IBRD. Both of these credit sources required a feasibility report for the intended manufacturing plant and its economic effectiveness.

After initial rejections and a year of revised applications, credit lines were secured from both institutions. Once the credit lines were cleared, it came time to buy the machinery and equipment—from Italy, since the credits were offered by the Italian government. HEE persuaded the university friend with whom he had previously built the domestic boiler to accompany him on his visit to Italy. During the visit, however, they became less convinced that their choice of machinery suited their aim of manufacturing faucets. Pressurized dying technology was innovative but could result in more discards than hard mold dying, especially in the 1950s, when automation was not technologically advanced enough to support the former process. This was a major mistake made at the beginning, because all the reports and documents, as well as the factory planning and layout, were prepared to fit the pressurized dying technology. Nonetheless, HEE did not step back from his decision for the factory; he quickly revised the entire project and bought the appropriate machinery from another Italian supplier. Some of the pressurized molding machinery, however, had already been ordered and could not be cancelled, creating a redundant capacity for the intended faucet production.

This mistake clearly demonstrated that there was an extensive shortage of technological know-how and very little capacity to review feasibility reports in Turkey at the time. After such a frustrating start-up period, the factory began to operate in Istanbul in 1957 and gradually

expanded its machinery capability. As opposed to their previous company locations in Ankara, the two brothers chose Istanbul, the most advanced and populated city of Turkey, in order to be closer to the domestic trade hubs as well as to be able to recruit experienced staff for the newly established plant.

Documents collected from the archives show that the initial years of the manufacturing business were very problematic. Failure rates and thus discarded goods were very high, and the learning curve had marginal effect because of the early diversification of products.³⁴ The company's operational losses demanded more cash flow from the contracting business, even as credit installments for the machinery investment for the plant were already bothering the two brothers. Indeed, manufacturing of faucets and industry valves required a relatively high technology at the time and their demand in Turkey was less than sufficient to amortize the investment. Even though the manufacturing business opened up an innovative and technologically advanced pathway for the company, which indeed matched the level of technologically advanced countries, costs of production escalated and profitability suffered.³⁵

The late 1950s brought about a significant economic crisis as a result of the trade deficit problem, which was soon coupled with a political crisis that led to a military coup in 1960. The turbulence in Turkish social and economic life settled down only after a couple of years, when a new constitution and a new democratic political regime were designed in 1963. The RPP became the ruling party once again, supported by the military regime, and an import-substitution industrialization strategy was formally declared by the new government. A central planning agency, the State Planning Organization, was established, and it prepared three consecutive macroeconomic plans for five-year intervals. According to the plans, import-substitution investments were prioritized, and the transition from agricultural to industrial production was promoted. However, the import-substitution process was designed as a staged transition, starting with consumer goods, continuing with intermediate goods, and finally concluding with the production of investment goods by domestic agents in each consecutive planning period. This type of import-substitution

³⁴ The factory had to diversify its products starting from the very first years because of the limited demand and underutilized capacity created by the initial mistake. Archival documents showed that various components of consumer goods were produced during those years such as aluminum parts for toys or even the heels of women's shoes.

³⁵ Our assumption that the manufacturing business was technologically advanced is based on documents that indicated that there were significant exports in the early 1960s. Also, additional company documents from the same years affirmed that their products could compete with German faucets in several foreign markets.

strategy was also being utilized in Latin America.³⁶ The new strategy not only planned to create an import-substituting industry but also classes of industrialist entrepreneurs and industry workers as well. The increasing demand for industrial workers would be satisfied via the already intensifying migration from rural Anatolia to the urban areas. Yet, two important inconsistencies occurred between what was planned and what actually took place. First, populist policies and intensifying union activity led to higher wages, which eventually became uncontrollable and diminished the positive effects of import substitution. Second, the productivity level of newly arrived workers was very low, and there was a shortage of expertise both for industrial workers and for technical white-collar and managerial positions. The lack of such critical know-how also caused inefficient production and thereby eventually led to the decoupling of domestic and global prices under a controlled trade regime.

The changing conditions had a significant impact on the brothers' contracting business. Because expenditure flows authorized by the state shifted to import-substituting manufacturing businesses, which favored domestic assembly of fast-moving and durable consumer goods in the initial stage, contracting gradually lost its relative attractiveness. The type of bids in which the brothers' contracting company was specialized became too competitive and margins eroded, as other contractors built capacity and capabilities as well. However, during the early 1960s, the contracting company managed to win large-scale construction projects, which required it to build up a significant machinery operation. Soon enough, a maintenance department was established within the company to service the machinery. During the projects, engineers working for this department recognized that some of the prefabricated housing units, which were being imported, could easily be produced within the department, requiring only a small amount of investment. The maintenance department thus evolved into a small-scale production unit, which performed simple cutting, molding, welding, and assembly tasks. The unit further evolved into building special dampers and cases for trucks and eventually became a freestanding company.

Because CE was more involved in construction projects, the product line of the newly established company included special heavy machinery for construction sites, such as trailers, conveyors, sand washers, and pebble sifters. Unfortunately, the new manufacturing company was susceptible to the shifts in expenditure flows, which now favored investments in consumer goods rather than capital goods. Thus, no significant demand for such equipment could be found and, with the diminishing of state expenditures on infrastructural investments in the mid-1960s, the company started to struggle. The brothers started to think

³⁶ Albert O. Hirschman, "The Political Economy of Import-Substituting Industrialization in Latin America," *Quarterly Journal of Economics* 82 (Feb. 1968): 1-32.

about building partnerships to float the company, but CE's sudden death in 1965 hampered the process.³⁷

Shocked by the sudden death of his brother, HEE divested both the contracting and the trailer manufacturing company in 1966, thinking it would be better for him to focus on faucets and valves. He also started to recruit high-ranking professional managers after he was left alone to expand his business. A new organizational structure and a more formal governance system for the expanding operations of the company were required. A recent organizational innovation by the Koç Family, with whom he was acquainted during his contracting business, caught his interest. In 1963, Vehbi Koç, the biggest private investor in Turkey, consolidated all his business under the roof of Koç Holdings, an investment company that held the controlling shares of other operating businesses. With this form it became possible to create a central control and coordination unit to manage a portfolio of unrelated operating companies. Formal gathering of legally independent companies under one roof created scale and scope advantages and therefore served as a significant innovation. This innovation was immediately copied by other big entrepreneurs as well as by HEE. It should be noted that the absence of regulatory frameworks forbidding market concentration and the holding form's legal suitability for solving family inheritance and private property allocation problems resulted in acceptance and diffusion of the holding company form in Turkey. Accordingly, in 1967 HEE established a holding company, which held the controlling shares of his enterprises.

The Labor Unrest and Expansion as a Business Group: 1967-1980

At the end of the first macroeconomic planning period (1964-1967), which produced successful results in terms of growth, the demands of organized labor started to become more intense. Indeed, the separation of a group of radical unionists from Turk-Is, the only confederation of labor unions up to that time, to form the Confederation of Revolutionary Labor Unions in 1967 marked the beginning of a long period of industrial conflict and labor unrest in Turkey. Fed by the relatively enlarged sphere of freedom created by the 1963 constitution, there was a sudden proliferation of labor unions, some of which were politically charged. This resulted in an increase in the number of unsettled collective bargaining discussions and eventually, an escalation in the number of strikes and lock-outs. Wages of labor also started to rise, as this issue was abused by the weakly structured coalition governments of the time as a populist policy tool. Fragmented internal politics could not sustain legitimacy, and the government faced a semi-coup in 1971. The sustainability of the import-substitution strategy became contested. Significant increases in domestic wages not only caused

³⁷ Although the details of CE's death remain a mystery, the evidence indicates that he accidentally drowned during a summer vacation at one of Istanbul's famous beaches. The incident was shocking and mysterious because he was known as a very good swimmer, had no known major diseases, and was very fit.

productivity decreases but also brought about a considerable increase in the inflation of domestic prices. The controlled trade regime and fixed exchange rates worsened the overall situation. The outbreak of the Cyprus conflict in 1974 and the unfolding of the OPEC (Organization of Petroleum Exporting Countries) oil crisis caused an upsurge in the trade deficit; a period of macroeconomic instability kicked in after 1975, signaling that the import-substitution strategy was no longer sustainable. Politically weak coalition governments tried to prolong the strategy, however, fearing that a radical change in macroeconomic policies would produce adverse political effects. In the late 1970s, Turkish social and economic life turned chaotic, as the conflict in society grew into armed clashes. The escalation of the trade deficit and the inability to find credit brought companies to their knees, as imports virtually stopped and a supply shortage intensified. The situation became so uncontrolled that even basic consumer goods such as LPG tubes, kerosene, cigarettes, and alcoholic beverages could not be manufactured. Long queues and black markets flourished. Capital markets failed to function, and it became virtually impossible to keep business operations running. In September 1980, the military intervened, and Turkey for the second time fell under military rule.

Under these conditions, HEE embarked on an expansion of his businesses, which he had brought under a holding form. At the beginning, only the sales and trading business, a small construction company, and his relatively large manufacturing operation existed. Nonetheless, the new structure required different organizational capabilities than had the earlier contracting-based organization. Rather than the project-based, decentralized, ad hoc character of the contracting business, manufacturing operations were continuous, technically more complex, and required more integration of functional tasks and units. Therefore, starting from the late 1960s, HEE began to recruit experienced core managerial staff for the headquarters and began to train his engineering cadre especially in the business administration area, where he saw there was a lack. With these efforts, he developed a core team of professionals, who served as the board of the holding company from the late 1970s until the beginning of the 1990s. Although HEE always remained the top decision-making authority for the whole operation, he delegated substantial power to the top management team, starting from 1970, when he decided not visit his business sites. This decision and its effects had a very significant impact on the culture and governance structure of the holding, especially compared to other big business groups of Turkey.

Starting with the first planning period in 1964, the manufacturing business started to benefit from the demand created by the expanding urban housing industry and the rapid development of consumer goods manufacturers. On the one hand, HEE served the housing market through faucets and valves; on the other hand, he diversified his product assortment to serve industrial customers such as newly established passenger cars, electrical appliances, and LPG tubes, especially after the

second half of the 1960s. The latter were durable consumer manufacturing businesses, which were also established by other business groups at the initial stage of the import-substitution strategy. Thus, HEE's plant in Istanbul, which was initially underutilized, became overburdened as the demand from first wave import-substitution manufacturers advanced. HEE chose to expand into related businesses by establishing a pressurized molding business for industrial consumers and also by growing backward in the value chain to start a company for manufacturing blocks of alloys such as brass. Lack of market intermediaries, frequent shifts in expenditure flows, and the limited demand for specialized products made diversification and undersized ventures still feasible. The controlled trade regime and fixed exchange rates buffered domestic goods from the threat of import goods and enabled high overall prices for virtually any product. Thus, until 1970, the newly established holding grew rapidly.

However, on account of the events related to the labor unrest in 1970, both the strategy of the group and HEE's personal leadership behavior transformed. In 1970, a group of workers forcefully occupied his manufacturing plant at Istanbul, and they strongly protested against HEE's policies. Having believed strongly in justice and rights, this protest deeply hurt HEE, and he chose not to set foot in his plants ever again. He mainly kept his word: the next time he entered one of his plants would be twenty-four years later, in 1994. As was discussed earlier, the physical distances between workplaces inevitably resulted in the delegation of operational decisions to professional managers. Interviewed top management team members stated that even though HEE was emotionally hurt by the events of the 1970s, the decision he made was also related to transforming the governance structure and giving more discretionary power to the professional top management team. Having no family members to trust for his expanding businesses, HEE chose to place his trust in a limited number of professionals, all of whom were engineers, to run the companies and became involved in the board of the holding company.³⁸

Expansion through vertical integration and related diversification continued during the 1970s as well. However, now the locations of the newly established manufacturing units were different. Instead of growing in Istanbul or other big cities, the group chose to locate their new manufacturing units in the Aegean and Thracian regions of Turkey, which were relatively remote and underdeveloped. Even though, substantial advantages such as state incentives and cheaper real estate existed, these places often had insufficient resources and were far from trade hubs. The group chose to establish smaller units in Anatolia and Thrace as opposed

³⁸ Later, three more investment companies were formed within the group. The reason for creating so many investment companies and making a complex cross-shareholding network is not clear. Although these companies were closed down in the late 1990s, HEE sat on the board and personally held a controlling share of the investment companies as well.

to bigger cities because of the escalating threat of unionism and labor unrest. Interviews also suggested that personal contacts of some of the top managers were important in making the location choices as well. But we see the most important factor behind such decisions as related to the constraints on national demand factors. Because of the controlled trade regime, the absence of factor markets, and the lack of market intermediaries, transaction costs and market prices were very high. Moreover, because of the monopolistic, or at best, oligopolistic structure of many markets that the group served, prices were high enough to absorb incredibly costly manufacturing operations. The new units were undersized, failing to create scale advantages. They were inefficient because of the inexperienced labor force and their extremely high labor turnover and absenteeism ratios. Also, they were dependent on key resources from the Istanbul plant and had to serve big cities in order to market their products, which brought about high logistics and transportation expenses. Even under such pressures, the prices of the products could create substantial margins, enabling these companies to survive. In time the Aegean plant, which was close to Izmir, another big city and a central international trade hub of Turkey, grew in capacity and eventually became the central manufacturing operation of the holding.

The late 1970s were difficult years for the company, as for many others in Turkey, because of the escalating social upheaval and economic depression. Even so, HEE strategically chose to grow under these conditions and made a risky decision to enter the ceramics and sanitary equipment business in 1978. Interviewees suggested that the decision was related to gaining a stronger competitive position vis-à-vis another big business group, which specialized in the ceramics business and wanted to enter faucet production. This decision was also related to the expanding housing market, which was strongly affected by the demand created by European migrant workers.³⁹ Also, during a high inflationary period real estate was deemed a secure and low-risk, high-return investment. Although the ceramics business was related to his market from the demand side and he believed that his faucet vendor network could sell sanitary products and ceramics, HEE was unfamiliar with the production technology involved. He therefore recruited a top manager who was experienced in the cement industry, and delegated the construction of a

³⁹ As a result of the shortage of labor during the 1960s and 1970s, many Central European countries demanded workers from Turkey. Hundreds of thousands of unskilled or semi-skilled workers migrated to Europe initially on a conditional basis, but many of them settled there over time. Although these workers made their living in Central European countries, among which Germany, the Netherlands, Austria, and Belgium were the most prominent, their social and economic ties with their extended families and/or local acquaintances were not severed. Thus, they kept investing their savings in their home country. These savings were important, especially during the 1970s, when Turkey's national trade imbalance and shortage of foreign exchange were increasing.

plant and the installation of equipment to him. The operation was a success, as the factory was completed in a very short time, while the other business group could not finish its faucet plant until the early 1980s. This incident marked the beginning of inter-group competition in Turkey, as unrelated diversification among Turkish entrepreneurs began to saturate major markets.

Nonetheless, the group managed to grow significantly in this period, reaching thirty-six companies in 1979. Eight of these companies were input providers for the major manufacturing companies. Some of them were specialized in producing metal raw materials, whereas others provided molds, specialty machinery oils, chemicals, and even catering services. There were seventeen manufacturing or stand-alone service companies, which produced radiators, valves, faucets, automotive radiators, oven resistors, sanitary equipment, ceramics, flushers, plumbing connections, and related materials. There were two service companies to provide engineering and automation project services. There were four other companies to coordinate the domestic sales operations of these products, one company for running international trading operations, and another for providing after-sales and maintenance services. There were two service companies to provide information and brokerage services for the entire group. The last three companies were investment companies, one of which was the holding company.

Even though some of the companies in the group were very small and a considerable number of them had serious problems regarding their financial outputs, operating under a holding form had significant scope advantages. With the diffusion and entrenchment of the holding form in the Turkish business system, it became legitimized. Legitimization had real benefits, especially in regard to being able to gain scarce resources from the environment. In our case, evidence gathered from the documents and interviews clearly revealed that operating under a holding form facilitated securing relatively high amounts of credit from banks at relatively lower rates. Using high leverage for financing its growth, the holding grew rapidly, thanks to the relatively low interest rates. The holding form also helped to mobilize critical resources and capabilities within the group affiliates, creating advantages over unaffiliated firms. These group-related advantages helped the holding to prosper during the difficult times of the late 1970s.

Export Orientation and Unrelated Expansion: 1981-1990

The 1980 coup and the following military rule, which lasted for three years, had a profound influence on the social, political, and economic conduct of Turkish life. All of the political parties were abolished, and their leading actors were banned from political action. Most of the unions were closed down and their leaders were imprisoned. Key media figures and opinion leaders from various universities and other not-for-profit organizations were suspended from action. The acts of the military

government not only caused a radical shift in the social and political life of Turkey, but also led to the alteration of macroeconomic expenditure flows, as the import-substitution strategy, which could not be prolonged in the late 1970s, was officially terminated. Instead, an export-orientation strategy was declared as the new macroeconomic strategy for development, and after the official elections in 1983, the new Motherland Party government enthusiastically backed it.

The new government tried to remove trade barriers while attempting to utilize the manufacturing capacity built during the import-substitution era for exportation. Substantial regulatory changes were enacted and incentive mechanisms were designed to support exports. A gradual restriction of barriers blocking imports followed. While these changes created substantial expenditure flows toward the industries involved in international trade activities, a considerable amount of expenditure was allocated to large-scale infrastructure projects as well. A southeastern Anatolia project, high-speed freeways, telecommunication networks, and metropolitan municipality projects were initiated by the new government and created opportunities for contractors once again. Many of these projects were financed by international capital sources, and a substantial amount of World Bank credit was secured during the first half of the 1980s.

In order to facilitate export growth, the government had begun to offer tax refunds and credit opportunities for exports that exceeded certain threshold amounts. Therefore, this period witnessed the proliferation of various international trade brokerage firms, which collected the export claims of various firms under one roof and then filed for government incentives for the total sum of all export revenues. In this way, some of the companies that otherwise were not qualified to receive refunds from the government could secure export incentives, of course in exchange for a commission fee. Nearly all holdings in Turkey founded such international trade firms, and almost all of these companies engaged in such brokerage services for unaffiliated export claims. This mechanism was vulnerable to manipulation and fraud, however, because the claims for export could not be effectively monitored by the international trade firms and the government. In the second half of the 1980s, there was an upsurge in the number of fictitious claims, and those cases caught increasing media attention.

Banning of unions and the suppression of real wages created room for increased margins for manufacturing enterprises. Export-oriented manufacturing industries especially benefited from this era, which lasted until the 1987 elections. Yet, there was a rapid escalation in the interest rates as a result of the liberalization efforts. This made external financing options for firms less feasible, and finding finance from international markets became more important in this period. After 1987, populist policies followed by the Motherland Party caused a rapid increase in real wages once again. A considerable deterioration in industrial relations

occurred in this period, resulting in surging numbers of strikes and lock-outs. While wage increases led to more inflation in domestic prices, this, in turn, exerted more pressure on exchange rates and interest rates. The GDP growth rate considerably decreased after 1988 and began to fluctuate afterward.⁴⁰ Under these conditions, the government liberalized the capital flows in and out of Turkey in 1989. Although this liberalization provided flexibility and created a buffer for adjusting short-term imbalances, in the long run it paved the way for major macroeconomic shocks at the hands of populist governments.

The liberalization period and export-orientation policies had a significant impact on the holding's strategy and structure in this era. Under the military rule, the first years of the 1980s were difficult in terms of providing finance for growing businesses. A sudden jump in interest rates adversely affected the holding's external finance-based growth strategy. Even with the scope economies provided by the holding form, the group struggled to find finance and made structural changes in its organization. A senior manager was recruited from the Turkish Industrial Development Bank in 1980 and another followed in 1987. While this provided the holding a valuable capability to secure scarce financial resources—for long-term project financing—it also led to the development of capacity for better project feasibility review and a superior capability for strategic planning and forecasting. We found sophisticated reports and several workshops on strategic planning activities at the group level as well as regular forecasting reports for macroeconomic indicators. Having overcome financial difficulties through long-term project and export financing, the holding pursued an aggressive growth strategy throughout the 1980s, based on two pillars: exploiting export-oriented development strategy and investing in new businesses that were presumed to hold potential.

The holding moved quickly to exploit the export-oriented development strategy at the beginning of the 1980s and tried to reorganize its resource base and some of its capabilities to focus on export markets. The firm focusing on international trade, which was established during the previous era, was positioned at the center of the group's international trade activities. The holding's top management team swiftly moved to take advantage of a number of incentives provided by the new export-oriented growth strategy. The international trade company was organized to become a brokerage company for other unaffiliated export claims, allowing the incentives granted by the government to be exploited more effectively. Because the government offered significant opportunities for low-interest rate financing for export activities, the holding management invested in the trading company to take advantage of this opportunity under the tight capital market conditions of the 1980s. Thus, in the first half of the 1980s,

⁴⁰ Kepenek and Yentürk, *Türkiye Ekonomisi* [Turkish Economy].

this firm earned above average profits with the help of cash incentives and brokerage commissions. Yet, toward the end of the 1980s, the planned export targets could not be met, and the company started to struggle in terms of its accounts receivables and profitability. On top of these difficulties, the firm and its top management team were sued because of some illicit claims and non-refundable export claims. This had a strong negative impact between some of the holdings' top management team members and HEE. The strong moral values of HEE, especially his strong ethical position regarding contractual rights and compensatory justice, created a negative stance toward some of the top managers and an erosion of trust between the owner and some of his team members.

In spite of these difficulties, strategic decisions at the holding level were repeatedly made in order to encourage affiliated firms to adjust their products for exports markets. The key target markets for exports in this era generally included the Middle East, North Africa, and the Arab countries, while Europe remained as another target. Also, the contracting firm was revived in this period to seek construction opportunities from rapidly developing Arab countries. Some projects were contracted in Saudi Arabia, and there were repeated attempts in other countries as well. Yet none of the export efforts resulted in the desired outcomes, as the exports portion in overall group companies' revenues accounted for only 15 percent at best. Also, many operational problems ensued, as international expansion could not be systematized. Entry decisions were not planned in terms of their modes and timing, which brought about less than average returns on export investments.

Regarding its aggressive growth initiatives, the holding began to expand the scope of its diversification in the 1980s. While exploitation of the export orientation continued, an aggressive campaign for acquisitions and organic growth also was initiated. Accordingly, the holding acquired a generic drugs manufacturer in 1984, making a completely unrelated business diversification. Linkages established with the Turkish Industrial Development Bank were useful in consummating the deal. After the acquisition, however, a usual pattern followed to create vertical expansion in this industry by acquiring a drug raw material manufacturer. Two other acquisitions, of intravenous solutions and hypodermic syringes, ensued, resulting in a group of companies specialized in drugs and medical devices.

Apart from drugs and medical devices, the holding made acquisitions in a related fashion as well. A manufacturing company that specialized in housing plumbing products was bought in 1990. Also, new manufacturing companies to serve construction and industrial product markets were founded. In addition, the holding tried to revive its contracting firm and engaged in housing contracts. As of 1988, the holding had fifty affiliated companies, reaching its biggest form in terms of affiliated company numbers.

However, the aggressive growth gave rise to problems. Some of the acquisitions made at the end of the period proved to be problematic because of their diseconomies of scale, diluted operating capital, and weak liquidity ratios. The acquisitions made in medical devices, intravenous solutions, and plumbing systems had become especially serious burdens on the group companies. With the shrinking housing and construction industry at the end of the 1980s, the overall effect of these new acquisitions proved to be detrimental to the holding's financial standing. Thus, the holding began the rough years of the 1990s with an already vulnerable standing.

Another important change occurred in the legal governance structure of the group of companies. In 1984, HEE established a foundation, to which he transferred all of his property rights. Thus, legally, the foundation began to function as the institutional owner of all the group companies. Yet during his lifetime HEE remained as the unchanging president of the foundation, and thus in practical terms his engagement in business operations did not change.

Globalization, Competition, and Consolidation: 1990-1999

With the liberalization of capital inflows and outflows, the Turkish economy became susceptible to economic shocks, especially related to short-term international credit financing. Rapid inflows and outflows of capital put significant pressure on the exchange rates and, in turn, increased the level of uncertainty about main macroeconomic indicators. The sudden and unexpected death of Turgut Özal, the Turkish president and former president of the Motherland Party, in 1991 began a period of political uncertainty as well. Weaker coalition governments, which could not make the structural adjustments necessary to spur sustainable macroeconomic growth, were formed throughout the period. High inflation rates, fluctuating and generally weaker GDP growth, and instability of exchange and interest rates were the outcome of this weak political structure. In addition, a major economic shock occurred in 1994, and, after a gradual restoration the macroeconomic indicators began to deteriorate after 1998.

Worsening macroeconomic conditions substantially increased the variation in the expenditure flows of the Turkish economy. With the liberalization of incoming and outgoing capital flows, expenditure flows became unpredictable. Scarcity and the cost of capital increased. On top of these issues, competition in industries intensified. In particular, the signing of the Customs Union Agreement with the European Union in 1995 resulted in a major influx of European products into the Turkish market. As many European producers began to enter into the Turkish market, the speculative atmosphere provided a major cash flow to the banking and finance industries, and imported goods trading was also positively affected by the developments.

Given the deteriorating macroeconomic conditions and the holding's weak financial structure, the beginning of the 1990s was very challenging for the business group. Acquisitions from the earlier period negatively affected the group's overall debt financing and the costs of credit, which rapidly escalated. Moreover, the new firms, be they acquisitions or greenfield investments, were all financed by a variety of group-affiliated firms, creating a complex cross-shareholding structure. With these new investments failing at the beginning of 1990s, many of the pioneering and profitable group-affiliated firms were suffocated by the burdens of the bankruptcies. The 1994 macroeconomic shock made the situation even worse, and a crisis of governance erupted between the top management team and HEE. Many of the holding's senior management team members, who had been in their positions for almost two decades, left after this group-wide financial difficulty. The previous strategy of aggressive expansion and diversification was changed to crisis management at the beginning and then into a focus on retrenchment and consolidation. HEE began to get more involved in the decision making, especially by placing a family acquaintance on the board. The drug and medical devices businesses, the plumbing and ceramics businesses, and a joint venture in the field of boiler manufacturing were divested during the second half of the 1990s. Some of the undersized firms were merged with bigger affiliates. Thus, the holding went back to its form of diversification among related businesses, similar to the mid-1970s.

However, the capacities and capabilities of the original businesses in faucets, valves, radiators, and boilers were upgraded. Compared to their original technological capabilities, which were based on either licensing agreements or copy-cat technology transfers, the group's affiliated firms had developed substantial design capabilities as well as state-of-the-art production process capabilities. Yet, relying too much on engineering- and technology-based solutions and working with an engineering-dominated governance structure, the group could not develop sufficient intellectual capital, which would have been more relevant during the liberalization and globalization period. Financing and marketing capabilities were not systematically developed, as opposed to operational efficiency and product quality. The conservative attitude of HEE resulted in less public visibility and less than average relational capital compared to other family holdings. Competitive environmental conditions and scarce resource flows required more connection to the state and government contacts for the exploitation of rare opportunities. Likewise, joint ventures with foreign multinationals required more flexibility and capabilities related to contract management systems. The lack of such capabilities and the failure to address such deficiencies were among the most important reasons for the consolidation during the 1990s. Interviews with the former directors of the holding repeatedly indicated that the conservative attitude and introverted behavior displayed by HEE caused the holding to bend itself inward. Relationships with the state could not be extended to the new political

rulers, which brought about a competitive disadvantage in an environment where other business groups systematically sought to build and exploit such relationships.

Interviews with the former top managers suggested that HEE's age and his worsening physical condition might have also resulted in the low risk-taking behavior of the later stages. When HEE passed away in 1999 at the age of 75, he had a group of companies mainly focused on faucets, valves, radiators, boilers, gas meters, and sanitary equipment. According to his will, all of his private property was inherited by the foundation that he had previously established. The foundation's board of trustees was already determined beforehand and comprised members from prominent universities, scientific institutions, and a number of lifetime members who were his personal acquaintances. The board of trustees elected the holding's executive board of directors, and a certain amount of money was deducted from each group firm for the expenses of the foundation. Thus, with an unusual governance structure for Turkish family enterprises, the holding still exists and functions over a decade after its founder's death.

Concluding Remarks and Discussion

In an attempt to explain the evolution of business groups in their respective contexts, we have posited an evolutionary framework, which takes into account macro-level expenditure flows and constraints on national supply and demand factors. Our case study, which detailed the evolution of a Turkish family holding for almost half a century, clearly reveals that our framework is in line with and holds significant potential to explain the evolutionary course of the business group's behavior.

Complementing the existing strands of argument over business group evolution, ours suggests that frequent shifts in the level and areas of macroeconomic expenditure flows exert significant pressure on entrepreneurs in emerging or developing economies toward diversification of their investments. Given the lack of factor markets, the presence of institutional voids, the restriction of international investment and trade flows, and the absence of appropriate regulatory frameworks, the only logical alternative to sustain firm growth seems to be forming diversified business federations. Because markets for products and services are small in a developing economy, a natural way to exceed the potential of market growth seems to be diversifying into other markets and exploiting opportunities that can create above-average returns.

The formation of the Turkish holding in our case is completely in line with the variation in macroeconomic expenditure flows, the lack of factor markets, and the presence of other contextual constraints. The imperfections in the Turkish market were so great and the transaction costs were so high that even entrepreneurial mistakes in timing and technology choice did not hinder the prosperity of the group. Lack of market externalities and the absence of markets for various goods and services allowed HEE to diversify his businesses. In addition, our case also

confirmed that the asymmetric trade regime helped Turkish entrepreneurs to found and diversify their businesses in the absence of significant foreign competition. Although the state's overwhelming presence in the Turkish economy impeded the flourishing of private entrepreneurs during the statist period, it provided experienced human resources, one of the most critical and scarce resources, for private agents in later periods. Our historical account also suggests that the holding form adopted by Turkish entrepreneurs served as a tool for effective capital utilization, as well as a controlling and monitoring device for operating multiple business units.

However, the sustainability of business groups when these environmental conditions change represents a challenge. In our case, we documented that the scale and scope economies provided by a group create significant advantages. Moreover, legitimacy provided by the diffusion and institutionalization of the holding form in Turkey offered significant advantages to secure scarce resources. In-group channeling of capabilities and resources also provided benefits over nonaffiliated companies. Once these groups grew and created specific competitive capabilities in one or more businesses, they created value added that could stand up to the liberalized market conditions. In our case, the group's experience with unrelated diversification could not be sustained under the liberalized trade regime and intensifying competitive conditions. However, we observed that entrepreneurial choices and path-dependent group characteristics also played a significant part in the strategic course and structural adjustment of the group. Strategic fit with macroeconomic expenditure flows explained the growth, and misfit generally accounted for below average growth rates and even decline. However, agent's choices should also be included in this explanatory scheme to provide a better representation. Thus, we believe that the initial framework that we have proposed has worked well to represent the evolutionary trajectory of our historical case.

Since we have worked on a single case study, our findings are severely limited by evidence confined to this specific family holding. We are fully aware that our case does not represent the whole population of Turkish family holdings. However, putting aside specific entrepreneurial characteristics, the evolutionary dynamics of our business group are fairly in line with what has happened in the Turkish context. Nevertheless, more detailed case studies are needed to corroborate our claims and the framework suggested in this study, which we strongly encourage.