

**TOFAS AND THE
INTERNATIONALIZATION OF THE
TURKISH CAR INDUSTRY**

Luca Brusati



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1. Business-government relations in Turkey: an overview.

During the period beginning from the foundation of the Turkish Republic in 1923 and ending with the world-wide depression in the late 1920s and early 1930s, state involvement in economic activities was rather limited in Turkey. Two factors were mainly responsible for this relatively limited role. Firstly, the basic principles adopted in the 1923 İzmir Economic Congress indicated a commitment to the establishment of a private enterprise economy. Secondly, some economy-related provisions of the Lausanne Treaty (1924) restricted the area the Turkish government could operate considerably. The country was, for instance, bound to apply the Ottoman tariffs for another five years. In the period in question, however, not much success had been achieved in terms of industrialisation since the private sector lacked the necessary technological competence and capital accumulation.

Such internal factors, combined with the external ones, the Great Depression in particular, were enough to convince policy makers that the private sector alone could not be entrusted with the task of leading economic development. This started a new period (1933-1945) in Turkish economic history called “etatism”, during which the government heavily intervened both in production and consumption of goods and services.

Especially because of wartime difficulties, the government was unable to control the economy in the 1940s, and became increasingly hostile toward the business community (Buğra, 1994). The main underlying reason was rent-seeking activity, which was accelerated by the extraordinary environment of the war. The government introduced the Wealth Levy in 1942. Taxing at least some part of the incomes derived from wartime profiteering, hindering black market activities and providing funds for the pressured government budget were amongst the major purposes for introducing this levy. In practice, however, since different rates were applied to different religious groups, this tax caused serious difficulties for minorities in the country¹. Most importantly, although it was abolished soon (sixteen months later, in 1943), this unfortunate levy had far-reaching impacts with regard to business ethics and state-business relations in Turkey (Buğra, 1994).

In the post-World War II period, until 1960, some liberalisation attempts were observed, shaped by a new type of etatism where the government supported the private sector. The transition into a multi-party regime and the Marshall Plan are considered as the major underlying reasons in this policy shift. This period witnessed either the establishment of or a major turning point for most of today’s important Turkish enterprises. Regarding state-business relations, the 1950s started as positive since the newly elected government was committed to the encouragement of the private sector and pursued pro-business policies in general. However, what they could achieve was to foster a rent-seeking activity, which was becoming an increasingly deep-rooted phenomenon in the Turkish business environment. Both government and business circles accused each other for being responsible from this situation. Interestingly, in this relatively liberal period, Turkish businessmen saw that the pro-business policies of the government did not bring stability. Both politicians and business circles, as a result, started to question whether or not it is possible to achieve stability and more liberalisation at the same time. In this respect, it is worth mentioning the fact that some

¹ The Muslim population in the Ottoman Empire to a large extent was not involved in commercial activities, which were left to non-Muslim minorities. Such a heritage from the Ottoman Empire had its remains in the Turkish business culture in the Republican era. Therefore, an explanation for the above-stated discrimination in the Wealth Levy is the government’s attempt to encourage the making of the Turkish business class.

prominent Turkish entrepreneurs speak more positively about the 1940s as compared to the 1950s regarding state-business relations in Turkey. To give an example, in his autobiography, Akkaya (1989: 78), the co-founder of the leading Turkish construction company STFA, mentions that there was a mutual trust between contractors and the state until the 1950s. The state treated them “like its own employees”, and helped them in every possible way so that they could establish themselves in the market. This situation began to change in the 1950s together with the new attitude towards the business community, and mutual trust started to be the exception rather than the rule.

The resulting disappointment with the liberalisation experience, together with the parallel tendencies towards more intervention in the world, caused the military government of the early 1960s to introduce a development strategy favouring “planning in a mixed economy”, which would continue for the following two decades. Accordingly, an import-substituting development strategy was to be implemented via five-year development plans. During the period, there were impressive improvements both in the growth rate of overall output and in industrial production (Öz, 1999). Regarding business-government relations in the planned period, big businessmen especially were also in favour of a planned approach and stressed the importance of having a long-term economic strategy to be able to reduce the uncertainty in the economic environment. The need for clarifying the boundaries of the private sector activity was also influential in taking such a position. The fact that the newly emerging big bourgeoisie felt a responsibility in the economic development process paved the way for the establishment of an highly influential body in business-government relations in Turkey: TÜSİAD (Turkish Industrialists’ and Businessmen’s Association) (Buğra, 1994).

These two decades witnessed unusual political turmoil, and thus three military interventions (1960, 1971 and 1980). Immediately after a military intervention, we see some concern as to the position of the private sector but Buğra (1994) argues that such concerns were soon replaced by the ones that were related to the instability generated by the nature of macro-economic policies. In the 1970s, two additional developments, the oil shock and the Cyprus crisis, further complicated the already bleak scene in the country. We see that the big business elite, especially TÜSİAD, although the Association supported the social democratic party of Ecevit rather than the pro-business Justice Party, turned against Ecevit later on. They complained about the state-induced uncertainty in the business environment and accused Ecevit for populism rather than following social democratic policies. It is argued that the public opinion campaign started by TÜSİAD was of determining importance in the defeat Ecevit suffered in the following partial elections (Buğra, 1994).

The coincidence of an unfavourable economic environment in the world with an unstable political one in Turkey led the Turkish economy into a major crisis in the late 1970s, resulting in a military take-over in 1980. The year 1980 is at the same time associated with the “January 24 Resolutions”, which introduced a comprehensive stabilisation programme under the auspices of IMF and the World Bank. The structural adjustment policies adopted in accordance with the programme intended to shift the economy from an inward-looking to an outward-looking orientation, emphasising export-led growth. The Resolutions consisted of structural reforms in a number of key areas, one of which was trade policy with the introduction of extensive export promotion measures and gradual liberalisation of imports. The results were impressive in terms of exports in general and manufacturing exports in particular, despite the fact that the increase in exports was matched by a corresponding boom in imports. Moreover, the composition of exports also changed with an apparent shift in favour of the manufactures. The existence of a military government, somewhat ironically, made it simpler to implement policies otherwise difficult to confront (Öz, 1999).

The second half of the 1980s witnessed a considerable reduction in export subsidies. Meanwhile, tariffs and quotas, thus the level of import protection, were further reduced. Finally, together with the unexpected but comprehensive financial liberalisation achieved by initiating the convertibility of the Turkish Lira in 1990, the main policies of the liberalisation process have been completed. The immediate result of these recent developments was the worsening trade deficit of Turkey in the late 1980s and 1990s, mainly stemming from the increase in imports rather than a decrease in exports which actually continued to increase gradually, Turkey’s world export share remaining fairly stable. Lastly, as a recent phenomenon, we should mention the customs union between Turkey and the European Union that has been in effect since January 1996, and is likely to bring both challenges and opportunities for Turkish industry. The long-run effects of the union, of course, are not yet clear (Öz, 1999).

The impact of these outstanding changes on state-business relations in Turkey has been highly visible. Very important and largely unpredictable changes were taking place in the business environment, and thus it was vital for businessmen to have good contacts with the state to form at least a vague idea about what was going on. Businessmen often complained about not the changes themselves but rather the way they were handled (Buğra, 1994). The frequent and unexpected changes in key policies undoubtedly created a chaotic business environment in Turkey. What is even worse however is that such an environment offered considerable opportunities for abuse. Allegations regarding tax rebates for exports, for instance, caused some scholars to question the export success achieved in Turkey in the post-1980 era as to whether or not these exports were “fictitious” (Arslan and van Wijnbergen, 1990). An equally unpleasant phenomenon, particularism, emerges as another major characteristic of state-business relations in Turkey in the 1980s. It is unfortunately not that difficult to find examples of policy changes contributing to the enrichment of particular individuals and/or harm certain individuals. A related example to our case study is the decision to encourage further investments in the automobile industry taken in the late 1980s. The existing firms in the industry, the Koç group in particular, were sceptical about the decision of the government given the already low capacity utilisation rates in the industry. In fact, the decision was mainly beneficial for the Sabancı group, the main competitor of the Koç group in many industries. Expectedly, shortly after the decision, Sabancı Holding announced its intention to invest in the automobile industry through a joint venture with Toyota. The incident left question marks in public opinion given the close ties with the Sabancı managers and Özal, who, apart from being in charge of the State Planning Organisation, later the prime minister, and later the president of the country, had worked for Sabancı for a while (Buğra, 1994).

We can conclude from the above analysis that the nature of the state and business as well as their relations with each other is of special concern with regard to the context in which business activity takes place in Turkey. An examination of the broad characteristics of the Turkish business environment reveals a domination by the small and medium enterprises, whereas big businesses are rather a recent phenomenon. The family-dominated nature of the management, no matter how big or diversified the firms are, is another distinguishing feature of Turkish firms. We should also mention the fact that big businessmen in Turkey are, on average, a well-educated group that attributes high value to education, and their level of education is superior to that of most politicians and bureaucrats. Of course, the high degree of state involvement in business activity, whether it is in the form of subsidised credits, input supply or output demand, is also detrimental in shaping the business environment. Given such a high degree of government involvement in the economy, good connections in government circles contribute significantly to business success. The uncertainty in government behaviour, incompetent public management and unexpected changes in key policies introduce further complications for Turkish businessmen (Buğra, 1994).

2. Major developments in the Turkish automobile sector.

The Turkish automotive industry is one of the youngest in the world with a history of around 30 years, as opposed to the industry’s world history of one-hundred years. Despite its short history, it is considered to be one of the most strategically important sectors of the Turkish economy, a position which is, in fact, well-justified: its contribution to employment, for instance, amounts to half a million when those working in the automotive parts and components, service outlets and motor vehicle insurance industries are included. It follows two giant industries of the Turkish economy, food and beverages, and textiles, in terms of production capacity. The value-added of the industry is high, and it facilitates the spread of recent technological developments to related industries. The Turkish automotive industry, however, has a poor record when its relative position in the world markets is considered. Turkey is, as a result, a net importer of automotive products.

The reasons for the relative lagging position of the Turkish automotive industry can be traced by looking back through its history. The first cars Turks used were imported from Europe in the times of the late Ottoman Empire and in the early years of the Republic. The first automotive firms of Turkey were, therefore, the dealers of foreign corporations. In the mid Twenties, both Ford and Chrysler had become established in the newly founded Turkish Republic. Later in 1929, Ford Motor Company started to assemble parts in İstanbul to sell in Turkey as well as in the USSR and the Middle East. Low demand stemming from the low

development level and low purchasing power in these regions, coupled with the depression of the early 1930s, however, caused this first assembling plant, İstanbul Ford Motor Co., to soon stop production.

After World War II, the industry gained some impetus with the help of the Marshall Plan, which, among other things, facilitated the entry of tractors into Turkey since it attributed special priority to the development of the agricultural sector. The first tractor assembly plant in Turkey, Türk Traktör Fabrikası, which imported most of its parts and components, was founded in 1954 under the Minneapolis Moline license. The first local jeep production was performed by Türk Willys Overland A.O. in the same year, which was the first private sector involvement in the automotive industry. 1954 also witnessed the establishment of a truck company, Federal Türk Kamyonları Fabrikası, under the license of Federal Truck. Later in 1959, Otosan, which is a Ford Motor Co. and Koç Ticaret A.Ş. partnership, producing mainly trucks and automobiles, was founded (Azcanlı, 1995).

Until the mid-1960s, in other words, the Turkish automotive industry consisted mainly of a few assembly plants of imported parts, working under the license of foreign firms. In 1964, the “Regulations of the Assembly Industry”, which marked a milestone for the Turkish automotive industry, were issued. This directive is, in fact, widely considered as the origin of today’s Turkish automotive industry. Its rationale was parallel with the import substituting philosophy of the time. The main objective was to transform the initial stage of assembly operations into full-scale local manufacture. Accordingly, the local content was encouraged to increase. The most outstanding result was the immediate increase in the number of firms in the automotive industry (Azcanlı, 1995).

The production of the first Turkish automobile, Anadol, was started in 1966 by Otosan. Following Otosan, two important automobile producers, Tofaş (a Koç and Fiat partnership) and Oyak-Renault (an Oyak and Renault partnership) were founded in 1968 and 1969 respectively. In 1971, the former started to produce Murat 124 and the latter Renault 12, and these two models dominated the Turkish automobile industry for a long period of time.

The Turkish automotive industry was protected and supported throughout the period 1964-1980. In 1984, a new import regime was enacted, through which finished car imports were made possible. Local producers would however still be protected with the help of custom duties. The new import regime, which replaced the “Regulations of the Assembly Industry” and marked the start of the reflection of liberalisation on the automotive industry, aimed to improve the competitiveness of Turkish automotive products, and by so doing prepare the industry for the customs union with the European Union (Azcanlı, 1995).

Finally, the lack of a consistent long-run strategy for the industry, together with the preservation of some protective measures, resulted in a distorted structure with too many firms, some of which were operating below capacity most of the time. The limited purchasing power of customers further contributed to the overall picture by restricting potential demand. Operating below the optimum level results in higher costs of production and makes Turkish automobiles relatively more expensive.

In summary, the automobile industry in Turkey has enjoyed high protection levels for a long period of time. The sector has, however, gained some dynamism since the mid-1980s, with diminished import restrictions and new foreign investments. The consequent increase in competition has pushed the industry participants to improve their productivity levels and quality as well as product diversity. The Turkish automobile industry seems to have been experiencing a take off especially since the beginning of the 1990s, mainly stemming from the rise in income levels and spread of consumer credit schemes.

3. Koç Holding.

Vehbi Koç, the founder Koç Holding and Tofaş, began its business in 1917 with a one hundred dollar investment from his father, who was a small grocery store owner in Ankara. Koç was at the right place at the right time, since Ankara was growing rapidly as the capital of modern Turkey. He certainly did have a natural gift for commerce as well, and was able to expand the family business in retailing by taking part in government projects as a contractor. In the 1930s, he was also active in importing and distributing oil and

gas, and became a sales agent for Burroughs and Mobil Oil. The next step was getting involved in importing motor vehicles, and Koç soon managed to be the representing agency of Ford in Turkey (Root and Quelch, 1997).

As a milestone in his business life, Koç mentions the importation of Fiat tractors for the government during and following the World War II with commissions as high as 90% of the retail value. In 1948, he built a factory to manufacture light bulbs with General Electric. Clearly, he realised the benefits of not only foreign partnerships but also of good relations with the government. He had very close contacts with government officials and was himself a member of the ruling RPP (Republican People's Party). It is interesting to note that in the late 1950s, he had to resign from the RPP following a government change since the newly elected DP (Democratic Party) forced him to do so through continuous threats and bureaucratic obstacles. His company by then was the most advanced one in Turkey, and he himself was the most influential businessman of the country. He accepted to resign because he knew the importance of the state support for business success in Turkey, although it was understandably a hard decision to take personally. In fact, he states that his wife and his daughters refused to speak to him for some time after the event (Buğra, 1994).

In the 1960s, he enlarged its activities in the automobile industry by getting engaged in assembly production. In 1963, he established a holding company, Koç Holding, by combining its activities in different sectors, a move that was to be followed by many Turkish companies later. It remained, and still remains, however, as a family company, Koç family holding a controlling share. Interestingly, Vehbi Koç's daughters are all married to relatives of distinguished managers in the company. If we think of this, together with the fact that his grandsons are educated in top American schools, it becomes possible to see the Koç case as a typical example supporting the argument put forward by some scholars (e.g. Buğra, 1994): Turkish firms try to achieve the professionalisation of the management via the "professionalisation of the family".

Currently, Koç Holding consists of about 100 companies, and is an important player in sectors as diverse as the automotive industry, household appliances, consumer goods, energy, mining, construction, tourism, finance, and international trade. The total output of the company accounts for almost one-tenth of Turkey's GNP. It is possible to see its corporate logo, a red ram's head (Koç means ram in Turkish), throughout Turkey. Koç Holding is the leading tax-payer in Turkey; with the words of Demirel, the President of Turkey, "five companies like Koç Holding would be enough to finance Turkish government's total expenditures". The company is also active in charity projects in areas ranging from education to health, cultural heritage, and environmental conservation (Root and Quelch, 1997).

4. Tofaş.

We can learn the background story of the decision to built Tofaş from a letter to Bernar Nahum (14.09.1963) in Koç's autobiography:

It is necessary to manufacture automobiles in this country. In 1965, Ereğli Iron and Steel Works factory will have been finished. A considerable portion of inputs can be obtained from this factory. [...] Fiat is the most suitable company to contact with its accumulated experience and models, and the company knows us very closely. I would like to visit their manufacturing facilities in Yugoslavia and Spain personally. It is no longer possible to go on with assembly only. (Koç, 1983: 87-88)

Fiat managers, whose business style Koç had the opportunity to sample during the importation of tractors, according to him, knew how to do business in a developing country. With these positive thoughts in his mind, he visited the Seat factory in Spain and was convinced that a factory like that could also be established in Turkey. After his return from Spain, he signed the initial agreement with Fiat. Tofaş was established in 1968, construction began in 1969, and manufacturing commenced in 1971. A nice brand name was soon agreed upon for the first cars manufactured in Tofaş: Murat (which means "desire" in Turkish, here implying the desire to own a car) (Koç, 1983: 87-88).

Tofaş is currently the leading automobile manufacturer of Turkey. The company now employs more than five thousand people and has a capacity to produce 250,000 cars per year. The general manager of Tofaş, Jan Nahum, states that there is no automobile factory of this scale in the region until you reach South Korea and Japan.

The main shareholders of the company and their participation in equity capital are shown below in Table 1. Table 2, on the other hand, gives the production figures for the company for the recent years. Finally, the export and import figures that the company realised in the last three years can be seen from Table 3.

Table 1 - The Main Shareholders of Tofaş (source: IMKB, 1998)

Shareholders	Share in Capital (%)
Koç Holding	37.8638
Fiat Auto	37.8638
Others	24.2724

Table 2 - Tofaş's Production (source: OSD, 1999 and IMKB, 1998)

	1995	1996	1997	1998
Number of cars produced	120.868	96.871	105.181	92.994
Capacity utilisation rate (%)	60.4	38.7	42.1	37.2

Table 3 - Exports and Imports of Tofaş (source: IMKB, 1998)

	1995	1996	1997
Imports (USD)	319.605.035	195.506.621	243.479.354
Proportion of imports in costs (%)	29.7	29.0	30.4
Exports (USD)	214.224.128	245.341.224	68.041.642
Proportion of exports in sales (%)	26.8	32.3	12.9

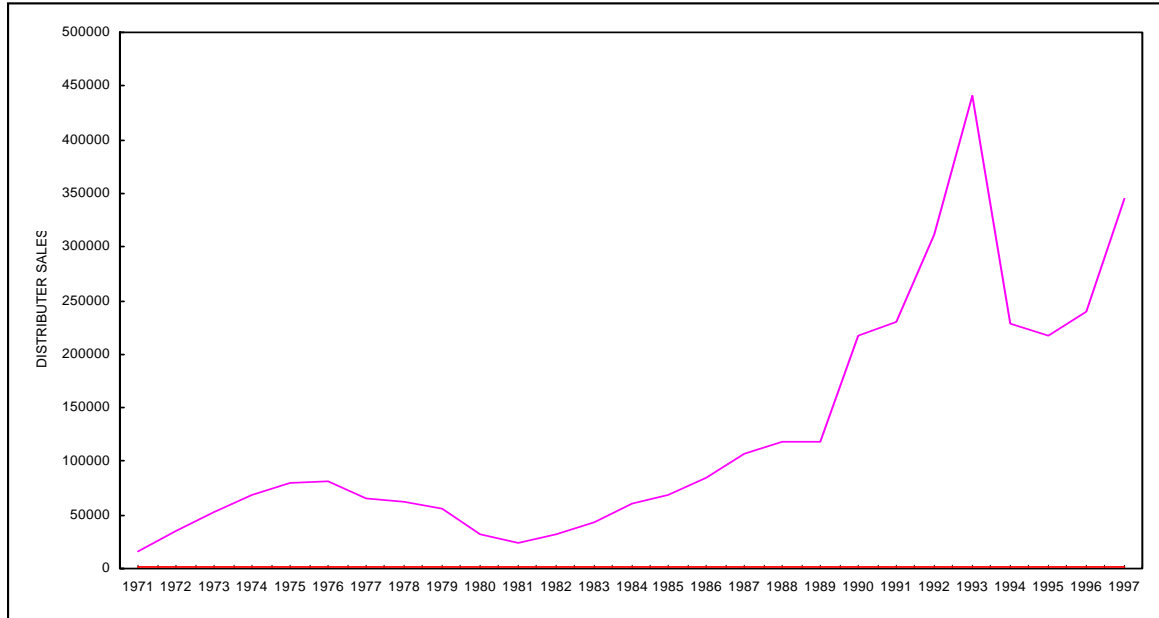
5. Demand.

Economic growth and the rapidly increasing population in Turkey have triggered the urbanisation process and resulted in a need for more and better transportation facilities. When we examine the transportation policy of the government, we see that motorway transportation has been clearly favoured since the 1950s. The share of motorway transportation was about 50% and railway transportation was 42% in 1950, whereas by 1985 the same shares were 92.6% and 6.6% respectively, showing a tremendous increase in favour of motorways. Moreover, public transportation facilities could not be developed properly, which resulted in a constantly increasing demand for automobiles. Demand for automobiles in Turkey is, however, still rather low, which is evident if we compare the per capita car figures of Turkey with those of many other countries. The number of people per car in Turkey is 39, whereas the related figures for some other countries are much lower; specifically the average figure for Europe is 4.90, for North America 2.50, for South America 15, for Asia 58, for Africa 79, and the world average is almost one third of that for Turkey: 12. The potential demand, in fact, is believed to be much higher. This potential, however, cannot be exploited totally because of still low per capita income levels in Turkey (GNP per capita is USD 6.430 at PPP rates), very high tax rates on automobile products (around 50%) and the lack of a well-developed consumer credit market.

When we examine the growth of demand for automobiles in Turkey (see Figure 1), we observe that it only reached one hundred thousand in 1987, followed by rapid increases until 1993, a year marking the peak in sales with around 442 thousand cars. Then, the automobile sales in Turkey decreased again to around 229,163 in 1994, to 216,611 in 1995, rose to 239,716 in 1996, and with some revival increased further to

344, 835 in 1997 (IMKB, 1998). In terms of the segment structure, small, cheaper and fuel-efficient cars seem to be increasingly preferred recently, resembling the trend in many countries of the world. Specifically, the share small cars captured increased from 13.3% in 1997 to 17.5% in 1998. The relevant figure for the first six months of 1999 is 23.9%, Fiat Palio of Tofaş being the leader of this category with a market share of 24% (Sabah, 1999).

Figure 1 - Automobile Sales in Turkey (1971-1997) (source: Tofaş, 1997 and IMKB, 1998)



The export interest of the industry has always been low, and the domestic market has been the driving force of production. A recent increase in the export performance of the industry is associated with tough economic conditions and intensifying competition at home. Exports, however, remain still rather low (see Table 4), although considerable rises are expected in the forthcoming years. They are mostly targeted to developing countries, especially Egypt, Russia, the Turkic Republics of the Commonwealth of Independent States and recently to Europe, especially France, Germany and Italy.

Table 4 - Automobile exports of Turkey in USD (1993-1998) (source: OSD, 1999) *

Firms	1993	1994	1995	1996	1997	1998
A. Honda	-	-	-	-	-	1.805.700
Ford Otosan	11.248.597	6.741.000	11.083.000	266.336.000	8.696.382	4.007.072
Hyundai Assan	-	-	-	-	-	3.893.664
Opel	1.551.239	1.267.512	1.167.958	523.349	1.428.000	686.208
Oyak Renault	12.058.057	23.400.000	26.000.000	21.660.000	53.000.000	55.800.000
Toyota	-	-	-	2.365.200	907.159	1.522.009
Tofaş	31.312.729	42.646.740	209.076.572	228.138.239	57.847.045	64.632.095

* Complete vehicle, parts exports are not included

While exports of the industry continue to expand only gradually, the increase in imports is strikingly high. The share of imports in total automobile sales of Turkey reached 24% in 1996, and this figure rose to 35% in 1997 with the bulk of the vehicles coming from European Union countries (see Table 5).

Table 5 - Passenger Car Imports of Turkey (1994-1998) (source: Association of Turkish Distributors of Imported Cars)

Region and/or country	1994 (%)	1995 (%)	1996 (%)	1997 (%)	1998 (%)
EU + EFTA	35.8	46.2	63.1	64.5	74.6
Eastern Europe	28.0	19.9	5.7	2.0	1.9
Russian Federation	13.9	9.8	2.1	0.1	0.0
Czech Republic	14.1	10.1	3.6	1.9	1.9
Far East	36.2	33.9	31.2	33.5	23.5
Japan	24.3	18.6	16.5	18.6	18.1
South Korea	11.9	15.2	14.7	14.9	2.9

6. Competition.

High potential demand for automobiles in Turkey as well as its favourable geographic position, coupled with the ongoing protection provided for the automotive industry and the recent customs union agreement with the European Union, have resulted in increased interest by the foreign giants in establishing automobile firms in Turkey. General Motors, for instance, established a line to produce the Opel Vectra in 1990. Toyota made the decision to invest in 1992, and production started in 1994. These were soon followed by increasing interest from Honda and Hyundai, both of which started to produce automobiles in Turkey as of 1998. Existing firms in general and Tofaş in particular are, however, rather sceptical about the local market getting increasingly crowded, which further intensifies the competition fuelled by the customs union with the European Union. The company is concerned about the extent to which the domestic market can absorb that many firms. According to Tofaş's managers, existing firms are already suffering from excess capacity, and it is a mistake in government policy to support and give incentives to the establishment of new firms. New entrants, on the other hand, argue that the industry will gain impetus and export drive as a result of the recent developments. To support their view, they use the projections of demand for passenger cars in Turkey which show that it will reach 700-800 thousand cars towards the early 2000s, and, therefore, that the Turkish market can absorb 7-8 car manufacturers, each producing around a 100 thousand cars. Production capacities of currently existing firms in the Turkish automobile industry can be seen in Table 6.

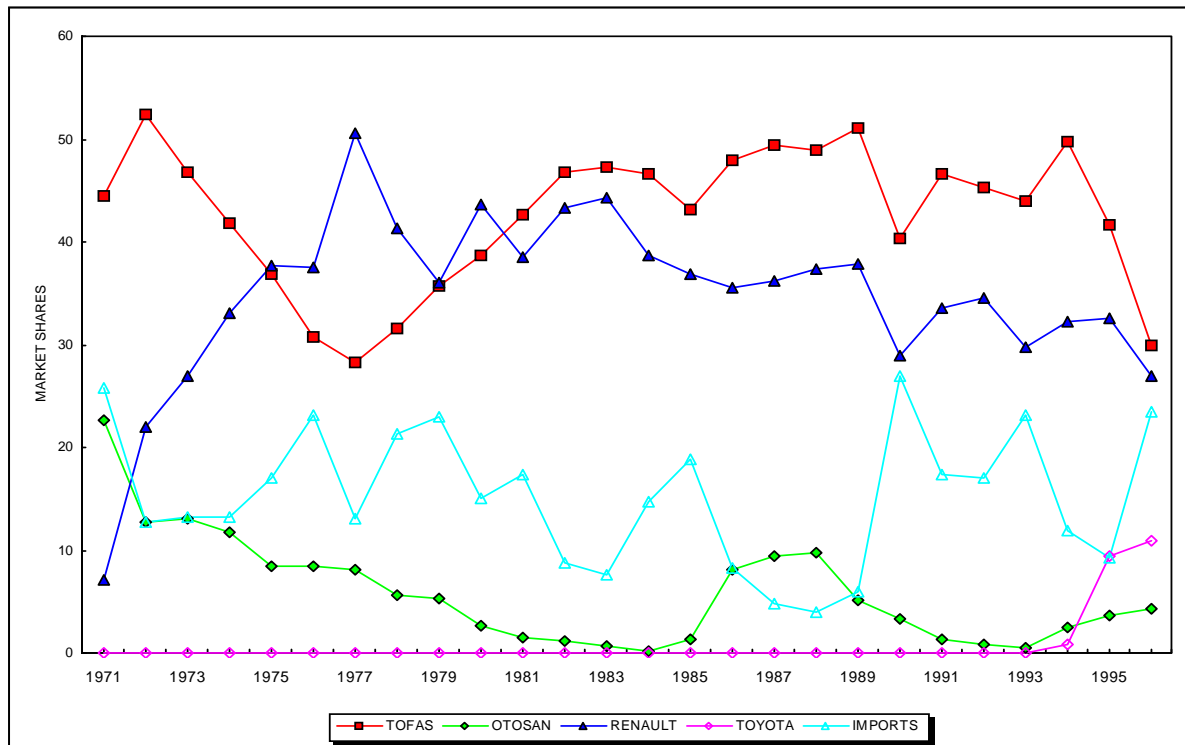
Table 6 - Production Capacities of Automobiles Manufacturers in Turkey (source: OSD, 1999)

Firms	Capacity	Production	Capacity utilization rate
A. Honda	30.000	8.251	27.5%
Ford Otosan	25.000	6.619	26.5%
Hyundai Assan	100.000	22.024	22.0%
Opel	25.000	7.030	28.1%
Oyak Renault	160.000	88.506	55.3%
Tofaş	250.000	92.994	37.2%
Toyota	100.000	14.513	14.5%

There are currently seven automobile manufacturers in Turkey: Tofaş (Koç-Fiat), Otosan (Koç-Ford), Oyak-Renault, Toyota (Sabancı-Toyota-Mitsui), Opel (GM), Assan-Hyundai and Honda. The ones that captured the first four places in terms of market shares in recent years are depicted together with the share of imports in Figure 2. When we examine the sales patterns of the two leading automobile producers of Turkey between the years 1971-1996, we see that Tofaş is the industry leader with a market share of around 30%, closely followed by Renault. We should, however, state that despite these two companies dominating the Turkish car

manufacturing industry, their shares show a decreasing trend in recent years. They, for instance, together captured almost 60% of the market in 1996, which is still high, but represents a fall from their combined share of 90% in the early 1980s. In the meantime, the success of Toyota, which has managed to reach a market share of 10% in two years, is spectacular, and the share of imports, which reached 24% in 1996, and rose to 35% in 1997, is especially noteworthy. The latest figures show that, despite a further fall in its relative position, Tofaş led the industry in 1997 as well, accounting for a 41.5% share of the market for domestic makes, and 27.5% share of the total market for cars.

Figure 2 - Market Shares in the Turkish Automobile Industry (1971-1996) (source: unpublished company data, Tofaş, 1997)



Until recently, in other words, domestic competition was not that intense. Tofaş and Renault were enjoying a comfortable life and high profits and offering a few outdated models, knowing that Turkish customers had no choice but to buy them in a protected market. It was not uncommon for a customer to wait several months for the delivery of the car. For a long period of time, Turkish customers did not know any other model apart from Otosan's Anadol and Taunus, Tofaş's "Bird" series and Renault's Toros. Competition in the domestic market is, however, definitely getting tougher with diminishing protection levels and a number of threatening new entrants. Although quality has improved considerably since the early 1980s, Turkish automobiles still have problems related to noise, emission, safety and standardization.

In terms of technology, since all firms operate under a foreign license, assembly technology compares well with European and American standards. There are, however, several factors limiting the employment of superior technology in Turkey. Expensive licenses, the high cost of investment in full automation, the expectation of rapid changes in technologies, the relatively low labour cost in Turkey, restrictions dictated by the limitations of the parts and components industry, purchasing power and even the education level of customers, and the quality of motorways are just a few factors to remember. These can be plausible explanations for slowing the introduction of brand-new models as well as full automation.

With intensifying competition, Turkish automobile producers have begun exploring alternative means of improving their positions in the market and stimulating consumer demand. An increase in their concerns for quality, technology and product diversity is clearly noticed. Since 1980, for instance, model changes, which

were the exception rather than the rule until the end of the 1970s, have become more frequent. Product innovation, or at least some upgrading of the existing model range, has become important. Another example is the establishment of special financing deals, pioneered by Koç Holding, which have created the opportunity for consumers to purchase their cars at low interest rates.

As a response to the recent changes in its environment, Tofaş has been undergoing a restructuring process and trying to correct its poor image as well as its bad relationship with the government. The company executives believe the company's poor image stems from the fact that most of the old cars currently in use in Turkey are products of Tofaş, and the company is usually judged by them, despite the recent improvements achieved. The company has plans for further investments, modernisation and introduction of new models. An examination of the on-going projects and investments of the company reveals that a clear priority is given to new product investments (TL 43.012.000 million), followed by investments aimed at increasing the capacity (TL 8.971.000 million)². Their model "Tempra", for instance, has brought modernisation since its introduction in 1990, especially in microelectronics, not only in Tofaş itself, but in the components industry as well.

7. The role of government.

The protectionist policies are often considered to be responsible for Tofaş's concentration on the domestic market and the resulting small-scale production. The protection the "Regulations of the Assembly Industry" brought about went on until the liberalisation of the early 1980s. In 1984, imports of parts and components were liberated to a large extent, and signals for automobile industry itself were given by a gradual decrease in protection levels. The government also permitted large-scale imports of used cars. Since imports increased too much, however, it later had to introduce a new levy to limit imports of used vehicles. Another related development after liberalisation is the reduction obtained in red-tape, especially in the import and driving license procedures (Azcanlı, 1995).

The protective rates for motor vehicles have been, nevertheless, always above the industry average in Turkey. Nominal protective rates for the Turkish economy in general, for instance, have been calculated as 42% for 1981, 16% for 1985, 9% for 1989, 15% for 1991, and 13% for 1992. The corresponding rates for the automotive sector, on the other hand, are 39%, 37%, 29%, 30% and 29% respectively. The rates for automobiles only are even higher, and, furthermore, it is not possible to detect a decreasing trend. They, in fact, increased from 93% in 1989 to 99% in 1992 (Turhan & Tanrıku, 1992). A decrease could be recorded only after the customs union in 1996, to a percentage ranging from 33 to 59% depending on the type of car.

According to the agreements, Turkey will be able to apply protection levels (now ranging from 27 to 33%) higher than EU levels (10% for cars, 11% for light commercial vehicles) towards third countries until 2001. The industry demands further protection, stating that the Turkish automobile sector is a young industry. In particular, they have serious concerns about cheap imports from the former Eastern Block countries. Specifically, they demand a further protection for 22 years after the customs union against third countries for automobiles. If their demand is not met, they expect a fall in local production that may amount to as much as 60% (Renda, 1995).

Another government policy that indirectly but considerably affects the automotive industry, already mentioned while discussing demand conditions, is the transportation policy. The emphasis, which was on railways between 1923 and 1950, shifted in favour of motorways thereafter. Several factors responsible for the overwhelming current dominance of motorways in Turkey have been identified, ranging from the large number and the scattered nature of cities to the argument that it was dictated by developed countries. It is also argued that the reason is political, in that government wanted the automotive industry to prosper, since it creates considerable employment and contributes to the development of other sectors as well. No matter what the reason is, today Turkey has an inefficient public transportation system and an almost non-existent railway system, making transportation highly dependent on motorways, which is highly advantageous for automobile producers, since it increases the demand for cars.

² USD 1 = TL 430.000.

Taxes deserve special attention in an examination of the role of government, since they amount to almost 50% of the price of a car in Turkey. The maximum related figure for Europe is 25%, or actually lower for many countries (around 15-20%). In Turkey, value-added tax is higher for automobiles, and there are some additional taxes like motor vehicles tax, vehicle purchasing tax and pollution tax. These, of course, decrease the demand for automobiles, thus posing an obstacle for firms aiming to operate at full capacity. Apart from restricting demand, these taxes also serve as an enormous source of revenue for the government.

Another issue of criticism for the government relates to its attitude towards new entrants. Jan Nahum, the general manager of Tofaş implies that there are too many automobile producers in Turkey by stating that there are five automobile manufacturers in Germany, three in Italy and two in France. Only Japan may be an exception, but its production amounts to 5-6 million per year. Nahum argues that it damages the existing companies when the government lets or even encourages the entry of new firms into the industry.

The practice of allowing imports of used vehicles without custom duties started as a considerate move to enable Turkish workers abroad to bring in their cars when they return to Turkey. In practice, however, it was largely abused, especially after being extended to cover some commercial vehicles as well. The 1984 regulation allowing the use of this practice was often regarded as having made Turkey Germany's scrap heap. It was also criticized as causing unfair competition. Not surprisingly, as a result, it was abolished at the end of the year (Azcanlı, 1995). This issue came onto the agenda again when preparing for the customs union with the EUROPEAN UNION, and it was in principle agreed that Turkey would retain the right to control the importation of used vehicles³. In 1996, however, the government decided to introduce the regulation again, this time organizing it in such a way that not only Turkish citizens abroad but also the ones in Turkey could make use of the opportunity. This predictably caused disturbance among the industry participants including Tofaş's managers, who engaged in intensive lobbying activities but could not prevent the government from putting it into practice. The company also criticized the government about not consulting the firms in the industry before taking such a vital decision that could affect them considerably. Even the rumours and expectations about such a regulation caused a considerable fall in demand for automobiles since customers preferred to postpone their purchasing decisions. In 1998, a new regulation banned the importation of used cars.

One of the most important issues related to the role of government in the automobile industry is the lack of a master plan and, hence, a consistent policy towards the industry. In 1987, the government organized a Council of Industry meeting, and the automotive industry was among the ones invited. Although the meeting was regarded as being highly successful, hopes and expectations of a master plan could not be fulfilled. Instead, policies concerning the industry have continued to be rather ad hoc and inconsistent. Industry participants have been rarely consulted before vital decisions about the industry are made. A typical example may be the above mentioned issue of importing used cars. The general negative attitude towards the industry also creates disappointment among the industry participants. The industry has been indeed seen as an import-dependent assembly line for a long time, which has affected the attitude of government as well. An interesting example is an anecdote told by İlbahar, the president of the Automotive Manufacturers' Association and Otosan in which a high level government official has allegedly stated "Your cars are crap, I will recommend Mercedes as my preference for official car purchases". İlbahar points that they have to deal with this negative image among other things and reminds us that the Japanese even used to have marching songs for their domestic cars.

8. Hard times ahead or a bright future for Tofaş?

"The machine that changed the world" may also change the destiny of more than 500 thousand people working in the automobile assembly and related industries in Turkey. Since the industry is in the process of a major restructuring, cautious handling of this critical transition is of crucial importance. In light of the preceding analysis, it is obvious that there is a tense relationship between the industry and government, although it is true that the industry has been protected for a long time. It is undeniable that during the

³ For example, a similar arrangement covering 25 years had been made for Mexico during its NAFTA negotiations. In case of the Turkey-EU agreement no time period was specified (Bayraktar, 1995).

relatively short history of the industry, Tofaş and other established automobile manufacturers of Turkey have enjoyed a cosy life for a long period of time thanks to the high levels of protection provided. Recently, decreasing protection levels and an increasing number of new entrants, and the resulting intensifying competition have, however, started to destroy this comfortable environment, and have brought about problems that have long been postponed, but had to be faced sooner or later. Tofaş, however, has gained some dynamism, in that the stiffer competition pushes the company to improve quality levels and increase product diversity.

A very important factor to keep in mind owes to chance rather than to policy, and it is the location of the country. Turkey has an intrinsic advantage with regard to transportation, stemming from its favourable geographical position. In fact, apart from the country's recent customs union with the European Union, its proximity to the newly emerging markets of the CIS as well as East Europe have probably also contributed to the increasing attention towards Turkey given by the leading foreign automobile manufacturers. As an advertisement slogan puts it, "Turkey is not the centre of the world, it is just located there". This favourable geographic position and Tofaş's high production capacity causes its parent company Fiat to consider Tofaş as its hub in the region, especially as an export centre (Hürriyet, 1998).

After the customs union with the European Union, however, the existing firms in the automobile industry are the hardest hit by decreasing protection levels and intensifying competition. Chance events therefore bring both challenges and opportunities for Tofaş. It is argued that, despite relatively low labour costs in Turkey, when protection levels are equalised with EU levels the industry in general, and Tofaş in particular, are likely to face difficulties. Now, given Tofaş's contribution to employment (more than 5.000) and to tax revenues (TL 1.770.129 million in 1997), the social costs associated with the possibility of its failure are, of course, hard to face.

Following the customs union with the European Union, established producers in the industry led by Tofaş started clashing with the government, which thinks that automobile manufacturers have been enjoying an easy life at the expense of the customers who are forced to buy lower quality cars at higher prices. The industry is, in other words, seen as a typical example of an infant industry that cannot grow up, and needs to be "put into order" and "disciplined". According to the government, the customs union with the European Union provides eventually this opportunity.

Questions for discussion.

1. Please map the web of relationships among the players described in the case.
2. What alternatives can be considered by the Ministry of Economic Development? What are the benefits and the costs associated to each of them? What would you recommend, and why?
3. Based on the information included in the case, and with Porter's "diamond" framework as the background, please be ready for a roundtable of negotiations on how the government should deal with the car industry in the future. A representative of the Ministry of Economic Development is chairing the meeting. Participants to the roundtable include:
 - Representative of Automotive Manufacturers' Association
 - Representative of importers of foreign cars
 - Representative of Unions
 - Representative of the Ministry of Labour
 - Representative of the Ministry of Finance

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