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**Asli M. Colpan**
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## Working Paper

**15-035**

**November 6, 2014**

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# Entrepreneurship and Business Groups: An Evolutionary Perspective on the Growth of the Koç Group in Turkey

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## Abstract

This working paper examines the origins and development of the Koç Group, which grew to be the largest business group in Turkey. This enterprise was an important actor in the emergence of modern business enterprise in the new state of the Republic of Turkey from the 1920s. After World War II it diversified rapidly, forming part of a cluster of business groups which dominated the Turkish economy alongside state-owned firms. This study shows how the founder of the Group, Vehbi Koç, formulated his business model, and analyzes how his firm evolved into a diversified business group. The research supports prevailing explanations of business groups which identify the role of institutional voids, government policies and contact capabilities, but it also builds on and extends earlier suggestions in both the management and business history literatures that entrepreneurship needs incorporating more strongly as an explanatory factor. This working paper argues that Koç acted as both a Kirznerian and Schumpeterian entrepreneur to build his business group, both in its formative stages and later in its subsequent growth into a diversified group.

**Entrepreneurship and Business Groups: An Evolutionary Perspective on the Growth of the Koç Group in Turkey**[1]

## 1. Business groups in developing economies

Once greatly overlooked, there is now an extensive literature on business groups. It is well-established both that they are a prevalent form of business enterprise across much of contemporary Asia, Latin America and the Middle East, and that they are highly heterogeneous. The term business group has been used broadly to encompass quite different organizational forms, including network-type, diversified and pyramidal groups, even if most research has focused on "diversified" business groups that are active in technologically unrelated businesses.[2]

There remain differences between academic disciplines in the dominant theoretical explanations for the growth of business groups. The market imperfections theory favored by many economists and in Strategy has explained them as responses to the institutional voids that are commonly found in developing countries.[3] Political scientists have emphasized the role of government policies in targeting particular industries and sectors for growth through selective policies and giving special privileges to selected business group.[4] Some management researchers have identified the importance of the "contact capabilities" of business groups, both with their home government and also with the multinational enterprises which supplied advanced technology.[5]

A less-well developed insight concerns the role of entrepreneurship. In 2001 Kock and Guillen, employing an evolutionary perspective on the growth of business groups, suggested that the development of their "contact capabilities" should be seen as an entrepreneurial response to the environment of late industrializing countries. These authors argued that the protectionist

environment in developing economies after World War II encouraged entrepreneurs not to innovate new products, but rather to leverage local and foreign contacts to combine international knowledge with local markets. They also predicted that as economies liberalized and reduced tariff barriers entrepreneurs would shift to building organizational and technological capabilities.[6] In 2006, in a study of the evolution of Taiwanese business groups, Chung also emphasized the role of entrepreneurial founders in diversification strategies. He suggested that the personal relationships of entrepreneurial founders, more especially networks in politics, shaped early diversification strategies, although over time the business groups developed their own capabilities which shaped later diversification patterns.[7]

The business history literature on business groups has provided empirical support for all of the dominant theories of business group formation and growth. This research has certainly undermined the initial Kock and Guillen chronology by showing that business groups were a vibrant form of business enterprise for a century before World War II, while finding no evidence to support a view that they declined as economies liberalized. Without offering formal generalizations, much of this literature has also lent support to Chung's emphasis on the importance of entrepreneurial founders in the initial phases of business group formation. Indeed, by identifying the role of successive generations of family owners and managers, business historians have pointed to a continuing and important role for families in the growth and resilience of business groups. This appears to be as true for the families behind the long-established business groups owned in the developed economies of Britain and Sweden, such as the Swire's, Keswick's and Wallenberg's, as for their counterparts in Latin America, India and other emerging markets.[8]

This working paper looks at the historical evidence on Turkey, where the importance of

business groups in the emergence of modern industry is well-established.[9] As Table 1 shows, out of 50 largest businesses by employment in Turkey in 2005, 28 were diversified business groups.[10] These groups accounted for 57% of the total workforce of Turkey's top fifty business enterprises.

*Table 1 50 Largest Turkish Business Enterprises by Employment, 2005*

| Business enterprise | Number of employees | |
|---|---|---|
| | Total number | Ratio (%) |
| Largest (Koç Group) | 81,926 | 10.72 |
| 5 largest units | 249,172 | 32.62 |
| 10 largest units | 367,016 | 48.04 |
| Family business groups (26 units) | 389,124 | 50.94 |
| All business groups (28 units) | 436,235 | 57.10 |
| State-owned enterprise | 260,091 | 34.05 |
| Foreign-owned enterprise | 61,237 | 8.02 |
| Total 50 units | 763,946 | 100.00 |

Source: Adapted from Asli M. Colpan, "Business Groups in Turkey", in Asli M. Colpan, Takashi Hikino and James R. Lincoln, eds., *Oxford Handbook of Business Groups*, Oxford: Oxford University Press, 2010.

Table 2 traces the origins of the 30 business groups that owned one or more of the 500 largest companies in Turkey by sales in 1988. The table shows that eight of these large businesses originated in the interwar years, including Koç as well as Çukurova and Sabancı. This was not the norm. Of the eight largest business groups in 1988, besides Koç, Cukurova and Sabanci that emerged in the 1920s and 1930s, two emerged in the 1940s, two in the 1950s and one in the 1960s.[11] However, in terms of the 30 largest groups as a whole, Table 2 shows that

almost one-half of them emerged in the 1950s.

*Table 2 Years of Foundation of the Largest Turkish Business Groups in 1988*

| 1920s | 1930s | 1940s | 1950s | 1960s | 1970s |
|---|---|---|---|---|---|
| Koç | Sabancı | Yasar | Akkök | Anadolu Endüstri | Ekinciler |
| Çukurova | Sapmaz | Eczacıbaşı | Kutlutaş | Özsaruhan | |
| Sönmez | Vakko | Ercan | Borusan | İzdaş | |
| Özakat | | Transtürk | Bodur | | |
| Santral Mensucat | | | Tekfen | | |
| | | | Enka | | |
| | | | E.C.A | | |
| | | | Profilo | | |
| | | | STFA | | |
| | | | Alarko | | |
| | | | Akın | | |
| | | | Deva | | |
| | | | Tamek | | |
| | | | Altınyıldız | | |

Source: Adopted from Ayse Buğra, *State and Business in Modern Turkey: A Comparative Study*, New York: State University of New York Press, 1994, pp. 57.

Note: Decades denote the period that the business groups started their original businesses. The business groups shown above are the ones that control at least one of the 500 largest industrial firms listed by Istanbul Chamber of Industry in 1988. Overall the 30 business groups controlled more than 150 large industrial firms.

This working paper aims to go beyond this broad mapping of the chronological growth of Turkish business groups by exploring the dynamics of that growth through the case of the Koç Group from its foundation until the late 1980s. Drawing on the entrepreneurship theories associated with Kirzner and Schumpeter,[12] this study explores the significance of entrepreneurial process, which it is argued goes beyond the rudimentary contact capabilities and personalistic relationships suggested by Kock and Guillen and Chung. Further, and departing from the earlier

work, the present research points to a continuing and important role for entrepreneurship in the growth and resilience of the business group organization well after the initial formation stages.

To assess a detailed evolution of the Koç Group that has been described by several authors,[13] this working paper seeks to build on this evidence by utilizing more fine-grained data which mostly came from three resources. The primary sources were the Koç corporate archives, as well as interviews with the Koç family and retired and current managers. The paper also draws on published autobiographies of Vehbi Koç, other Koç family members, and executives in the Koç Group as well as corporate histories of Koç group companies. These sources provide an element of trianglization. The paper adopts an in-depth qualitative case study method for its analysis.

Section 2 will briefly review the emergence of modern business in Turkey. Section 3 will discuss the origins of the Koç Group before 1945. Section 4 will examine the expansion of the Koç business group after World War II until the late 1950s. Section 5 analyzes the reorganization and further expansion of the Koç Group between the 1960s and 1980s. Section 6 concludes.

## 2. The Emergence of Modern Business in Turkey

Before the nineteenth century, the Ottoman Empire, a vast political entity spanning three continents, including the much smaller modern state of Turkey, had a substantial handicraft industry, and as well as a powerful and well-organized state. During the nineteenth century, however, the Empire struggled to adapt to the Industrial Revolution underway in Western Europe. The ownership of the modest modern business sector was on ethnic and religious lines, with few Muslims involved in commercial activities.[14] The West's political power partly shaped these developments. The so-called "capitulation" treaties, especially those from the early 19th century, gave special privileges to Europeans and the non-Muslim minorities who lived in the

Empire, primarily Greeks, Armenians and Jews. They had privileges in choosing European legal jurisdictions besides the Ottoman Islamic judicial system in disputes involving non-Muslims, such as in contracting and dispute resolution. They were also exempted from several taxes and paid lower custom duties.[15] As the Ottoman Empire aimed to modernize itself during the Tanzimat (Reform) period (1839-1876), Muslim Turks could obtain jobs in the bureaucracy, and viewed business as an inferior occupation. The overall result was that the Turkish Muslim majority were relatively absent in private business.[16]

Table 3 shows that by 1913 the Ottoman Empire was far behind major Western economies in terms of per capita GDP, and also behind latecomer economies such as Japan and Argentina. This remained the situation up to 1990.

*Table 3 Per Capita GDP of Turkey and Selected Other Countries, 1870-1990 (in 1990 international Geary-Khamis dollars)*

| | 1870 | 1913 | 1950 | 1970 | 1980 | 1990 |
|---|---|---|---|---|---|---|
| Ottoman Empire/ Turkey | 825 | 1,213 | 1,623 | 3,078 | 4,022 | 5,399 |
| India | 533 | 673 | 619 | 868 | 938 | 1,309 |
| Japan | 737 | 1,387 | 1,921 | 9,714 | 13,428 | 18,789 |
| Argentina | 1,311 | 3,797 | 4,987 | 7,302 | 8,206 | 6,433 |
| Germany | 1,839 | 3,648 | 3,881 | 10,839 | 14,114 | 15,929 |
| USA | 2,445 | 5,301 | 9,561 | 15,030 | 18,577 | 23,201 |

Source: Compiled from Angus Maddison, "Statistics on World Population, GDP and Per Capita GDP, 1-2006 AD".www.ggdc.net/maddison, 2009.

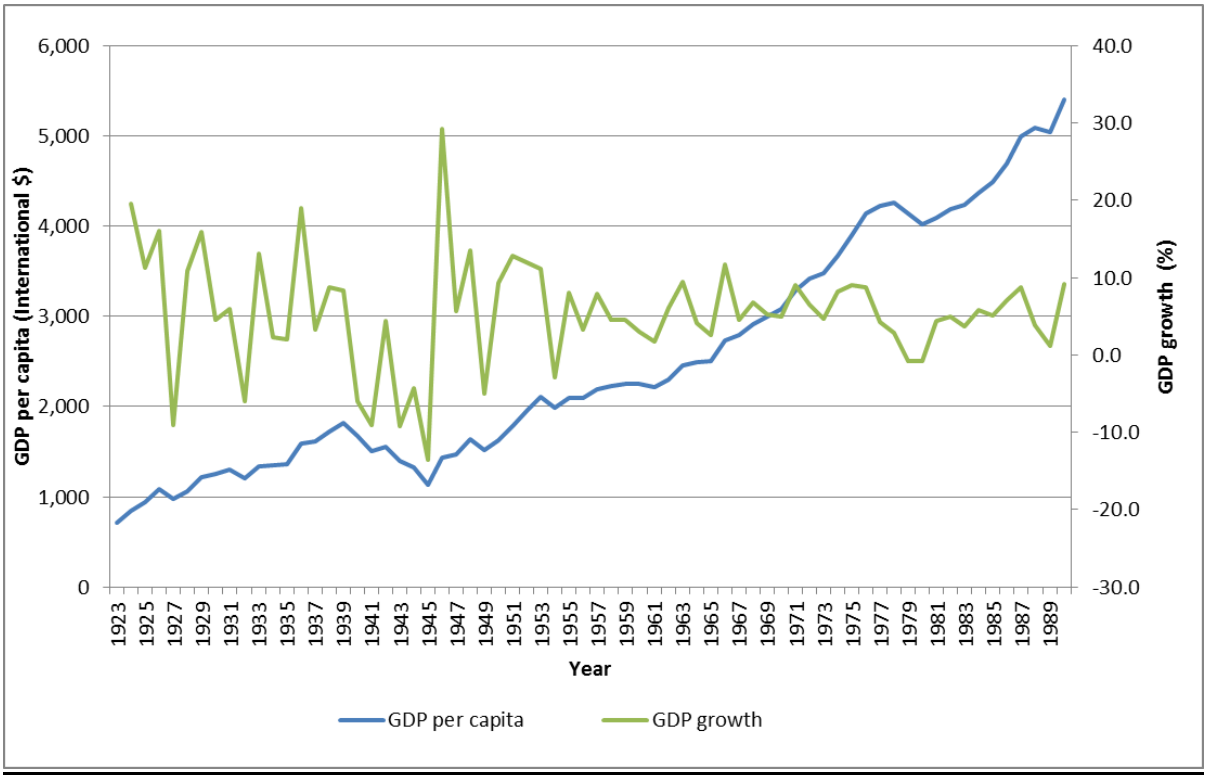
After being defeated in World War I, the Ottoman's vast empire in the Middle East was lost. The ethnic minorities which had dominated the modern business sector were expelled or

marginalized.[17]

After the Republic of Turkey was established in 1923, the new regime of Mustafa Kemal sought to modernize the country. The creation of a business class from the now dominant Turkish Muslim majority of the population was a priority. The government of the Republican People's Party (RPP) provided financial incentives to private firms, including tax allowances and exemptions, and awarded customs exemptions for importing industrial machinery. Government policy moved toward more direct intervention following the onset of the Great Depression. High tariffs were imposed. State-owned enterprises were created to promote growth. Further measures were taken against non-Muslim citizens. A Wealth Levy of 1942 was enforced in practice by separating taxation rates based on the religious faith of the taxpayer, and represented a selective policy to dispossess non-Muslim businesses.[18]

After World War II, which Turkey had stayed out of until almost the end, governments experimented with more liberal policies, especially after Adnan Menderes and Democrat Party came to power in 1950 as the first democratically elected prime minister in the history of Turkey. However, policies soon shifted back towards increased state intervention.[19] The Foreign Capital Incentive Law was enacted in 1950 to encourage FDI, but in practice bureaucratic and legal complexities and hurdles resulted in few foreign firms entering Turkey.[20] The overall economic environment was highly volatile during this period up to the mid-1950s although GDP per capita rose steadily See Figure 1.

*Figure 1 Turkish GDP Per Capita and GDP Growth, 1923-1990*



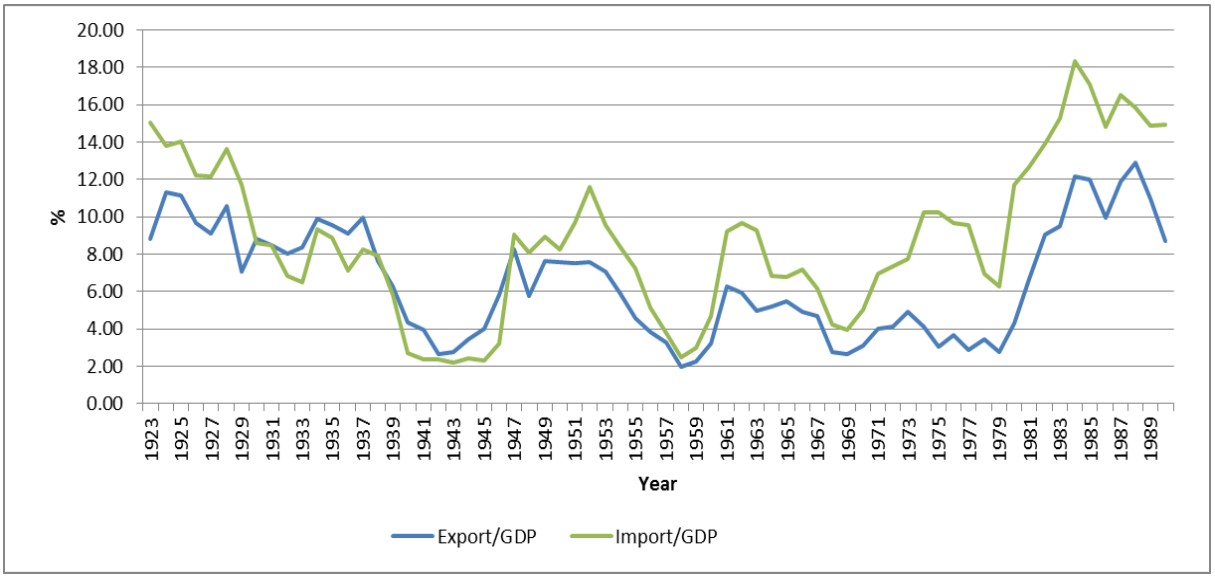

Source: Compiled and drawn based on Angus Maddison, "Statistics on World Population, GDP and Per Capita GDP, 1-2006 AD", www.ggdc.net/maddison, 2009; revenue data provided by Koç Holding.

Note: Real GDP per capita data is shown in 1990 international Geary-Khamis dollars. Real GDP growth is shown in percentages.

After 1960, when an army coup overthrew the government, policies were characterized by planned economic development with protectionist trade policies. Incentives were given to local firms to enter into the manufacturing sector, foreign exchange was allocated to favored industries, and state contracts were granted to enable construction and international trade. The policies were poorly implemented. By the 1970s there was soaring inflation. There was political turmoil with eight short lived coalition governments and two military coups in 1971 and 1980.[21] Turkey had one of the lowest levels of FDI as a ratio of GDP in the world. It was not until 1980,

when the country faced critical macro-economic conditions, that a policy reversal began, as tariffs started to be lowered and other liberalization policies adopted.[22] Figure 2 shows the low ratio of exports and imports to GDP during most of the period, with the ratios moving upwards after 1980 as liberalization was put in place.

*Figure 2 Turkish Exports and Imports as a Percentage of GDP, 1923-1990*




Source: Compiled from statistical data (Yıllara göre dış ticaret, gayri safi yurtiçi hasıla) at Türkiye İstatistik Kurumu at www.tuik.gov.

The policy environment, therefore, provided the context for the emergence of Koç as well as other business groups. Clearly, however, such advantages were available to any business within Turkey. Although Muslims were clearly favored, two of the largest groups created in the 1950s, Alarko and Profilo, were Jewish. An important question, therefore, relates to explaining why it was Koç, and a handful of other firms, which seized them.

## 3. Vehbi Koç and the founding stages of the Koç Group

Vehbi Koç was born in Ankara in 1901, which at the time was an impoverished city in the middle of Anatolia. At the time Koç was born, his father was living on the rent he obtained from

the stores left by his own father. In 1916, Koç's father together with his three Muslim friends decided to found a partnership to trade wheat. When his father's business failed, Koç decided to enter into business himself and dropped out of school. Together with his father, they opened a small grocery shop selling shoe rubber, sugar, olives and pasta below their own house in 1917. After two years, Koç started to investigate new businesses by looking at the businesses of his Greek, Armenian and Jewish neighbors. As a result, he decided to enter into leather trading, and offered a high salary to an ethnic Greek salesman to provide the necessary expertise.[23]

As he succeeded in the leather business, Koç looked for new opportunities. He entered the hardware store business, which was largely controlled by ethnic Jewish merchants, and recruited a leading salesman from one of these Jewish enterprises. Over time the initial hardware business was expanded to include textiles, glassware and other products. He also sought to enter the large business of selling kerosene for gas lamps, and seeking to become the Ankara agent of an international company. After working successfully for the small business of the Anglo Persian Oil Company, he secured the Istanbul agency of the largest importer, Standard Oil.[24]

As Ankara became the capital of modern Turkey, new business opportunities emerged, such as the development and construction work in the city. Given the increasing demand in those new businesses, Koç entered into the sale of construction materials and exited the grocery and leather sales. He worked with a politically well-connected building contractor called Nafiz Kotan in the construction materials business, who was able to secure multiple government contracts. As Koç grew in this business, he also built a contracting business undertaking projects in partnership with other firms.[25] In 1926, his father passed the ownership of their firm to Vehbi Koç, changing the enterprise's name to Koçzade Ahmet Vehbi.

Ankara's new prosperity provided other opportunities. During the 1920s US firms

including Ford and Chevrolet began their automotive sales in Turkey by using local agents that are primarily based in Istanbul. Koç observed that the representative of Chevrolet in Ankara had a profitable business bringing in automobiles from Istanbul. Thanks to his established reputation in Ankara, in 1928 Ford gave Koç an agency agreement when they searched an agent in that city.[26] Koç later hired an ethnic Jewish manager, Bernar Nahum, working at an automobile and parts business in Ankara at the time to build the automotive business. Ford, with the assistance of the government which agreed to charge no customs duties on the imported parts, started its own local assembly in Istanbul in 1929. Nevertheless, Ford closed the plant in 1934, as in the wake of the Great Depression, the hopes to develop an export business collapsed, and Turkish workers, fearing for their jobs, emptied boxes of automotive parts into the sea.[27] Koç retained the sales agency, Otokoç.

As his success in Ankara grew, Koç opened an Istanbul venture, organized as a partnership, for construction materials in 1937. Koç owned 70% of the company, and gave the rest of the shares to two other partners who would be the managers of the branch. As none of the partners spoke foreign languages Koç recruited İsak Atabef, who was an ethnic Jewish banker educated and worked in Germany, and at the time was working for a successful firm in government contracts in Turkey. He also gave 15% of the equity out of his own shares to Atabef to make him a partner. He then took as a partner another competitor who was known as a good salesman to lead the sales of his Istanbul business, and also hired executives from two-state-owned banks to join him by offering high salaries.[28]

In 1938 Koç turned his unincorporated company "Koçzade Ahmet Vehbi" in Ankara into an incorporated firm "Koç Ticaret Anonim Şirketi" (Koç Trade Corporation) with 300,000 lira ($238,095) of capital. His two stores, one dealing with construction and electricity, and the other

with automobiles, were organized as branches of Koç Trade Corporation. The partnership in Istanbul also turned into an incorporated company which became a branch of the Koç Trade Corp. in Ankara. Koç Trade Corp. was also being utilized as the financing vehicle of the various Koç businesses.

A key constraint on the growth of the business was a shortage of capital. The country lacked both a capital market and banks willing to make loans to promote industrial growth. With the outbreak of World War II however Koç decided to move into the truck importing business, for which there was a massive demand because of wartime shortages. A huge black market for vehicles emerged, as a result of which huge profits were made. Koç later lamented in public that "morality" had "deteriorated" with his organization. However there had also been significant capital accumulation.[29]

The evidence on the formative stages of Koç's group, then, confirms the conclusion of most business history research on business groups in general that all three leading theories have empirical support. Interwar Turkey had plentiful institutional voids. The policy regime was clearly favorable to the emergence of domestic business groups. The importance of contact capabilities was clear as evidenced with Koç's alliance with Nafiz Kotan in securing government contacts.

However the role of entrepreneurship has to be emphasized in explaining why it was Koç who created a business. The story is partly one of a Kirzner-type entrepreneur who was alert to opportunities. Koç was disadvantaged by not being in Istanbul, but successfully identified the new opportunities arising from Ankara's becoming the capital of the new nation state. He also identified that the ethnic minorities in the city, especially Jews, were knowledgeable about business, knew foreign languages, and were vulnerable. He offered them high salaries and, more

importantly, made them partners in his companies.

However Koç was also a Schumpeterian entrepreneur. This was most evident in in Koç's assembly as well as mobilization of financial resources. Capital scarcity was a huge constraint on the development of modern entrepreneurship. Koç accumulated capital in the Koç Trade Corporation which it used to fund diverse businesses from construction to automobile agency to create an internal capital market. A large proportion of capital accumulation came from the commissions in import deals, especially during the distinctive circumstances of World War II.[30] In a country which was short of capital and, especially, effective financial institutions and markets, the effective assembling and mobilization of financial resources was an act of Schumpeterian entrepreneurship.

**4. Growth as a diversified business group 1940s-1960s**

This section now turns to the growth of Koç as a diversified business group between the 1940s and the 1960s. The policy regime of import protection and the obstacles to foreign firms provided the key exogenous context for the emergence and growth of multiple business groups. However it would be misleading to describe Vehbi Koç's business strategy in functional terms as a passive response to policy and market conditions. The strategy was proactive and Schumpeterian.

In particular, he began a lengthy and single-minded pursuit of alliances with highly skeptical foreign multinationals. During 1943 Koç became convinced that the Allies would win the war, and there would be many business opportunities with American firms. He sent to the United States a young man, Vecihi Karabayoğlu who was an engineer with an American undergraduate degree. Karabayoğlu returned from the United States with the agencies of several firms, including General Electric (GE) and US Rubber.[31] In 1945, Koç established a company by

the name “Ram (Koç in Turkish) Commercial Corporation”, with a capital of $25,000 in New York City, which was the first company to be established in the US. The primary business of the company was to provide consulting to Turkish official delegations visiting the U.S., which was closed in 1954.[32]

In 1946 Koç himself went to the United States to meet the executives of the firms that he represented in Turkey, and to persuade them to invest in manufacturing in the country. He persuaded GE to establish a light bulb factory. GE Lighting was founded as the first joint venture with a foreign company in Turkey in 1948. Negotiations with US Rubber to build a tire factory were unsuccessful. Koç also met with Ford executives in Detroit about creating a joint venture assembly operation. However Ford, which had serious troubles in its Western European business, had no interest in investing in developing countries, not least Turkey where its prior experience ended in a disaster.[33]

As imports became increasingly restricted by high tariffs, Koç remained doggedly in pursuit of a Ford assembly plant.[34] He found an opportunity to meet Henry Ford II, President of the Ford Motor Company, after his automotive agency won a dealership contest among the 34 agencies of Ford in the Near East in 1956. Koç carried a letter from the Prime Minister Menderes introducing Koç and asking Ford to invest into Turkey jointly with him. Menderes also was offering to support the joint venture through incentives.[35] Ford eventually agreed to support the establishment of a truck assembly factory by providing a credit of up to $300,000, although this came with highly demanding guarantee conditions and the proviso that the name Ford could not be used on the venture. However this time it was the Democratic Party government under Menderes which declined to support the initiative which floundered amidst lengthy administrative delays. Koç waited eight and a half months for a meeting with the Prime Minister

to approve the agreement.[36]

The Ford agreement had become entangled in the conflicted politics of postwar Turkey. Koç had been loosely associated with the ruling political elite during the interwar years. In 1920 he became a member of Müdafaa-i Hukuk Cemiyeti (Association for Defense of National Rights), the predecessor to the RPP, at his father's request. He then regularly met with the RPP and government officials, including the second President of Turkey, İsmet İnönü as he became a well-known businessman. He was even invited to become the Representative for Ankara in the Turkish Parliament for the RPP in 1943, which he declined. The advent of the Democrat Party to government in 1950, therefore, was a problematic development. His businesses' tax records were checked, and his business dealings were investigated in Parliament, even though no allegations of corruption or anything against Koç were proven. Government ministries stopped buying gasoline and other goods from his companies. He was also removed from his position as the Ankara Chamber of Commerce President.[37]

During the late 1950s the Democrat Party increased pressure on Koç to join their party, as it wanted powerful business leaders on their side. Koç did not want to leave RPP, not least that he felt any move would be interpreted that he was trying to get special favors or cover illegal business dealings.[38] The delay in the approval of the agreement with Ford was one of the casualties on this period. Eventually in early 1960 the pressure from the Democrat Party became so strong that Koç had to resign from the RPP, without joining the Democrat Party.[39] This was a shrewd move as within months the Army had seized power, executing Prime Minister Menderes despite international uproar. For the next four decades, the Turkish Army remained the power broker in the country. Koç never re-joined a political party, although he did seek to maintain good relations with new governments as well as the Army.[40]

Despite his political travails, Koç continued to seek a path into automobile assembly. In 1958 he finally secured an agreement with the government under which an assembly plant could be established with Ford, though under strict conditions. Ford executives considered this venture, which involved no equity investment by the company and continued avoidance of the American company's name, as a temporary project that would be unnecessary when import restrictions were relaxed. In 1959 the Otosan company was launched, initially engaged which in the knock-down assembly of Ford trucks. Koç group companies and other Ford dealers in Turkey became shareholders in the new venture.[41] This was a modest venture, certainly compared to the automobile manufacturing facilities that Volkswagen had begun to construct in Brazil in response to market closure policies.[42] However it was Turkey's first automotive assembly plant. In 1963 Koç explicitly noted the first mover advantages he believed would accrue to the first company to start an automotive industry.[43]

Koç became involved in domestic assembly and manufacturing more broadly from the mid-1950s onwards. Policy incentives to private enterprises to move into manufacturing and growing protectionism provided the exogenous context, yet Koç was creative and ambitious in his pursuit of partners. He sought to enter steel furniture manufacturing in 1954 with the Burla family, who were ethnic Jews who owned an established steel trading business. As incomes rose and the demand for white-goods expanded, and there were not enough supply of such goods as washing machines and refrigerators, Koç and his partners decided to make an agreement with a Belgian company for technical assistance in 1959. They bought motors, gearboxes and other parts to make washing machines. The company, then named "Arçelik", was able to make an agreement with Amcor, an Israeli company, to receive technical assistance and purchase parts for the manufacturing of refrigerator in late 1959, after the initial attempts for licensing and know-

how agreements with US and European firms including GE and Siemens failed, as those companies saw the local Turkish market to be too small.[44]

Difficulties in importing key components prompted Arçelik to look for ways to produce components for the white-goods business within Turkey. The company initially began to manufacture plastic plates and gearboxes themselves as there were not any qualified suppliers which could provide these to Koç in the country. For more sophisticated parts, Arçelik made agreements with multinational firms, including technology licenses from GE and German-based Bosch-Siemens. Arçelik soon diversified. Due to the fluctuations in the domestic market for home appliances, the company used their steel plates to make other products, including harvesters and steel bathtubs.[45]

At one level, then, Koç's growth in diversified assembly and manufacturing businesses can be explained by policies which provided incentives for profitable entry into such activities. Rising incomes provided a demand which the low industrialization of the country could not meet. At another level, the way such opportunities were seized needs to be seen as Schumpeter-style entrepreneurship. He was not so much alert to new opportunities, as creating them. Koç perceived how to capture value by acquiring knowledge from the multinational firms who were shut out of the market, but were not especially interested in entering it as it was considered small, marginal and risky. He was relentless in pursuing and negotiating with those international firms. When Koç could not persuade such firms to partner with him, he pursued the innovative gambit of seeking knowledge from innovative firms in the newly created state of Israel. Koç also did not appear to be a rent-seeker benefiting from political contacts. Indeed, he suffered from being affiliated with the political party which had lost power, and subsequently carefully avoided explicit political affiliation whilst remaining on good terms with the power brokers in the regime.

## 5. Reorganization and expansion 1960s to 1980s

The rapid growth of the Koç Group between the 1960s and the 1980s saw attempts to build organizational capabilities, although the search for ideal organizational model to manage such a diversified business proved challenging. This section highlights Koç to change laws that stood against the organizational form he envisioned. It also shows Vehbi Koç's s role in search for a best administrative mechanism and the making of organizational innovations within the Group. Now owner and manager of a large business enterprise, then, Koç continued to function as a disruptor of established legal norms and organizational methods, although he continued to play critical roles in the strategies of the Holding and its operating companies.

### *Creating a Holding Company*

The number of Koç companies increased from the early 1960s. They were nominally independent firms in which Vehbi Koç personally was the dominant voice in strategic decisions.[46] The managerial diseconomies of this strategy soon became apparent as he struggled to manage unrelated businesses, including preventing duplication of service functions. Koç, who was sixty-four in 1965, also began to consider his legacy. He was concerned that his successors might struggle to manage his personal creation, which had become a complex business entity involving multiple outside shareholders.[47]

These challenges were hardly unique to Turkey. Indeed, they had been faced decades previously as firms in the United States and Europe had begun to grow. By this period there was a substantial body of management theory addressing the issues, especially in the United States. In 1960 Filiz Ofluoğlu, a female human resources manager in Koç companies, who held an MBA from Wharton and a doctorate from Columbia University, suggested the creation of a holding

company.[48] Koç asked the American consulting firm of George Fry and the Associates to prepare a report on the concept, and it suggested a plan, to incorporate Koç's companies within a central holding company.[49]

By the time of the consultancy report, there was already an embryonic headquarters structure in place in the form of the Koç Trade Corp, which had evolved as a management and monitoring centre. The building of the company was appropriately named "Central Inn". An initial idea was to change this company into a company that would hold the shares of several other Koç companies.[50] The Koç family would transfer their shares in the several operating companies to the newly established holding company, which would then become the shareholder of the operating companies. Koç also planned to allocate shares to senior managers in the holding company. To balance the family's majority ownership in management, Koç also wanted to give certain shares of the holding company to a foundation under his name.[51]

The creation of such a holding company faced considerable challenges from the Turkish legal system. Turkey had a multiple taxation law which taxed corporate income when a firm transferred profits to a parent firm. This meant that when an affiliate transferred profits to a holding company, the same profit would be taxed twice. In addition, Turkish Civil Law did not appear to allow the establishment of the kind of foundation that Koç envisioned. The upshot was that Koç needed to lobby to get laws either changed or clarified. In 1961 the government legislated to remove the danger of double taxation. Six years later a law was passed permitting the establishment of foundations passed in 1967.[52]

As changes to the law were pursued, it was eventually decided that Koç Trade Corp. would remain as it was, and that another company, "Koç Holding", would be established, in November 1963. Koç Holding became the first such holding company established in the country,

although in time other business groups also adopted this structure.[53] Vehbi Koç himself was the largest shareholder with 73.7% of the equity, with the remaining majority held by his wife, and each of his four children. With the passing of the law on foundations in 1967, Koç established the Koç Holding Foundation which was a pension fund for employees, which also invested in the holding company.[54] In 1969 the Vehbi Koç Foundation was also established to handle the philanthropic contributions of the Koç family. This also took equity in the holding company.[55]

In 1965 the new Holding Company assumed ownership of 28 Koç companies, organized into an automotive group, an industry group, a trading group, and an LPG group.[56] Subsequently the Group grew mainly organically but also by acquisitions. It engaged in both related diversification to produce components necessary for manufacturing operations, such as the creation of an alloy steel plant and a foundry to cast engine blocks, and technologically unrelated areas, including canned food, supermarket chains, foreign trade, banking and insurance, and meat processing. While the former decisions of related diversification mainly hinged on group's resources, the latter especially did on Vehbi Koç's entrepreneurship. For example, when Koç visited Japan in 1969 and saw the role of large trading companies, he thought that a similar export and import company would be a significant asset for the Koç Group. He established Ram Dış Ticaret (Ram Foreign Trade) in 1970.[57] Koç also decided to acquire the majority of the shares of Migros Turk in 1975 when a director of Migros Turk approached him in 1974 as the company decided to exit due to economic and political instability.[58] Koç's decision came despite the group executives, who were alarmed that price controls would cause losses, opposed such a move.[59]

Koç drew particular attention to the nature of the domestic market to justify such diversification in his autobiography, published in 1983:

Turkey is a small country relative to the world's developed countries. Here, it was difficult to grow doing business in one field as it is done in big countries. Our economic and political status has continuously shown ups and downs. If one business made a deficit, the other would make a profit, and as such I acted in thinking that I would make balance.[60]

The number of companies in the Koç Group increased from 28 in 1965 to 92 in 1988, while the product groups also increased from four to seven. The three automotive related businesses, Tofaş, Otosan and automotive supplies, stood as the largest of the Koç businesses in terms of total sales before 1990. See Table 4 which shows sales ratios by activity.[61]

*Table 4 Koç Consolidated Sales by Activities, 1972-90 (% of total)*

| | 1972 | 1975 | 1980 | 1985 | 1990 |
|---|---|---|---|---|---|
| Automotive | 57.2 | 52.4 | 53 | 44 | 45 |
| Industry | 27.1 | 28.6 | 31 | 45 | 45 |
| Commerce | 8.1 | 8.4 | 6 | | |
| LPG | 7.6 | 7.1 | 9 | | |
| Koç Investment and Marketing Company | - | 3.6 | 1 | - | |
| Financial and Foreign Trade Companies | - | - | - | 11 | 10 |

Source: Compiled and calculated from Koç Holding Annual Reports, 1976-90 and reports provided by Koç Holding, Koç Holding Archives.

Note: The table shows figures from year 1972 which is the first year consolidated data is available. The LPG group is renamed as Energy group in figures for 1980 and afterwards.

Financial and Foreign Trade companies include Koç Investment Company. In 1985 and 1988 figures, industry, commerce and energy group's figures are combined, as the companies belonging to those groups have been gathered under a new presidency called the "Industrial, commercial and energy companies' presidency.

Koç used the earnings from individual group companies to provide equity capital for newly established companies in new business fields. Koç family members would also personally invest in such businesses, which served as a signaling device to outside investors.[62] A complex web of cross- ownership structures emerged as a result. The provision of capital for new ventures was another classic example of a business group filling an institutional void. The country continued to lack a modern organized stock exchange market until 1985, when the Istanbul Stock Exchange was established after a major scandal concerning brokerage firms.[63] The banking system before the mid-1980s also focused on short-term credit finance rather than longer-term industrial investment.[64]

***Group administration***

In its initial establishment in 1963, the function of the Holding company was seen as assisting in the formulation of the corporate strategies and execution of the operating companies, as well as controlling and monitoring their budgets. Vehbi Koç and two key managers, occupied the core of the decision making in the Management Council (later to be named Board of Directors) of the Holding.[65] A retiree from Sümerbank, a state-owned enterprise established in 1933 to create and manage diverse industrial businesses, including weaving, mining, cellulose, ceramics, and chemistry, was brought in as a lateral hire to be General Coordinator (later to be named President and then CEO) to assist in administrative matters.[66] The Holding top management was involved in key strategic decisions of the operating companies. Vehbi Koç

continued to have the last say in critical decisions.[67]

The following decade saw a search for structures which would systematize the chain of command, and clarify the authority of each "commanding member" across the entire Group. In 1970 an Executive Committee was formed to mark the first formal operational division of labor within the Holding. The task of the Executive Committee was to execute the decisions that the Management Council had made and to follow up the consequences of such decisions. It also coordinated the relationships between the Holding Company and operating affiliates.[68] Rahmi Koç, the only son of Vehbi, became the first President of the Executive Committee.[69] In 1971, Koç formed an office of planning coordination for establishing long-term (five year) plans for the whole group.[70] The following year Koç set up a "Family Council", which was an administrative mechanism he developed that included both himself and his four children. This council was established to discuss the strategies of the Koç group at the family level on a weekly basis.[71]

The first organization chart of the Koç Holding was drawn in 1973 (see Appendix Figure 1), which omitted the Family Council by design.[72] The organization chart was clearer than the reality. For instance, while the Industry Group (or division) was responsible for the production of white-goods together with other industrial activities of Koç, the Trade Group (or division) was responsible for the marketing of some of the white-goods and other goods as well as international trade. On the other hand, the Automotive Group included auto manufacturing and auto marketing companies under its own Group, but Koç Investment and Marketing Company under the Trade Group also marketed the Automotive Group's products.[73]

Two further organizational developments followed. First was the establishment of Group-wise Research and Development (R&D) Center, pioneered by Bernar Nahum, then Vice-

Chairman of Koç Holding, in 1973. This was the first private sector R&D Center in Turkey, which engaged in incremental technological innovation to adapt foreign technologies to local circumstances. Its main task was to support the automotive and industry groups in design, engineering, technical consulting, optimization, knowledge sharing and future research directions. In practice, it mostly worked for the automotive group, due to Nahum's expertise in that business.[74]

In 1982 the Koç Holding Training and Development Center was founded, whose establishment was originally put forward by one of the human resource managers in the Holding. This Center, whose function was to develop managers in different Koç companies, was the first attempt in Turkey to provide executive education within a business. Koç sought to nurture trained personnel for executive positions within his own organization. Again, it was a classic example of filling an institutional void. The teaching of management education had begun in Turkish universities by the 1970s, although primarily at the undergraduate level. Graduate level training, or executive education, was minimal.[75]

Koç's investment in research and development and management education was pioneering in Turkey, although over time the other large business groups followed. However there was no rapid Americanization of the management system, even as policy liberalization took hold. Vehbi Koç remained firmly in control as the unconditional authority for the whole group in the 1980s, with key strategy-formulation processes and decision-making mechanisms left in the hands of the family.[76]

Koç was interested in the management of the family-owned businesses of his partners, including Siemens, Ford and Fiat, and by the late 1980s had begun to believe that professional salaried managers could play an important role in a family business, which they did not in his

own firm. In 1988 he hired another American management consultancy, Bain & Company, to advise on the changes in organization and strategy required if the Koç Group was to flourish during Turkey's potential transition to a more open economy.[77] Given that the need to focus on core competences and avoid unrelated diversifications had become the mantra of American management thought during the 1980s, Koç received advice that was both predictable and predicted when the firm was hired. Bain recommended reducing the range of businesses in which Koç was involved, and further restructuring of the organization, especially clearly defining roles and responsibilities from the Board down to the operating company managers, and the empowering individual product divisions and business units. Bain also predictably suggested the appointment of a professional CEO.[78]

The Bain report was not acted up. Few businesses had been sold by the time Vehbi Koç died in 1996. There was little progress in the professionalization of top management. The family continued to take active roles in decision-making of the strategies of the Holding and its operating companies as well as the execution.[79] During that year Vehbi's daughter Suna wrote a letter to the Family Council saying "In the coming years, because of increased competition and (Turkey's entry into EU) Customs Union on the one hand, and on the other hand because of problematic governments, Koç Holding will face much more varied troubles. This necessitates a very professional and high quality management."[80] It was four years later that the first professional manager was appointed as chief executive of the Group.

Koç was evidently better at creating a diversified business group than dealing with the resulting considerable organizational challenges. The 2005 data cited at the start of this working paper also shows that Koç was the largest of the Turkish business groups, although it shared with the other firms in the four largest business groups a similar level of unrelated diversification.[81]

Among these groups, Koç pioneered the Holding Company concept, the centralized R&D facility, and the investment in management education, although the other groups followed his example, either directly or through acting on the advice of their own management consultants.[82] Koç remained typical of Turkish business in his unwillingness to cede family control at the highest levels of the Group, even though he sought out American management knowledge through hiring consultants, although did little to follow their advice.

Whatever the merits or otherwise of the Group's existing management structure, the performance of the business was quite good. Table 5 shows that while return on sales and return on assets fluctuated between 1972 and 1990, the return on equity steadily improved.

*Table 5 Financial Performance of the Koç Group at Benchmark Years, 1972-90*

| | 1972 | 1975 | 1980 | 1985 | 1990 |
|---|---|---|---|---|---|
| Return on sales | 0.12 | 0.10 | 0.06 | 0.06 | 0.11 |
| Return on assets | 0.12 | 0.10 | 0.10 | 0.15 | 0.32 |
| Return on equity | n.a. | 0.44 | 0.70 | 1.02 | 1.49 |
| Current assets-current liabilities ratio | n.a. | 1.40 | 1.27 | 1.20 | 1.49 |
| Debt-equity ratio | n.a. | 2.81 | 5.54 | 4.83 | 2.81 |

Source: Compiled and calculated from Koç Holding Annual Reports, 1976-90 and reports provided by Koç Holding, Koç Holding Archives.

The financials in this table reveal a business that was conservatively managed and operated with low debt levels. Evidently there were no pressing financial incentives for Koç to rush to follow the recommendations of Bain and (then) fashionable American management theory.

**6. Conclusion**

This study of the emergence of the Koç business group confirms many of the prevailing

theories explaining the growth of business groups, although a single case study naturally is not intended to serve as a "test" of such theories. Twentieth century Turkey was a textbook case of institutional void in an emerging market. There were weakly developed capital markets, banks focused on short-term credit, and there was a scarcity of skilled management. Government policies provided a broadly favorable context for the growth of domestic business groups. State construction contracts were important for the initial growth of the Koç business. Koç was one of the recipients of the import exemptions and other incentives designed to nurture indigenous business. The new Republic of Turkey constrained the ethnic and non-Muslim communities which had previously dominated modern business, giving opportunities to Muslim entrepreneurs. Protectionism and bureaucratic obstacles on inward FDI meant that foreign multinationals which wished to sell in Turkey had little option but to form licensing and other agreements with local companies. However the case of the Koç does challenge assumptions that government policies were always supportive. Governments are not homogeneous, and in the case of Koç, there were periods when they were as much an obstacle as a benefit.

The story of the growth of the Koç Group can certainly be told in conventional terms of business groups of building contact and organizational capabilities. Evidently administrative mechanisms were developed over time. However such terms hardly capture the reality of developing a large business in a volatile environment. Indeed, this study builds on the insights of Kock and Guillen and Chung that entrepreneurship needs to be incorporated into the determinants of business group growth, especially to account for why particular entrepreneurs built such groups while others, faced with similar exogenous conditions, did not. Moving beyond the personalistic networks and contact capability functions in the entrepreneurial process, the working paper finds evidence both of Kirzner-style entrepreneurship of being alert to the new

opportunities offered by the Republic, and Schumpeterian-style disruption and creation of new opportunities.

In the founding stages of the group Koç showed himself alert to the new opportunities created by government policies, and to his location in Ankara. He extensively reached out to ethnic minorities to build managerial expertise His assembly and mobilization of financial resources was Schumpeterian. However, and departing from previous studies that emphasized the role of entrepreneurial process in the initial phases of group formation, the continued growth of the Koç Group demonstrated the continued importance of entrepreneurship during the postwar decades. Koç proactively sought to attract technological expertise from established businesses in the United States and Europe, which had little motivation to invest in Turkey, and when he could not entice such firms, he sought other partners in Israel. It is superficial to label Koç's search for, and negotiation, of such diverse partnerships solely as "contact capabilities." As he sought to make desired organizational innovations, Koç lobbied to change the legal framework of Turkish business. Koç also took the lead in Turkey in disrupting and changing traditional organizational methods, whilst he stayed behind the significant moves of his Group through the 1990s.

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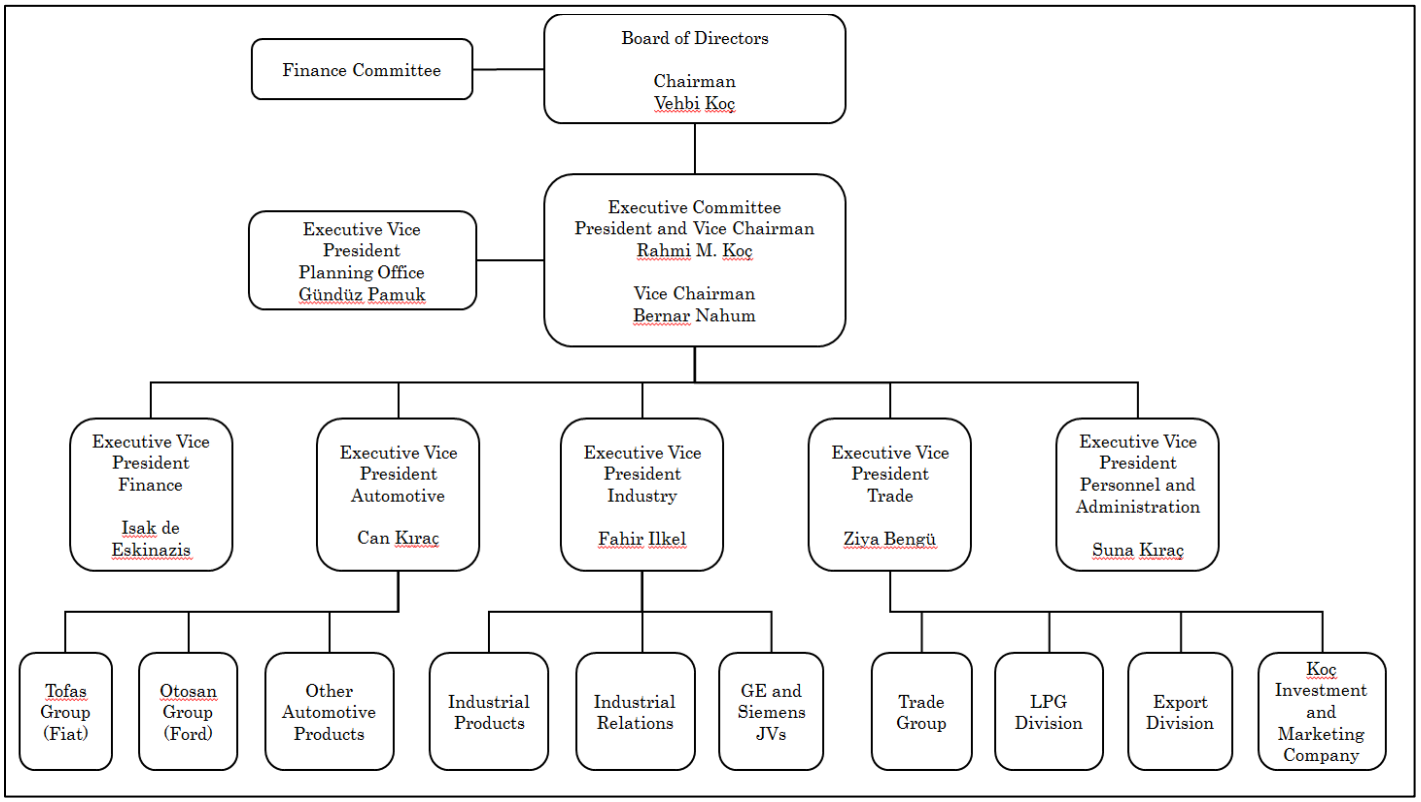
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Appendix Figure 1 Organization Chart of Koç Holding in 1973




Source: Drawn based on Koç Holding Organization Chart, 1973, Koç Holding Archives.

[1] We would like to thank several anonymous referees, Behlül Üsdiken and Şevket Pamuk, and the participants of the European Business History Association annual conference in Uppsala August 22-24 2013 for comments on earlier drafts. A revised version of this working paper is forthcoming in *Business History*.

[2] Colpan et al. (eds.), *Oxford*.

[3] Khanna and Yafeh, "Business Groups".

[4] Schneider, "Business Groups".

[5] Guillen, "Business Groups"

[6] Kock and Guillen, "Strategy", pp. 93-5, 103-4.

[7] Chung, "Beyond."

[8] Larsson and Petersson, ''Tradition'; Jones, *Merchants*; Barbero and Jacob, *La neuva*; Tripathi, Oxford History." A forthcoming volume on the history of business groups in developed economies is Asli M. Colpan and Takashi Hikino (eds.), *Business Groups in the West: The Evolutionary Dynamics of Big Business*, Oxford: Oxford University Press, forthcoming.

[9] Buğra, State; Colpan, "Business Groups."

[10] The definition of business used here includes self-standing enterprises and business groups including private sector businesses and state owned enterprises, both in manufacturing and agriculture, mining and services.

[11] Those largest enterprises were Koç, Sabancı, Yaşar, Anadolu Endüstri, Eczacıbaşı, Çukurova, Akkök and Kutlutaş. Buğra, *State*, p. 56.

[12] Casson et al, 'Introduction' and the associated Handbook provides a useful introduction to the rich economics literature on the theory of entrepreneurship, including the well-known theories of Isaac Kirzner and Joseph Schumpeter.

[13] Buğra, *State*; Colpan, "*Business Groups"*; Ercek, "Exploring."

[14] Kuran, *Long Divergence*; Colpan, "Business Groups".

[15] Kuran, *Long Divergence; Artunc*, "The Protégé System".

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[18] Buğra, *State and Business*, pp. 114-6; Karademir et al. 'The Co-evolution''; Yerasimos, Azgelismislik; Colpan, "Business Groups", Owen and Pamuk, History, p. 26.

[19] Buğra, *State and Business*.

[20] Yilmaz, '4875 Sayili'; Zarakolu, 'Yabanci Sermayeyi '.

[21] Buğra, *State*.

[22] Jones, *Entrepreneurship*, chapter 8; Öniş, 'Redemocratization'.

[23] Koç, *Hayat Hikayem*, pp. 11-23.

[24] Ibid., pp.39-42.

[25] Ibid.

[26] Duruiz, 'Ford' p. 486; Koç, *Hayat Hikayem*, pp.50-1.

[27] Duruiz, 'Ford', p.487.

[28] Koç, *Hayat Hikayem*, pp. 38-9; Interview with Hasen Bengü.

[29] Ibid., p. 53, 62.

[30] Buğra, *State and Business*, pp. 77-9.

[31] Email from Rahmi M. Koç,; *Hayat Hikayem*, p. 69-73

[32] Brynildssen, *International Directory*; http://www.biyografi.info/kisi/vehbi-koc

[33] Ford Otosan, p. 50. *Yıl Projesi*, pp.9-12, Koç, *Hayat Hikayem*, pp. 69-74, 81-84.

[34] Ford Otosan, p. 50. *Yıl Projesi*, pp.8-12.

[35] Koç, *Hayat Hikayem*, pp.136-7.

[36] Birand, *Vehbi Koç*; Ford Otosan, p. 50. *Yıl Projesi*, p. 10.

[37] Koç, *Hayat Hikayem*, pp.129, 132-4.

[38] Ibid., p. 139.

[39] Ibid., pp.139-48.

[40] In 1974 he donated through Koç Group companies and the Vehbi Koç Foundation, a total of 10 million TL ($740,000) to the foundations established to support the Armed Forces and Turkish Red Crescent Society. Dündar, *Özel Arşivinden Belgeler*, *1*, pp. 166-7.

[41] Ford Otosan, 50. *Yıl Projesi*, pp.11-12.

[42] Shapiro, *Engines*.

[43] Tofaş interactive history at http://english.tofas.com.tr/Tarihce.aspx, Koç, *Hayat Hikayem*, p. 87.

[44] Arçelik, *Mamulattan Markaya*, p. 41; Koç, *Hayat Hikayem*, p.75.

[45] Arçelik, *Mamulattan Markaya*, pp. 74, 108-9.

[46] Interview with Rahmi M. Koç.

[47] Nahum, Koç'ta 44 yılım, p. 263; Kıraç, *Anılarımla Patronum*, p. 146. Koç, *Hayat Hikayem*, pp. 94-5.

[48] *Nahum, Koç'ta* 44 yılım, p. 265.

[49] Email from Rahmi M. Koç; *Hayat Hikayem*, p. 96.

[50] Email from Rahmi M. Koç; Interview with Rahmi M. Koç.

[51] Koç, *Hayat Hikayem*, pp. 95-6.

[52] C. Kıraç, *Anılarımla Patronum*, p.146; Koç, *Hayat Hikayem*, p. 96; Email from Rahmi M.

Koç; Interview with Rahmi M. Koç.

[53] Email from Rahmi M. Koç.

[54] Koç's establishment of a pension fund followed a conversation with the chief executive of Siemens in Germany, who had advised him that the step would make his employees more loyal to their employer. Infini, *Dunden Yarina* .

[55] Shareholding structure of Koç Holding in 1963; Koc Holding Archieves; Koc Holding Annual Report, 1970.

[56] Koç Holding Annual Report, 1965.

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[59] Karlıklı, *Migros*.

[60] Authors' adaptation from Koç, *Hayat Hikayem*, pp. 93-94.

[61] Koç Holding Annual Report, 1988.

[62] Email from Rahmi M. Koç; Interview with Temel Atay.

[63] Istanbul Stock Exchange Historical developments at http://www.imkb.gov.tr/25yil/index.html; Capital Markets Board of Turkey at http://www.spk.gov.tr; Celasun and Rodrik, 'Turkish Experience'.

[64] Balkas, "Kredi Kavrami".

[65] The two managers were Bernar Nahum (responsible for the automotive businesses) and Isak de Eskinazis (responsible for finance.).Can Kirac website at http://www.cankirac.com/yazidetay.asp?id=177&kat=10; Koç Holding Annual Report, 1965, Koç Holding Archives.

[66] This was Hulki Alisbah. He drafted the initial Koç Holding project and became especially influential in financial and legal matters during the initial establishment process.

[67] Interview with Rahmi M. Koc; Koç Holding Annual Report, 1965, Koç Holding Archives.

[68] Nahum, Koç'ta 44 *yılım*; Email from Rahmi M. Koç; Interview with Rahmi M. Koç.

[69] Rahmi Koç had a business administration degree from John Hopkins University, and had started working in the business in 1958, when he joined Otokoç. He also became the General Coordinator of the Holding Company (Koç Holding Annual Report, 1965, Koç Holding Archives).

[70] Email from Rahmi M. Koç.

[71] Interview with Temel Atay; Interview with Rahmi M. Koç.

[72] Nahum, *Koç'ta 44 yılım*, Suna Kıraç, *Ömrümden*, p.104; Koç Holding Annual Report, 1973, Koç Holding Archives.

[73] Koç Holding Annual Report, 1973; Interview with Samim Seren; Beko History at http://www.beko.com.tr/tarihce.html.

[74] Email from Rahmi M. Koç; Interview with Rahmi M. Koç; Koç Holding R&D Center Report, Koç Holding Archives.

[75] Üsdiken and Çetin, "From Betriebswirtschaftslehre"; Kipping, Üsdiken and Puig, "Imitation"; Email from Rahmi M. Koç.

[76] Kıraç, *Ömrümden*.

[77] Kıraç, *Ömrümden*, pp. 137-8.

[78] Bain Report, Koç Holding Archives, December 22 1988.

[79] Kıraç, *Ömrümden*, pp. 144-7.

[80] Kıraç, Ömrümden, p. 146. Turkey entered into the EU customs union in 1996.

[81] Colpan, "Business Groups," pp. 491-5. Colpan, 'Business Groups' also shows that Turkish business groups overall are largely diversified being active in twelve 2-digit SIC industries in 2005.

[82] Conversation with Selçuk Yaşar at Yaşar Holding, April 24, 2014.