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Political Economy of the State-Capital Relation in Turkey:  
Internationalization Strategies of the SMEs

Türkiye’de Devlet-Sermaye İlişkisinin Ekonomi Politikği:

KOBİ’lerin Uluslararasılaşma Stratejileri

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## **Abstract**

This thesis investigates the internationalization state of Turkish SMEs by comparing them to those of other countries within the European Small Business Act framework. The main question investigated is that whether government policies and the conditions of the SMEs allow prospects for the internationalization process. A critical analysis of government policies and statistical data are included to bring a multi-dimensional perspective to the argument. This study first gives a theoretical background on SME internationalization theories and barriers to internationalization. Following the theoretical framework, overview of Turkish economy, Turkish SMEs and their contribution to the Turkish economy are illustrated with quantitative data. SMEs are the backbone of Turkish economy but they are hardly competitive internationally and face numerous challenges. Government policies in the last two decades have attempted to strengthen the SMEs and improve their presence in international markets. However, the policies have been less than fruitful, are short-term and accused of being biased towards certain sectors of SMEs.

**Keywords:** Turkey, SMEs, Internationalization, Islamic Capital, AKP

## Özet

Bu tez Türkiye'deki KOBİ'lerin; Avrupa Topluluğu Küçük İşler Yasası çerçevesinde, diğer ülkelere göre uluslararasılaşma durumunu araştırmaktadır. Araştırılan ana soru uluslararasılaşma sürecinde devlet politikaları ve koşulların KOBİ'lere nasıl olasılıklar sunduğudur. Tartışmaya çok boyutlu bir bakış açısı katabilmek için devlet politikalarına eleştirel bir analiz ile istatistiki veriler de dahil edilmiştir. Bu çalışmada ilk olarak KOBİ'lerin uluslararasılaşması teorileri ve uluslararasılaşması sürecinde karşılaşılan engellere ilişkin teorik arka plan verilmektedir. Teorik arka plandan sonra, Türkiye ekonomisi, Türk KOBİ'lerin Türkiye ekonomisine katkıları nicel verilerle gösterilmektedir. KOBİ'ler Türkiye ekonomisinin belkemiğidir, ancak uluslararası alanda rekabette zorlanmakta ve sayısız zorluklarla karşı karşıya kalmaktadır. Son yirmi yıldır hükümet politikaları KOBİ'lerin uluslararası pazarlardaki varlığının geliştirilmesi için önemli girişimlerde bulunmuştur. Ancak, bu politikalar beklenenden daha az verimli, kısa dönemli ve KOBİ'lerin belli sektörlerine karşı taraflı olmakla itham edilmiştir.

Anahtar kelimeler: Türkiye, KOBİler, Uluslararasılaşma, İslami Sermaye, AKP

## **Dedication**

I would like dedicate this thesis to my wife Hale and my daughter Ayşe for their continuous support and encouragement throughout my research and writing process. Without them this thesis would not have been completed.



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## **List of Abbreviations**

AKP: Justice and Development Party

EU : European Union

FDI: Foreign Direct Investment

IFB: Interest Free Banks

IMF: International Monetary Fund

INV: International New Ventures

İŞGEM : Business Development Center

iVCi : İstanbul Risk Capital Enterprise

KGF : Credit Guarantee Fund (Kredi Garanti Fonu)

KOSGEB : Small and Medium Enterprises Development Organization

KÜSGEM : Small Industry Development Center (Küçük Sanayi Geliştirme Merkezi)

KÜSGET : Small Industry Development Organization General Directorate

MUSIAD – Independent Industrialist' and Businessmen's Association

PPL: Public Procurement Law

R&D : Research and Development

SAP: KOSGEB Strategic Action Plan

SBA: Small Business Act

SEGEM : Industrial Training and Development Center General Directorate

SME : Small and Medium Enterprises

SSAP: SME Strategy and Action Plan

TEKMER : Technology Development Center

TESK : Confederation of Turkish Tradesmen and Craftsmen

TOBB : Turkish Union of Chambers and Stock Exchanges

TTO: Technology Transfer Office

TÜBİTAK : Turkish Scientific and Technologic Research Institution

TÜİK : Turkish Statistics Institution

TUSIAD: Turkish Industry and Business Association

TUSKON: Turkish Confederation of Businessmen and Industrialists

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# INTRODUCTION

## CHAPTER 1

### 1.1 Research problem and importance

Small and medium sized enterprises (SMEs) are not only vitally important for the developing economies but are also crucial with their large share in advanced economies as well. Although there are many different definitions of SMEs, they can broadly be described as establishments with less than 250 employees. SMEs make diverse contributions to the world economy. First and foremost is the employment opportunities SMEs generate which has consistently been above 80% on average worldwide. SMEs create between 50% and 60% of value added and are also instrumental in achieving GDP growth. Among OECD countries, more than 99% of all registered enterprises are SMEs and these enterprises account for about 70% of total private sector employment and generate between 52% and 60% of value added on average (OECD, 2016b). A similar scenario also exists in European Union where 98% of all enterprises can be classified as SMEs and they supply 67% of total employment and 58% of gross value added across Europe. On the social level they have a crucial role in improving social well-being and income distribution. SMEs function across many different geographic areas and sectors, employ a wide variety of labor force including low skilled workers and provide opportunities for skill development while also contributing to poverty reduction, access to social services and healthcare (OECD, 2009, 2017b). Other functions of SMEs, while being not as significant, are their contribution to innovative products and services, entrepreneurship and economic diversification. Thus, this thesis will investigate the internationalization level of Turkish SMEs since 2000 within the framework of SBA while also assessing entrepreneurship, innovation and access to finance performance. The research question of this thesis is “What is the current internationalization status of Turkish SMEs and how effective the government policies have been to reach set targets? Are there ulterior motives behind these policies?” In order

to provide an objective evaluation of current SME policies both action plans announced by government and the responses from critics will be included within this thesis.

Despite the undeniable economic and social role of SMEs, the challenges they face are monumental and frequently addressed in both developed and developing economies. The vulnerable nature of SMEs as opposed to that of giant multi-national, national or government held organizations has been recognized as the primary reason that necessitates a certain amount of public assistance. Many countries are implementing programs to provide support for both new and existing SMEs and have placed SME enhancement in the center of their socio-economic policies. There are many organizations that track and compare the business environment of countries with respect to SME development. OECD, World Bank and European Commission provide the public and governments with vast amounts of economic, statistical and comparative data. Objective regional comparisons enable policy makers to identify areas that need further improvement. In addition, a substantial amount of academic research regarding SMEs has been produced in the last couple of decades.

The consensus among all available data and research is that the transformed business environment of the 21<sup>st</sup> century, in particular the age of globalization, has affected the SMEs positively and negatively. Internationalization is one strategy that is frequently sighted as a viable option for SMEs to counter the negative repercussions and take advantage of positive aspects of globalization. However, there are a number of different ways to internationalize for SMEs and depending on the country, legislation and sector these vary substantially. Therefore, an overview of internationalization strategies and theories as well as barriers to internationalization are provided as the theoretical framework of this thesis.

SMEs hold a significant place in Turkish economy since 99% of all enterprises are SMEs employing about 74% of total work force (9 million people) and creating 52,8% of gross value-added totaling 93 billion €. Therefore, they have recently been attracting more attention than ever with respect to the challenges encountered and opportunities to be seized. Turkish authorities have been devising a number of strategies that are aimed at easing the pressures on SMEs and strengthening their competitiveness in the global arena. European Small Business Act and its principles constitute the framework for these strategies and Turkey's progress in providing a thriving environment for SMEs is regularly assessed. While such strategies are crucial, the impact of the measures taken are not fully apparent in economic indicators. Similar to comparable economies, Turkish SMEs are encouraged to internationalize but there are some fundamental problems that need to be solved before SMEs can fully realize their potential. According to the latest available data, Turkey lags behind its counterparts in internationalization level of SMEs since prerequisites of a healthy internationalization including innovation, entrepreneurship and access to finance have not been sufficiently developed. Furthermore, due to the unique socio-political environment in Turkey, SME policies are more populist than mitigating. There has been some criticism from academics and media on the viability of these measures and their role in enhancing the political agenda of the government.

This thesis is structured into three chapters to answer the research question. The first chapter gives a brief background on SMEs to lay the foundation of the research question, its significance and research methodology. The second chapter is dedicated to a theoretical overview of SME internationalization and various barriers to internationalization. In the third chapter, most recent statistical data on Turkish SMEs compared to that of Europe and an update of challenges they face in the internationalization process will be provided with an in-depth analysis of entrepreneurship, access to finance and innovation principles. Each title will be concluded with an

assessment of support mechanisms by government in the post-2000 period. In the last section of the third chapter political and economical aspect of state-capital relationships and their impact on Turkish SMEs will be provided.

The research for this thesis comprises of literature survey conducted to identify different theories of internationalization and barriers to internationalization of SMEs. A concise summary of this research is provided in Chapter 2 which is dedicated to SMEs in general. Chapter 3 provides an insight into the current state of Turkish SMEs and the impact of state-capital relationships on them. In addition to a literature survey, an effort was spent to include the most recent available statistical data which was gathered from different sources such as national databases (TUIK), country reports of OECD, World Bank and European Commission and was graphically depicted where relevant. Reports and performance reviews of government agencies responsible for SME development such as KOSGEB were diligently reviewed and evaluated. For critical analysis of Turkey's SME policies and state-capital relationships, in addition to academic research, recent newspaper articles, books and commentaries were scanned and incorporated into the last section of Chapter 3 which is an objective presentation of Turkish Government's SME policies and its repercussions. Finally, a conclusion on the research topic will be drawn in the last chapter. The main conclusion of this research is that as of 2018, Turkish SME sector is far from being internationalized with respect to SBA criteria, the government has failed to develop long-term sustainable strategies that would motivate and facilitate internationalization for most SMEs, and the underlying reasons of the current situation are not only economical but also political.

## CHAPTER 2

### **THEORETICAL FRAMEWORK**

#### 2.1 Small-Medium Enterprises (SMEs)

Globalization has impacted the world economy significantly not only with increasing opportunities but also with challenges especially for SMEs. Opportunities arise from higher trade and investment potential, deregulation of foreign exchange markets, efficient communication channels, wider transportation and logistics networks. On the other hand, fierce competition from international firms, pressure to upgrade to global standards of viable business practices, country-specific barriers are serious challenges that SMEs in both developed and developing economies face.

The definition of the SME is undoubtedly quite broad as the SME category includes more than 95% all the enterprises worldwide. SMEs constitute a heterogeneous group of enterprises with a diverse range of sizes, capabilities and business activities. A small artisanal workshop producing unique labor-intensive products and a sophisticated software start-up are both considered to be SMEs. This vastness has necessitated various sub-categories with respect to number of employees, profits, total capital, turnover and market position. Nevertheless, the most applied method of categorizing SMEs is by number of employees and turnover as both provide measurable quantitative criteria and facilitates cross-country and cross-industry analysis. Furthermore, the sub-categories determine the level of access the SMEs would have to various support programs, government incentives or financing mechanisms.

The table below depicts a widely accepted categorization of SMEs as per European Commission guidelines.

Table 1: SME Definition of European Commission

Company category	Staff headcount	Turnover or Balance sheet total	
Medium-sized	< 250	≤ € 50 m	≤ € 43 m
Small	< 50	≤ € 10 m	≤ € 10 m
Micro	< 10	≤ € 2 m	≤ € 2 m

Competitive advantage of an SME has also been used to differentiate SMEs. While some are considered “efficiency-driven” others are “innovation driven”. Efficiency driven SMEs capitalize on their ability to operate smoothly with respect to production, quality, product improvement and well-organized logistics. Innovation- driven SMEs excel in and profit from innovative products and services they develop and create their own market.

## 2.2 Characteristics of SMEs

SMEs hold a significant place in the world economy since they are the driving force behind economic growth and market diversity. While numerous studies have been conducted to evaluate their structure and characteristics, SMEs exhibit quite different characteristics depending on their country of origin and sector. Hollansen (2007) stated that SMEs usually have common characteristics with respect to organizational structure, risk adversity and flexibility. Firstly, SMEs are structured around the owner or the entrepreneur who dominates most of the decision-making process. Conformity to the vision and management style of the entrepreneur is expected from the employees for job security. The leader of an SME plays a significant role by initiating innovative strategies and the overall vision is both intense and personal in the small firm context. Secondly, while some SMEs are more risk-adverse than others, SMEs take risks more freely than larger corporations. The degree of risk adversity depends on the past experiences of the firm and boldness of the

company managers. SMEs may take risks if there is an apparent threat to its survival such as increased competition or an opportunity that calls for quick action. In some cases, the entrepreneurs may be over-confident and fail to complete a thorough evaluation before deciding which causes higher risk exposure. In contrast, some SMEs may have very little tolerance for risk especially when they were disappointed in the past. Lastly, SMEs are much more flexible than larger enterprises and can adapt to changes in the environment and supply/demand with more agility. In addition, they have a more direct relationship and communication with their client base and can accommodate the requests of their clients because of the structural and operational flexibility they possess.

### 2.3 Internationalization of SMEs

Internationalization, or presence in global markets, is considered to be an inevitable strategy for the survival of the SMEs. Through internationalization, manufacturing SMEs expect to benefit from improvements in their production inputs such as raw material access, know-how, technology and cheap and/or high skilled labor while trading SMEs welcome a wider market for their products. Furthermore, international collaboration and geographical expansion has become necessary to enable SMEs deal with higher R&D expenses and new product development because of shorter product life cycles.

SMEs which are reluctant to internationalize self-impose restrictions that pose a threat to their long-term survival. Moreover, the tendency to divert to internationalization only at times of stagnant local demand needs to be replaced with a plan that places internationalization at the core of the SME's long-term strategy. Despite the advantages of internationalization, many European SMEs still concentrate on their national markets where the share of exporters and importers of production inputs is only 8% and 12%, respectively. The main reported reasons for these low ratios are lack of financial resources, lack of skills or skilled human capital to tackle internationalization. In order to

have more internationalized SMEs government support remains vital since many SMEs would not consider internationalization without support.

International activities generally start from markets that are culturally and/or geographically close and entry modes that do not require substantial commitment are usually preferred. Sales by the company directly or through agents is usually the first step of a typical SME's internationalization process.

### 2.3.1 Traditional Internationalization Methods

Earlier theories of internationalization focus mostly on market penetration via exports, imports, foreign direct investments (FDI) or collaboration with local enterprises. Exports and imports are the most traditional form of foreign market entry. While being considered a less sophisticated form, it is still the most viable way of entry for many SMEs as it provides an immediate market expansion. In addition, SMEs benefit from multiple revenue sources and decrease vulnerability towards local swings in demand as well as other economic uncertainties. Therefore, market diversification provides a shield for SME's survival (Bartlett C. & Ghoshal S., 1986).

SMEs that are in later stages of being internationally established opt for collaborations with local enterprises by either forming strategic alliances or through subsidiaries and/or branches. There are several motives for such alliances. From the perspective of the host SME more variety of locally offered products and services without product development costs is clearly advantageous, while their foreign partners benefit from the local SME's market knowledge, experience, networks, and established organizational structure. However, these win-win partnerships do not always produce the expected results and quite a few potential problems exist. Some of the suggested reasons for failure of the partnership are dissatisfaction with partner's performance, conflict of interests, cultural variances, trust issues, level of mutual control, and divergence from initial goals. Therefore, alliances and subsidiaries are to be

carefully evaluated with respect to partner selection, growth potential, and sustainability of mutual benefits.

### 2.3.2 Schools of Internationalization Theories

There are three schools of thought that evaluate the internationalization process of enterprises. While SME internationalization process includes elements from all three schools (Coviello and McAuley, 1999), Uppsala (Stage model) is favored by more enterprises, followed by the network and FDI models. Internationalization through the three traditional channels necessitates long-term commitment by SMEs since the benefits are not immediately realized. Entry costs place a financial burden on the SME and a period of adjustment to the foreign environment is inevitable resulting in lower than expected profits in the early stages of entry. In addition, coordination with the parent company may prove to be a formidable task and an expense item for both novice and established internationalized SMEs. Such hindrances and politico-cultural risks may undermine the feasibility of internationalization for the SMEs.

Joint ventures and foreign direct investments (FDI) are a neo-classical approach to international expansion. Directly investing in a country other than one's own entails heightened benefits and risks for SMEs. Foreign presence in the form of branches or joint ventures avails the SME as it provides access to a diverse range of resources such as know-how, competitive labor costs and a first-hand understanding of the host market for a longer-term presence. However, considerably higher capital investment and limited flexibility in exit strategies require more scrutiny on the part of the SME than the above-mentioned options.

FDIs are endeavors that allow a firm to disperse its production to different geographical areas to benefit from lower labor costs, easier access to raw materials, gain geographical proximity and immediate access to target markets. Depending on the perceived benefits, a firm may choose to produce abroad rather than producing at home. Mergers and acquisitions allow a firm

faster entry where they acquire already established foreign factories and companies and take advantage of market knowledge and presence as well as management and technical expertise of the acquired establishment (Wilson, 2007). Alternatively, firms may invest in “greenfield projects” where they develop and build their production facilities and establish their management offices. Firms can choose between horizontal and vertical FDI depending on how they would rather produce their products. In horizontal FDI production takes place in one plant from start to the end and the firm may own multiple plants in different locations all producing the same product. In vertical FDI different stages of production occur in different plants and a final assembly is carried out in one of the plants. Critics of FDI claim that home country suffers from unemployment and lower growth rates as factory jobs and investment are lost to other countries. However, according to OECD horizontal and vertical FDI are actually beneficial to the domestic economy as local firms gain access to foreign markets as well as new know-how and technologies (OECD, 1998).

Uppsala Model (Stage Model) is a widely accepted theory developed by Johansson and Vahlne. The theory argues that internationalization process of enterprises occurs gradually in incremental stages. The main objective of firms is achieving desired levels of growth and profitability while keeping risk exposure at minimum. In pursuit of this objective, firms follow a relatively slow entry by first “acquiring, integrating and using knowledge” of the target market and “incrementally increase commitment to the market” (Johansson and Vahlne, 1977, 1990). The theorists appropriately named these steps as “establishment chain”. The initial step of this model is direct exporting which later is facilitated through independent representatives located in the host country. Other forms of alliances and collaborations such as licensing, joint ventures, franchises could also be pursued during this stage (Pollard, 2001). A wholly-owned sales subsidiary is eventually set up in the third stage when the enterprise is comfortable with the level of their market knowledge they have accumulated in the earlier stages. The final stage which requires the most

commitment is the establishment of a production facility. Each stage prepares the company for the next one in their efforts of integrating into the host country.

One aspect of the internationalization process of Uppsala (Stage) Model is the insufficient knowledge companies have about the foreign market which results in limited ability to make informed decisions. The barriers to entry and cultural differences lead to more uncertainties from the company's perspective and the most risk adverse option is to weigh the compatibility of the company with its present and future partners (Johanson and Vahlne 2003).

Critics of the Uppsala Model emphasize that it is based on a limited study of Swedish firms and that its global applicability has diminished with the changes in international business arena. More specifically, the model is criticized for being too deterministic (Johanson and Vahlne 1993), for lacking leapfrogging (Hedlund and Kvarnland 1993), for excluding acquisition (Forsgren 1990), and for putting too much emphasis on psychic distance (Melin 1992), and for not emphasizing the impact of social networks (Holmlund & Kock 1998). Some critics focus on the theoretical aspects while others argue against its practical implications. The Uppsala model's basic argument is that while internationalizing, firms pass through four consecutive stages of increasing commitment to international activities. Andersen (1993) criticizes that the stages mostly lack an explanation of the mechanisms that takes the firm through them. After testing the incremental internationalization hypothesis, Sullivan and Bauerschmidt (1990) concluded that the empirical evidence did not support this hypothesis. Many critics argue against the incremental, step-by-step character of the model since studies have found that it is possible for firms to skip some of the stages and achieve internationalization rapidly rather than gradually (Chetty & Campbell, 2003). Hollensen (2001) has suggested that companies can truly be considered internationalized when they have different strategies of entry into different markets and that interdependencies among parties need to be considered.

Andersen (1993) argues that the main problem of the model is that there is no explanation on why or how the process starts or the nature of the mechanism whereby knowledge affects commitment. Reid (1984) and Crick (1995) questioned the applicability of theory to operational practice. There are studies that contradict the building blocks of the Uppsala model such as Turnbull and Valla (1986) that have demonstrated that firms vary in their internationalization processes and hardly fit into any predetermined patterns. There are also occasions as suggested by Luostarinen & Welch (1990) where a company may reverse the process and take a step back or halt at a stage avoiding further commitment. Interpersonal relationships among SME owners, entrepreneurs and managers is significant in building partnerships but the concept is excluded from the theory. (e.g. Aldrich and Zimmer 1986; Greve 1995; Johannisson 1996). In response to criticisms Johanson and Vahlne (2009) introduced an update which took into account the relationship and network aspects of the internationalization process.

Network Theory was developed as a response to the limitations of the Uppsala Model which excluded the relationship aspect of internationalization and focused exclusively on gradual market entry. Network Theory emphasizes that firms in a particular market are interconnected in a complex network and this network provides a fast access to all players of that market including buyers, distributors, subcontractors, suppliers, regulatory agencies and government (Johansson & Mattson, 1988). Emerson (1981) describes a network as a “set of two or more connected business relationships” which enables relationships through exchange between its elements. Internationalization is considered to be a “natural development through network relationships” between individuals and firms in different countries (Johansson & Mattson, 1988). Networks act as bridges to the market and relationships within a network are built upon mutual benefits as well as trust and commitment (Mitgwe, 2006). In fact, those firms that do not have access to a network in their target market would take much longer to position

themselves. To demonstrate, firms in newer industries such as high-tech follow a much more aggressive internationalization strategy than the one suggested by the Uppsala model and capitalize on the market intelligence of their network partners. Penetration is facilitated through the network since the firm receives acceptance with the driving force of the trust and commitment it has shown. Networks also lead the path to further internationalization in other markets (Johanson and Mattsson (1988). Building international relationships is deemed to be a priority for both established firms and entrepreneurs (e.g. Aldrich and Zimmer, 1986; Greve, 1995; Johannisson, 1996; Björkman and Kock, 1995) not only to develop an understanding of a particular market but to demonstrate their ambition of going international. For more established firms, previous international market experience of the management plays a crucial role (Bilkey and Tesar, 1977) while the entrepreneur is the “key actor that positions the firm” in the network in smaller firms (Lindmark, 1996; Imai and Baba, 1989). Granovetter (1973) argues that there will be “strong and weak ties” to the information sought within the network.

Clusters are an important tool for SMEs that need to develop their network exposure. Since SMEs have limited resources and experience, they have the option of cooperating with other small firms in a cluster or a network. Such formations enable the SMEs gather their resources, collectively pursue internationalization, minimize risks and costs of foreign entry (Nummela, 2002). Sharing of intelligence, skill development, ability to form overseas alliances are some of the other advantages of clusters that lead to better business performance in terms of productivity and innovation.

### 2.3.3 New Approaches to Internationalization

International new ventures (INV) suggested by Oviatt and McDougall (1994) is a relatively new approach to fast internationalization of companies. An (INV) is defined as a “business organization that, from inception, seeks to derive significant competitive advantage from the use of resources and the sale

of outputs in multiple countries” (Oviatt and McDougall, 1994). International entrepreneurship concept is closely linked to the international growth of the firm which utilizes its network to identify and exploit opportunities in foreign markets. (Coviello and Munro 1995; Zahra et al. 2005; Oviatt and McDougall 2005; Johanson and Vahlne 2009). In other words, the entrepreneur is constantly seeking niches in foreign markets and once a feasible window of opportunity is found the firm acts quickly and enters the market. Therefore, it is also referred to as being an “action-based” process (Ellis 2011). Concepts of INVs such as exploration and exploitation of opportunity are explored in the works of Hohenthal et al. 2003; Oviatt and McDougall 2005; and Johanson and Vahlne 2009. It is apparent that the INVs are assumed to have a system of creating and reacting to opportunities. However, “the element of serendipity” has not been fully explored yet although McAuley (1999); Crick and Spence (2005); Kontinen and Ojala (2011) have mentioned this phenomenon as a possible reason of unplanned internationalization. Meyer and Skak (2002) and Schweizer et al. (2010) argued that “social co-creation”, the evolution of a firm’s network, contributes to the serendipity factor and provides the firm with unexpected business development opportunities.

Born Globals, like INVs, is another term used to define companies that do not fit into any of the earlier internationalization theories. The concept was elaborated on by Knight and Cavusgil (1996) to describe companies which are “small, technology-oriented companies that operate in international markets from the earliest day of their establishment” (Knight and Cavusgil, 1996). Rennie (1993) describes born globals as “competing on quality and value that is created through innovative technology and product design”. In addition, born globals may find homogeneous niches for a range of specialized low technology products in international markets. However, it should also be noted that not all high-technology firms are born globals since global reputation is a factor in market penetration and may pose a barrier to entry for start-ups. This is especially true for firms in technology service sectors such as internet firms

or software consultants where a predominant local presence as well as a local network is essential (Kotha et al., 2001; Borghoff and Welge, 2000; 2001)

Madsen and Servais (1997) draw attention to another element of born globals that should not be overlooked. Although a firm may be new as per its inception date, the founders and managers will most likely have gained experience in the industry prior to the inception and bring their expertise and a variety of other business practices to the new firm. In other words, “born globals already are instilled with organizational routines, decision rules, and capabilities that do not greatly depend on any local or national borders but were gained in the global context. Routines, decision rules, and capabilities can be considered as the ‘genes’ of an organization” (McKelvey, 1978). These genes are not geography specific; rather they indicate a specialized knowledge of a particular segment of the already internationalized industry. The born global already has direct access to knowledge, global network and markets at inception. Previous experience of the entrepreneur and the managers of a born global lays the foundation of the enterprise and is invaluable with respect to evaluation capabilities as its managers are alert about profitable collaborations, opportunities and ventures (Casson, 1982; McDougall et al., 1994). That is the reason why firms whose managers are experienced in a particular field such as exports are more likely to be positioned in that field (Wright et al., 2007).

To summarize, Oviatt and McDougall (1995) identified seven characteristics of successful global start-ups whether they are called INVs or Born Globals and that they adhere to the principal “To become global one must first think globally”.

- 1) A global vision has existed since inception.
- 2) Managers are internationally experienced.
- 3) Global entrepreneurs have strong international business networks.
- 4) Pre-emptive technology or marketing is exploited.
- 5) A unique intangible asset is present.

- 6) Product or service extensions are closely linked.
- 7) The organization is closely coordinated worldwide.



Theory of Planned Behaviour (Ajzen, 1991) utilizes intention as the link between attitude and behaviour of SMEs. According to this approach, decision making about a company's internationalization efforts is a cognitive process and therefore needs to be studied as such (Krueger and Carsrud 1993). Intention of the entrepreneur is viewed to be the most important factor of internationalization. Therefore, not only is entrepreneurship but also internationalization is decided after a series of cognitive processes which integrate perceptions, beliefs, aspirations of the entrepreneur (Ajzen, 1991; Krueger et al. 2000). A chain reaction starting with attitude leads to intention and finally to behavior which may or may not result in the ultimate decision of internationalization. However, this theory still needs to be empirically tested and further studied although it possesses a potential to predict intention as demonstrated in the meta-analysis of Armitage and Conner (2001).

#### 2.3.4 Limitations of Internationalization Theories

Internationalization theories assume SMEs follow a predetermined path after deciding to internationalize. However, there are plenty of empirical research and case studies (Kinkel et al., 2007; Fernandez and Nieto, 2005; Alon, 2004; Gankema et al., 2000) that prove that SMEs' internationalization patterns cannot be theorized. One of the reasons of this is that SMEs are dynamic organizations capable of employing a variety of strategies depending on their expectations from a particular market. Each new theory focuses on an entry strategy but disregards the possibility that these strategies do not have to be mutually exclusive. For example, the stage model and network theory can very well be applied by the same firm at the same time and even in the same market. While the firm may opt for a more cautious entry of incremental stages, it still can build an extensive network in the foreign market. Similarly, firm specific characteristics such as country, size and industry are not taken into account and a general theory is developed which naturally fails to fit all firms. This is demonstrated especially in the Uppsala model which is based on a study of only Swedish firms. Newer theories such as Born Globals mostly

focus on high-tech industries whereas Born Regionals operate in a specific geographic area. However, the most important limitation actually lies in the description of the SME itself. A firm with 250 employees would definitely have more resources and a different vision than one with only 20. There are so far no theories that incorporate the firm size into the equation although “size does matter” according to Wincent (2005), Audretsch and Elston (2000) and Spence (1999). On the contrary, usually larger multi-nationals (Borghoff, 2005), were researched to develop the most frequently referred theories. As Welsh and White, (1980) indicate “a small business is not a little big business” and applying theories developed for larger enterprises would not produce meaningful explanations of internationalization activities of SMEs. The wide range of strategies applied by firms make it impossible to develop a framework that explains how firms internationalize and therefore existing theories can be considered to have failed (Bell et al., 2003; Smolarski and Wilner, 2005).

### 2.3.5 Barriers to SME Internationalization

There are many reasons why enterprises remain local and refrain from internationalization. Numerous studies have been conducted across different geographies to identify barriers and it is evident that while some are globally valid others are more specific to a particular region or type of enterprise. The framework suggested by Leonidou (2004) addresses majority of the internal and external obstacles faced by firms. The diagram below provides a visual summary of Leonidou’s framework of barriers.

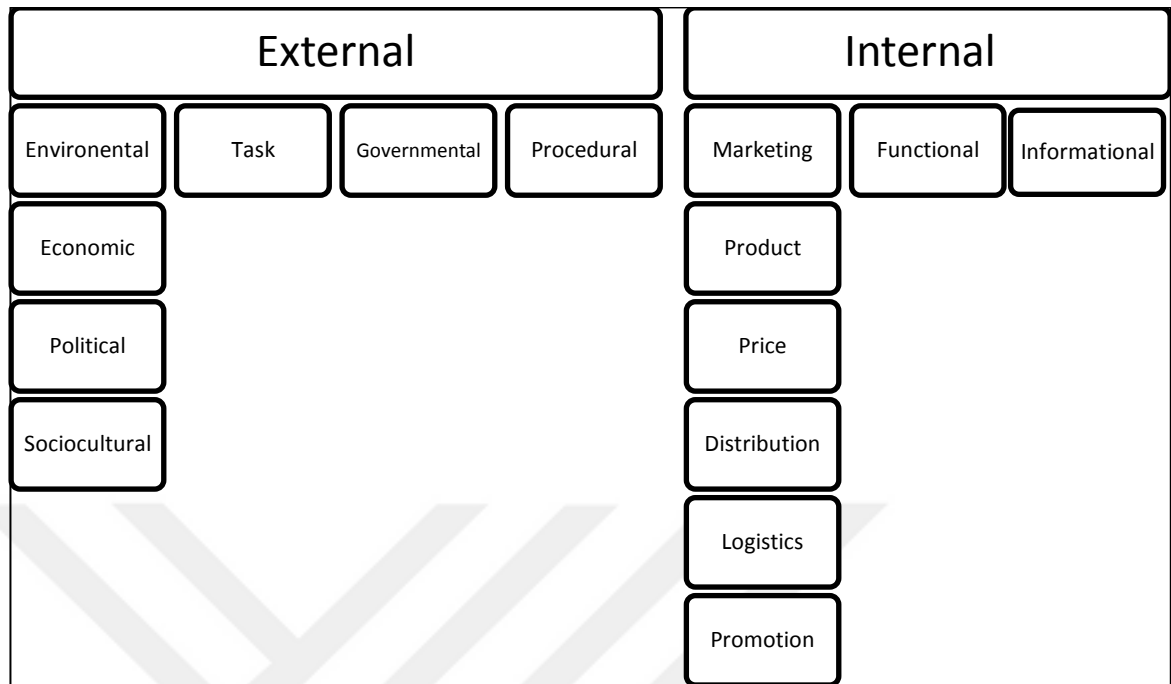


Figure 1: Barriers to Export

External barriers refer to factors that are beyond an enterprise's control. Environmental barriers are macroeconomic conditions, and social, cultural political and legal environment of the target market (Wach, 2015). In addition to a market's own dynamics, the presence of other domestic and international competitors may prevent SMEs from accomplishing a smooth and risk-free market entry and continuous presence. Foreign-exchange fluctuations as well as variations in aggregate supply and demand to SMEs' products and services are also considered environmental barriers. SMEs would need to modify their strategies and behaviour to overcome such market-specific barriers (Neupert et al., 2006; Kahiya et al., 2014).

Governmental barriers refer to the presence and effectiveness of government assistance to exporters. Depending on government's commitment to increasing exports, they may adapt a supportive approach which includes incentives to exporting SMEs, an unrestrictive regulatory framework and assistance to better understand foreign market's dynamics (Leonidou, 2004).

However, if the government refrains from facilitating exports, they actually create a barrier for existing and potential SMEs with their unsupportive attitude. Export promotion programs while having mixed results are one way of tackling governmental barriers. Research by academics including Cavusgil & Jacob (1987), Wilkinson & Brouters (2006), Gencturk and Kotabe (2001) have found export promotion programs to positively impact exports. On the other hand, there is contrasting evidence in the works of Hogan et al., (1991), Keesing et al., (1991) and Lederman et al., (2010) which show that such programs in developing countries do not produce the desired growth in exports mainly because of incompetence of designated agencies, lack of enthusiasm and bias in government strategies. The opposers of export promotion programs claim that import substitution strategies by governments have negatively impacted export capacity of SMEs. SMEs find little motivation in producing for external markets in inefficient and unproductive plants while having to import most of their inputs of production. Some countries have only one agency responsible for export promotion and this also results in insufficient support.

Procedural barriers refer to problems encountered in the operational level and include communication barriers, problems regarding prompt payments from customers, unfamiliar procedures and/or techniques in the target market. Some of these procedural barriers will become controllable to some extent as routine activities are learnt through experience and will no longer be limiting. Uncontrollable procedural barriers, those that are unique to a situation would need to be tackled with support from consultants (Ramaswami & Yang, 1990).

Accomplishing the task of fulfilling customer requirements which vary worldwide is also an external barrier that need to be overcome. Since external markets have unique characteristics their product demands are not identical. Climate, taste, purchase power, geographical elements and customs are some of the factors that cause such differences in demand. SMEs with their limited

product development capacity are unable to meet specific product demands and are prone to losing market share to larger or more specialized firms (Leonidou, 2004). Moreover, shorter product life-cycles and a global demand for constant innovation is an obstacle for SMEs. One way to overcome such challenges is to focus on products with reduced lead times as emphasized in Kotabe & Murray, (2004); Baumol, Nelson & Wolff, (1994); Levin, Klevorick, Nelson & Winter, (1987).

Internal barriers refer to firm specific factors and are controllable. They are divided into three major categories which are marketing, functional and informational.

Marketing barriers generally comprise of all setbacks encountered during product development, sales and distribution process. The product as the anchor of SME's export capabilities needs to be adjusted to international market specifications. However, of the five marketing barriers, product barrier actually has the lowest impact on export performance (Leonidou, 2004). Increasing the quality standard (McConnel, 1979), and changing the design (Kaleka and Katsikeas, 1995) may be necessary for existing product lines. Alternatively, different products may need to be developed to exploit foreign market niches (Leonidou, 2000, 2004). A service network (Howard and Borgia, 1990) also needs to be established to ensure customer satisfaction in the foreign market. The product development stage is therefore a formidable task for SMEs. Leonidou, (2004) has commented on the how the export performance is impacted by three elements of the product barrier. While after sales service has moderate impact, quality standards and product development have low and very low impact, respectively. Due to internal setbacks such as limited resources, lack of R&D skills and inexperienced management, some SMEs avoid the challenge and remain local. Price barrier has the highest impact on export performance due to free-market regulations (Leonidou, 2004). SMEs are expected not only to price their products competitively (Kedia and Chokar, 1986) but also be able to extent credit facilities to international customers

(Moini, 1997). Not benefiting from economies of scale (Terpstra and Sarathy, 2000) and wide global markets, SMEs take profit cuts to ensure their products are appealing to foreign customers in terms of price. The distribution and logistics barriers involve barriers in delivery stages of the products to the foreign market's end-user. In addition to finding the right distribution channels, accessing these channels, local representative and middlemen control issues (Bauerschmidt et al., 1985), and keeping inventory in the target market (Keng and Jiuan, 1989), the duration of the distribution process (Terpstra and Sarathy, 2000), high insurance and transportation costs (Kaynak and Kothari, 1984), securing warehouse space (Barrett and Wilkinson, 1985) are all sources of potential problems for SMEs. Coordinating distribution and logistics and ensuring that products are delivered on schedule and are stored in appropriate conditions require SMEs to invest in human resources experienced in international trade and undoubtedly ties up precious and scarce financial resources. (Cateora and Graham, 2001). Impact of logistics and distribution barriers on exports performance vary with accessing the distribution channel and local representation having the highest impact and control over middlemen having very low impact (Leonidou, 2004). The promotion barrier refers to all advertising, promotion and market research activities that are directed towards the end-users in the export market (Sullivan and Bauerschmidt, 1989). SMEs would also need to modify their domestic promotional materials to comply with government regulations in the target market. (Howard and Borgia, 1990) and export promotional activities such as product launches, participation in industry fairs require SMEs to undergo substantial expenses (Cateora and Graham, 2001). The impact of promotion barrier on export performance is moderate (Leonidou, 2004).

Functional barriers relate to the organizational capacity of the exporter and if the firm does not possess skilled and experienced human capital, financial strength and efficient production processes, it would be quite difficult to exploit foreign markets (Vozikis & Mescon, 1985). For example, a manager or entrepreneur without any international and industry experience would be a

hinderance to the firm's export potential (Athanasidou & Nigh, 2000; Ruzzier et al., 2007). To overcome the functional problems related to production and finance, strategic alliances can be considered where firms agree to share costs, risks and resources (Zhao, 2014).

Informational barriers include limitations in intelligence and knowledge about the target market. They are difficult to obtain for most SMEs although are crucial for a successful entry and competitive advantage. Having the right amount of knowledge reduces uncertainty (Liesch & Knight, 1999) especially for resource constrained SMEs (Johanson and Wiedersheim-Paul, 1975). Internationalization models have suggested various ways of increasing knowledge about foreign markets such as gradual knowledge accumulation, networking, local partnerships, and alliances.

#### 2.4 Conclusion

SMEs show different characteristics across the globe but one common aspect of all SMEs is the challenges they face despite their invaluable contribution to national economies. Therefore, especially in the last decades countries are devising strategies to ensure that these indispensable but underprivileged institutions are supported. SMEs have also been in the radar of international agencies which advise and guide governments in strategy development process. Academics have attempted to devise theories that explain how SMEs can survive global and national challenges by internationalizing. However, these theories are not mutually exclusive in their applications. Due to their flexibility, SMEs utilize a mixture of internationalization strategies depending on the target market and existing opportunities and threats. Exporting will always be the most utilized way of internationalization for a majority of SMEs because it is the most risk-free option. However, the network and market knowledge of the SME will also expand as the firm gains international experience so, when a firm considers entering a different market they may pursue more committed forms of entry such as FDIs or subsidiaries.

An unexpected opportunity such as partnerships or a possible acquisition may also arise in a market and if the SME has enough resources, a strategy just for that market could be devised. Furthermore, as will be elaborated on in the following chapter, in countries such as Turkey the role of government policies in terms of assistance and intervention play a critical role in the internationalization of SMEs. Regional trade pacts, tariff reductions or increases, and government's relationships with target market's authorities, which can be either amicable or strained, are all variable factors that cause theoretical framework's applicability to be limited. Therefore, it can safely be concluded from the information provided in this chapter that since support for SME growth is on the agenda of many governments, a different approach for SME internationalization which incorporates outside governmental support and target market's dynamics needs to be developed by theoreticians.

## CHAPTER 3

### **SMEs in TURKEY**

#### 3.1 Turkish SMEs

##### 3.1.1 Economic Overview and Adaptation of Neoliberalism

Turkey's political stability and the state of its economy are highly correlated. Turkey had three major interruptions to its democracy in military coups of 1960, 1970, and 1980 as the country moved slowly towards achieving political stability and economic strength. Prior to 1980 most of the economic power was held by state corporations and private sector was taking baby steps towards strengthening their capital base and competitive advantages. The economy was a form of "mixed-capitalism" of private and public sectors. A state-dominated economic development policy has been implemented since 1930's. There was a lack of significant entrepreneurial class, inadequate infrastructure and fluctuations in international markets. Turkey followed an inward-oriented development strategy called "Import Substitutional Industrialization Policy" up to 1980 (Karagöz, 2015) which was both interventionist and protectionist to allow domestic industry to grow without being threatened by foreign competition (Elveren, A. and Kar, M., 2005). However, towards the end of the 70's Turkey's economic state was in turmoil with an enormous deficit in balance of payments, reducing growth rates, and elevated inflation (Öniş, 1986).

Turkish economy entered a neo-liberal stage in 1980 with a stabilization move from the government called "24 January 1980" decisions to liberalize trade and introduce the "Export Substitution Model". The transformation was masterminded by Turgut Özal who later became the Prime Minister of Turkey after the military coup of September 12, 1980. International Monetary Fund (IMF) kept a close watch on Turkish economy's progress throughout this

period as inflation and interest rates rallied. Turkey had become a “free-market economy” and Turkish businesses were introduced to the competitive international arena. The results were dramatic as Turkish export and import volumes grew significantly achieving an average yearly growth rate of 10 percent between 1980 and 2000. By 2000, the exports had surged to 27,7 billion dollars from 2,9 billion in 1980. Floating exchange rates and a highly devalued Turkish Lira gave exporters a considerable advantage and enabled this growth. However, the increase in import volume was much larger during the same period and had reached 54,5 billion dollars from 7,9 billion in 1980 (TUIK). Consequently, a wide trade deficit which continues to date was a byproduct of the liberalization process.

A global shift from fordist to post-fordist production system has had an effect on this growth, as well. The post-fordist production system replaces the traditional assembly line of the fordist system with flexible specialization. In the post-fordist era, instead of separating conception from execution by utilizing unskilled labor, companies became forced to shift to skilled labor that produces specialized products (Piore, M. and Sable, C, 1984). Since achieving high levels of specialization of all the parts of a product was almost impossible for most firms, the production chain had been broken down into smaller components which were produced by smaller and more specialized firms. The world-wide growth of the SME sector was largely caused by this trend where SMEs have assumed the role of subcontractors of larger manufacturing corporations. According to Köse (2000), Turkish SMEs, unlike Asian SMEs, specialized in labor intensive sectors such as textiles in the 1980's. The period is also marked with “flexibilization” of the labor force where many worker rights including unionization had been suppressed. Turkish SMEs employed marginal, undocumented workers that had migrated from rural areas to newly developing industrial regions. The wages were low and the workers were not given any fringe benefits. With huge savings on labor costs Turkish SMEs were able to enter international markets with competitively priced products which were mostly private-label ones.

1990's was a period of fluctuating economic progress. The decade started with capital account liberalization. A disinflationary strategy was implemented along with efforts to attract foreign capital. However, these strategies did not produce any positive results and led to an economic crisis in 1994. Government desperately needed support and a stand-by agreement with the IMF went into effect but was short-lived because of undisciplined fiscal policy and unwillingness of the government to honor the requirements set forth by IMF. A second crises exploded in 1998 and this time it was even more severe as it coincided with the Russia crises. The inflation rates reached above 70% and IMF stepped in once again to reduce the rates to single digits.

In the 1990's many large Turkish corporations had a bank under their umbrella for a variety of reasons including providing preferential credit to their subsidiaries. Moreover, the banks were not under strict supervision by authorities and as a result their balance sheets rarely depicted their actual financial state which was less than acceptable. Naturally, a nation-wide banking crisis exploded in 2001 leading to a restructuring period after which most of these corporate owned banks were eliminated from the economic scene. The repercussions of the banking crisis was felt across all industries and facilitated the centralization process of the industry in the coming years although the main intention of the restructuring was to separate economy and politics. Large firms diverted to international financial markets as a source of finance since the Turkish equity markets was still in its earlier stages and was not mature enough. On the other hand, SMEs faced even bigger financing challenges than large corporations because of a multitude of reasons. Banks were reluctant to approve loan applications of SMEs and only a small number of SMEs met the criteria to access capital markets and issue securities. With such limited options SMEs continued to struggle financially although they had the potential of lowering unemployment rates and contribute positively to various other economic indicators. While the foreign trade volume continued to

increase, the major challenge to overcome at the beginning of 2000's was the high interest rates that had skyrocketed to 1500% per annum causing a stagnation in production output and a rentier economy prevailed. When the government stepped in to stabilize the economy during the banking crisis and its repercussions, a series of severe measures were taken and a new monetary policy was implemented by the central bank which had been given autonomy. On the macroeconomic level the goal was to reduce the inflation rates, lower public debt to GDP ratios, restructure the banks' balance sheets and implement a tighter supervision of the monetary system. High inflation had always been an element in Turkish economy and varied between 30% (1986) and 125% (1997) never dropping below 30%. Starting in 2000 high inflation rates were taken under control, and gradually fell down to below 10% with interim fluctuations. However, the high rates pre-2000 were never realized (TUIK). The newly implemented policy proved to be fruitful and the economic indicators showed signs of significant improvement. While the inflation and interest rates continued their declining trend, GDP growth reached pre-crisis levels and notable increases in export and tourism revenues were achieved. An average growth rate of 6,0 % was achieved between 2002-2007 until the global crisis of 2008. In the following two years growth rates were less than satisfactory with a low 0,7% in 2008 and -4,8% in 2009. However, the crisis proved to be overcome when impressive levels of 9,2% in 2010 and 8,8% in 2011 were reported moving Turkey up to the highest rank among OECD countries.

As of 2011, Turkey had become the world's 16th and Europe's 6th largest economy. While these rankings are promising and indicate a major potential for Turkey in being a regional economic power, there are some issues that need to be addressed. In broad terms, Turkey lacks enough natural energy resources to be self-sufficient and depends greatly on imports of energy. Any upward movement in energy costs is felt across all industries and creates a domino effect reducing the competitive advantage of many sectors while also contributing to the widening of the current account deficit in balance of

payments. In addition, Turkey is far from being a high-technology producing country. A third issue to be tackled would be political instability of the Middle East region and its negative effects on the strength of the economy.

Table 2: Macroeconomic Indicators 2008-2017

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
GDP (000 000 \$)	776.640	646.895	772.367	831.691	871.123	950.355	934.857	861.879	862.744	851.046
GDP per capita (\$)	10931	8980	10560	11205	11588	12480	12112	11019	10883	10597
Exports (billion \$)	132	102	114	235	152	152	158	144	143	157
Imports (billion \$)	202	141	286	211	237	262	242	207	199	234
Unemployment Rate	10,0	13,1	11,1	9,1	8,4	9,0	9,9	10,3	10,9	13,0
Inflation	10,1	6,5	10,4	7,8	6,16	7,4	8,17	8,8	8,5	11,9
Growth	0,8	-4,7	8,5	11,1	4,8	8,5	5,2	6,1	3,2	7,4

Source: TUIK

### 3.1.2 Background on SME Support Organizations

SMEs have a long tradition of collaboration dating back to 13<sup>th</sup> century. A system of moral support among businesses called “Ahilik” had existed in almost every city of Anatolia. The main goal of this system was to provide training and social security to craftsmen and tradesmen of the time and to strengthen solidarity among them. Eventually, sectoral guilds which were called “Lonca” became widespread. Their mission was to monitor the overall quality of products, training of new craftsmen, ethical business practices and level of craftsmanship. The guilds were negatively affected by the industrialization in Europe and alternative trade routes to Silk Road. The SMEs of the time were about to disappear when Istanbul Chamber of Commerce was established in 1870 and took immediate action to protect and merge small ateliers. Industrialization efforts were partially successful before the Turkish Republic was founded.

During the early days of the Republic, many institutions were founded such as the Chambers of Commerce and Manufacturing (1924), Türkiye Halk

Bankası (1933) for funding needs and different unions of trades and craftsmen. Industrialization accelerated after 1950 leading to even more unions and associations all of which aimed at improving conditions for SMEs.

Coordinated efforts to gather SMEs under the same roof started in 1973 with the establishment of Small Business Development Centers (KÜSGEM) as a pilot project in Gaziantep within the frame of the International Treaty between the Government of Republic of Turkey and United Nations Industrial Development Organization. KÜSGEM started providing service with community facility workshops for the small –scale industrial enterprises and industrial zones of relatively small sizes were built. The scope of the establishment was broadened with Small Industry Development Organization General Directorate (KÜSGET) in 1983 which aimed at raising awareness of quality standards, modern business practices and increased technology use. This action was in line with the liberalization of the economy in 1980's. Together with KÜSGET another initiative, SEGEM (Industrial Training and Development Center General Directorate), also worked towards improving the standards of the workforce by training high school and university graduates for manufacturing industry. In 1990, KOSGEB was established and took over the responsibilities of previous organizations. KOSGEB's beneficiaries, which were limited to manufacturing SMEs, were expanded to cover all SMEs regardless of industry after employment creation potential and increased value added of other sectors were recognized.

KOSGEB's position as the primary government institution in SME development and support mechanisms continues as of 2018. However, as many government institutions, the vastness of its task description may be a hindering factor in reaching its goals. As a matter of fact, when KOSGEB is compared to its counterparts in developed countries, KOSGEB's budget and employee numbers illustrate that despite having the lowest budget; KOSGEB employs the highest number of employees when compared to Japan, South Korea and the USA.

Table 3 Comparison of National SME Institutions

Country	Population (millions)	Number of SMEs (millions)	Budget of National SME institution (million USD)	Number of Employees of National SME institution
USA	321.4	28	701	2.200
Japan	127.3	3.9	9,300	829
South Korea	50.6	3.35	7,900	1.237
Turkey	77.7	3.5	219	1.248

Source: KOSGEB SAP 2016-2020



### 3.1.3 Definition and Size Distribution

SMEs in Turkey hold a significant place in the economic livelihood of Turkey. Despite their significant contribution, SMEs had been overlooked until 2000s when several initiatives were taken by the government to provide support and guidance to strengthen the competitiveness of SMEs.

After several revisions, the SME definition has been finalized in 2012 which is also in line with that of Europe in terms of sub-categorization and number of persons employed. The table below shows the categorization of enterprises that fall under the definition of SMEs as of December 2016 and their numbers according to by size. However, it should be noted that as Turkish Lira's devaluation against Euro and Dollar continues, the turnover threshold of 40 million TL is unrealistically low to describe SMEs which causes many medium sized enterprises to be excluded from the SME definition. The government has recently announced plans to increase the turnover limit to 125 million TL but as of the date of this paper no action has been taken.

Table 4: Turkish SME Definition

Company Category	Number of Employees	Annual Turnover (TL)	European Definition Turnover	Number of Firms	Share	Share in EU28 Countries
Medium-sized	50-249	≤ 40 Million	≤ € 50 m	22.010	0,89%	1,00%
Small	10-49	≤ 8 Million	≤ € 10 m	50.169	2,03%	6,00%
Micro	<10	≤ 1 Million	≤ € 2 m	2.399.097	96,91%	92,80%
Total SMEs				2.471.276	99,83%	99,8%
Non SMEs				4.238	0,17%	0,20%
Total Enterprises				2.475.514	100%	100%

Source: European Commission SME Fact Sheet 2016; KOSGEB

Based on the distribution table it can be concluded that SMEs in Turkey are mostly micro enterprises that operate with less than 10 employees with

annual turnover of less than 1 million TL. Turkish micro enterprises hold a greater share of 96.9% in the total number of SMEs than their counterparts in Europe which have a 92.8% share. Still, the micro enterprises both in Europe and Turkey comprise over 90% of all SMEs.

A breakdown of major SME sectors is depicted in Figure 2. Turkish SMEs mainly operate in trade and service sectors. Manufacturing has only a 14% share in total SMEs and the weakness of this segment is one of the reasons of low internationalization levels.

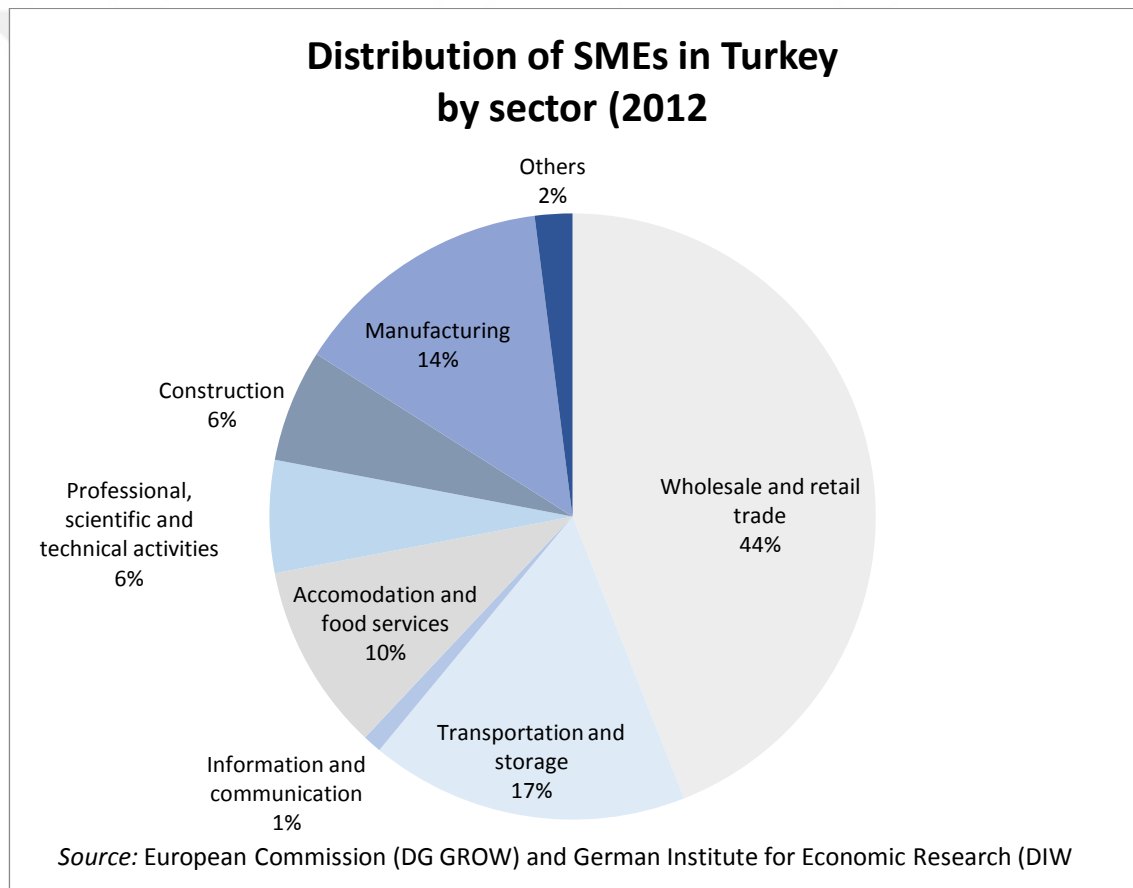


Figure 2 Distribution of SMEs by Sector

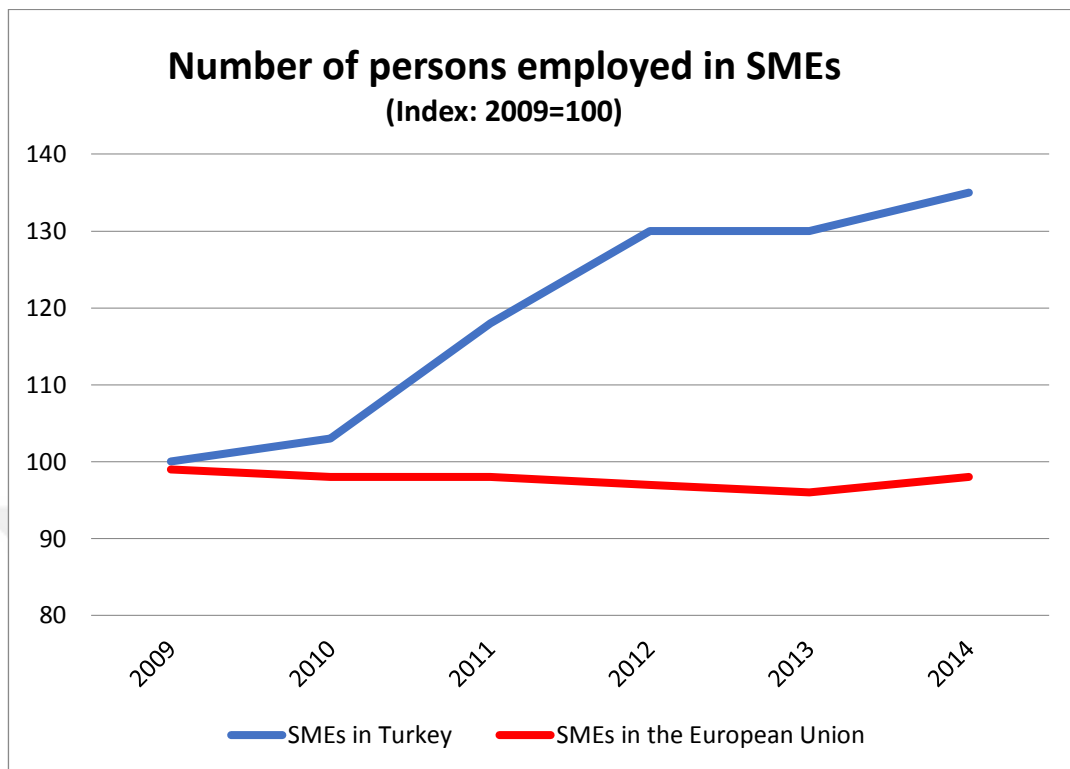
### 3.1.4 Employment and Value Added

SMEs make a substantial contribution to employment figures in Turkey where they account for about 74% of non-finance employment as opposed to 66,8% in Europe. During 2010-2014, growth in SME value-added and employment were 73% and 28%, respectively.

Table 5: Persons Employed and Value-Added of Turkish SMEs vs European Union

Company Category	Number of Persons employed Turkey	Share (Turkey)	Share (EU28)	Value Added Million (Turkey)	Share (Turkey)	Share (EU28)
Medium-sized	2.222.589	18,27%	17,00 %	37.155	21,08%	18,30%
Small	1.549.602	12,74%	20,20 %	22.188	12,59%	18,00%
Micro	5.222.751	42,94%	29,50 %	33.738	19,14%	21,20%
Total SMEs	8.994.942	73,95%	66,80 %	93.081	52,80%	57,40%
Non SMEs	3.168.972	26,05%	33,20 %	83.206	47,20%	42,60%
Total Enterprises	12.163.914	100,00%	100%	176.287	100,00 %	100,00 %

Source: European Commission 2016 Fact Sheet – Turkey



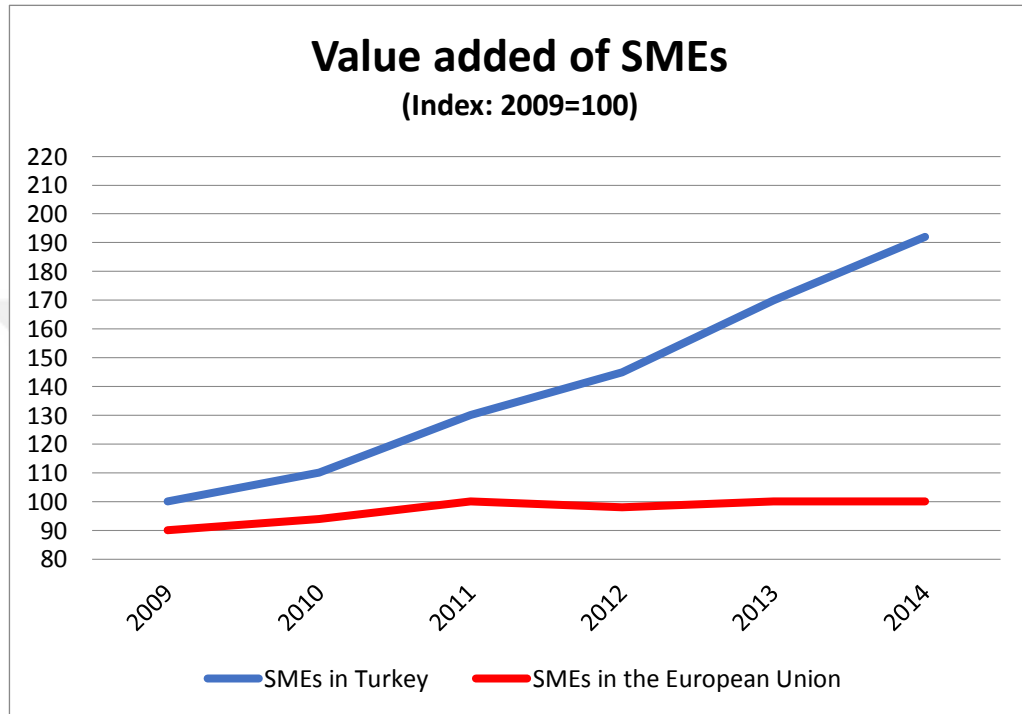
Source: European Commission 2017 Fact Sheet – Turkey

Figure 3: Number of Persons Employed in SMEs (2009-2014)

The number of people employed by Turkish SMEs show quite a substantial improvement compared to European SMEs. One of the major differences between European SME and Turkish SMEs is the share of micro enterprises in total employment. While Turkish micro companies had a 42,9% share in total employment, this figure was 29,5% for Europe in 2016.

Turkey has managed to increase its GDP per capita to \$13,000 but the income inequality between the western and eastern regions is prevalent and unemployment rates are alarming. Paradoxically, while there is a widespread complaint of lack of skilled personnel, a 25% of university graduates are unemployed. SMEs have an untapped potential to contribute to the normalization of these skewed statistics.

Although the value added showed considerable increase compared to that of the European Union between 2009-2014, the need to increase the value-added of small and micro enterprises is apparent as indicated in Table 5.



Source: European Commission 2017 Fact Sheet – Turkey

Figure 4: Change in Value Added of SMEs (2009-2014)

International trade is dominated by international value chains since stages of production take part in different countries. Up to 75% of all world trade is now comprised of intermediate inputs, capital goods and services (International Trade Center, 2017). Integrating into global value chains is one of the most viable internationalization strategies for Turkish SMEs because of Turkey’s strategic location and proximity to main regional business hubs. Supplying high value-added components to lead firms in the value chain would substantially increase income generated. However, Turkish SMEs although making progress are far from fully exploiting opportunities Turkey’s location offers. Currently, Turkey is an exporter of low value-added goods where the price per kilo is 1,36 dollars. This figure has never exceeded 1,6 dollars since

2005. Low R&D investments and ability to produce medium-high technology products is the main reason behind these low rates. This topic will be further discussed under the Skills and Innovation title.

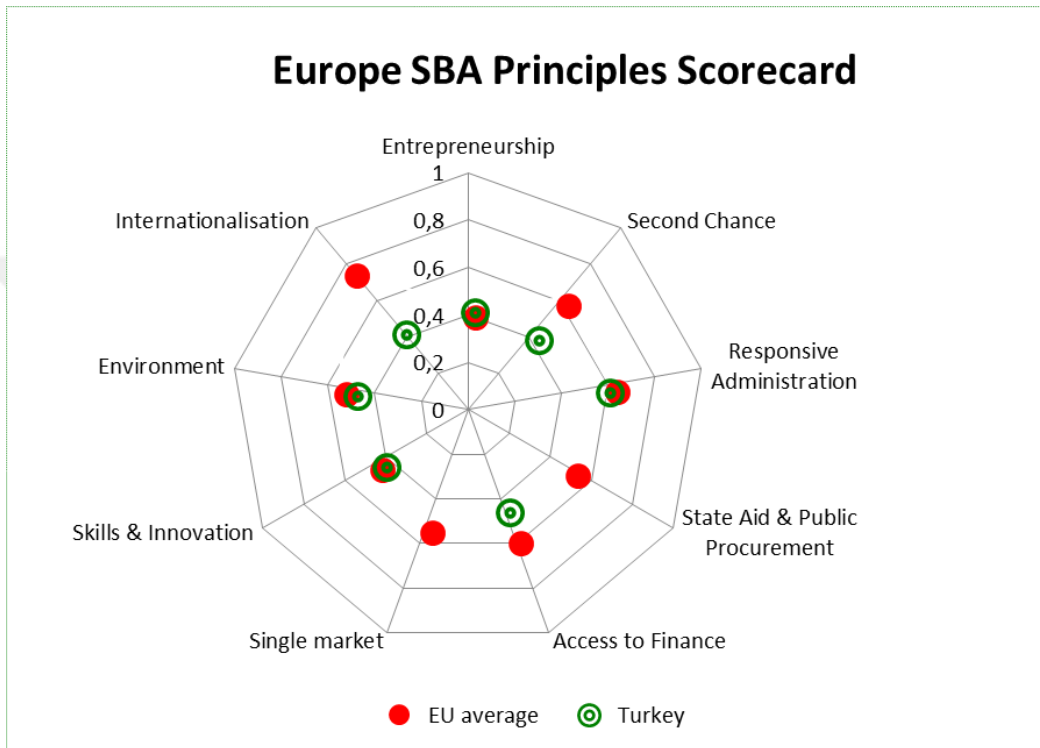


Figure 5 Export Goods Price per Kilo (USD)

### 3.1.5 Evaluation of Turkish SMEs

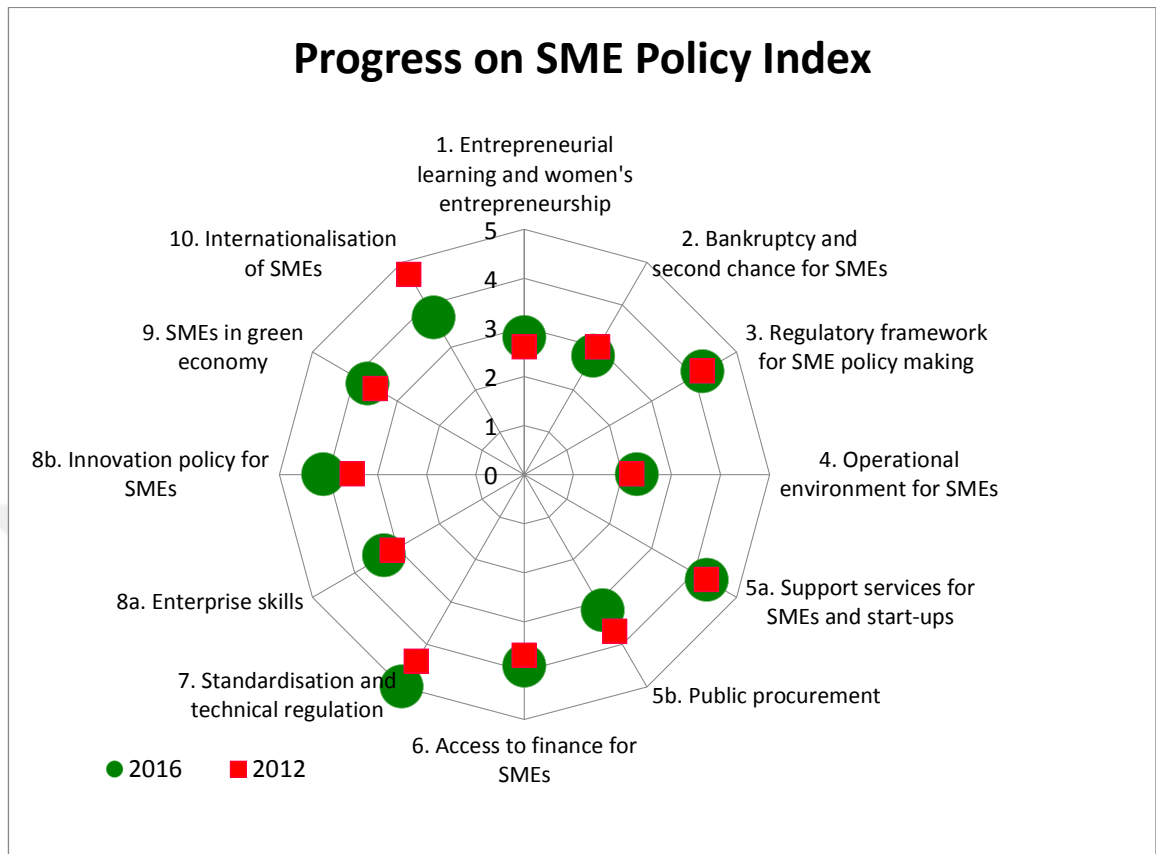
Turkey has acceded to the Small Business Act in 2010 and overall state of Turkish business environment for development of SMEs is being compared annually to that of Europe average per the guidelines and principles of the act. An analysis of Turkish SMEs with respect to the SME principles reveals that while Turkey exhibits strong performance compared to Europe average in “Entrepreneurship”, two areas that require significant improvement are “Internationalization” and “Access to Finance” as depicted in Figure 6. In addition to EU evaluations, a 2016 study of SMEs in Western Balkans and

Turkey published by OECD and EU reveal that Turkey’s internationalization level has deteriorated from 2012 to 2016 as demonstrated in Figure 7. However, compared to Western Balkan countries, Turkey has implemented better SME support policies during the period (OECD & EU, 2012).



Source: EU 2016 SME Fact Sheet Turkey

Figure 6: Turkish and European SME Performance Comparison



Source: OECD Western Balkans and Turkey SME Policy Index, 2016

Figure 7 - SBA Scores of Turkey 2012 vs 2016

Internationalization has been emphasized as the number one area that needs considerable improvement to reach developed world standards. In fact, the Fact Sheets published by EU since 2014 have continuously highlighted “internationalization” as lagging behind European countries. While this title encompasses only several indicators all of which are below EU averages, the other titles that lead to improved internationalization, such as innovation and skills, entrepreneurship and access to finance need to be considered holistically.

Turkey has recognized the need to overcome the “Middle-Income Trap”, which can be broadly described as the stagnation in the economies of countries after having reached a certain per capita income level. An export-

oriented growth strategy complimented by improved productivity, competitiveness and industrialization is incorporated in the 2007-2012 Development Plan. By 2023, Turkey aspires to reach a 500 billion USD threshold in export figures. Private sector is in the center of this strategy and government is proactive in providing the necessary supports. Overall there are 9 action fields and 19 strategic targets that have been identified as priority (SAP 2017). Three anchor fields, namely entrepreneurship, innovation and technology, and access to finance, will be discussed in this thesis to evaluate their roles in current internationalization state of Turkish SMEs.

Internationalization has been identified as one of the strategic fields to compliment the Development Plan of Turkey. Accessing global markets with competitive products requires a carefully planned strategy that integrates a variety of factors. Supports for SMEs that hold the potential for going global are channeled via KOSGEB under several programs. In addition to financial support via credits, SMEs are encouraged to take advantage of these programs.

Partnership with European Enterprise Network (EEN) has enabled SMEs to access a global platform which tracks product demand from international markets. Exporting SMEs are deemed to be a priority in the distribution of budgeted support funds and other means of support are provided via Ministry of Economy, Turkish Exporters' Assembly, KOSGEB and Turk Eximbank. However, strategic, operational, legal, financial and linguistic support systems could be further improved and documentation burden on the SMEs could be decreased. Export and import documentation processes are still cumbersome. As per SAP 2015-2020 specific actions that have been taken to reach internationalization targets are:

- Organization of international trade shows and fairs is subsidized
- Export certification expenses are more widely defined to also include expenses incurred as result of participating in global value chains and said expenses are also subsidized.

- Provisions on international competitiveness are broadened to allow a more flexible definition of supportable activities

Internationalization of an enterprise constitutes both import and export activities at an international level. There are different approaches to the internationalization process of an enterprise as summarized in Chapter 2. Developments in information and communication technologies have made internationalization a more attainable goal than ever before. The number of enterprises in both trade and manufacturing sectors have consistently increased reaching 58,000 by 2013 and is targeted to reach 60,000 by 2018. While the total number of exporting SMEs has increased about 30% between 2009 and 2013, the share of exporting SMEs in total SMEs is only 1.6%. As demonstrated in Table 6 the objective of increasing the number of exporting SMEs does not seem to have been reached as per most recent available data. (KOSGEB SAP 2017-2020)

Table 6: Number of Exporting SMEs by Sector

	Number of Exporting SMEs				Percent Change			
	Manufacturing	Trade	Other	Total	Manufacturing	Trade	Other	Total
2009	19.579	19.709	5.526	44.814				
2010	19.820	20.173	5.777	45.770	1,23%	2,35%	4,54%	2,13%
2011	21.311	22.298	6.334	49.943	7,52%	10,53%	9,64%	9,12%
2012	23.094	23.965	6.640	53.699	8,37%	7,48%	4,83%	7,52%
2013	24.919	26.096	6.692	57.707	7,90%	8,89%	0,78%	7,46%

On the other hand, Table 7 highlights the fluctuating export volumes of SMEs. For example, 2013 is marked by a decrease of 0,4% in overall export volume. However, the decrease in export volume of SMEs was 5,8% and can be interpreted as SMEs being more vulnerable to global economic crisis. Overall, Turkish SMEs realize about 60% of total exports and this figure is proves that internationalization is not a priority for most SMEs. As a matter of

fact, as Turkey distanced itself from Europe and hopes of EU membership were shattered after 2007, SMEs lost motivation and diverted their attention to local business opportunities and markets outside the EU. Middle East in particular has increased its share in total exports while Europe's share is deteriorating. However, the reason of such a decline is more political than economical as will be discussed further in the next section.

Table 7: SME Export Volume

	SME Export Volume (Million USD)	Percent Change	Total Export Volume (Million USD)	Percent Change	Share of SMEs in Total Exports
2009	60,675		101,394		59,84%
2010	68,169	12,35%	113,391	11,83%	60,12%
2011	80,262	17,74%	134,682	18,78%	59,59%
2012	95,278	18,71%	152,255	13,05%	62,58%
2013	89,751	-5,80%	151,570	-0,45%	59,21%
2014	88,575	-1,31%	156,900	3,52%	56,45%
2015	79,226	-10,55%	143,824	-8,33%	55,09%
2016	78,812	-0,52%	142,405	-0,99%	55,34%

Source: TUIK Exports

Almost 30% of all SME exports were realized by micro enterprises between 2009-2013 while 40% is realized by small size firms. The average export volume per enterprise is 0,9 million USD in micro enterprises, 1,7 million USD in small enterprises and 3,7 million USD in medium enterprises.

Table 8: SME Exports by Size

	Micro		Small		Medium		SME Total	
	Number of SMEs	Export Volume (Million USD)	Number of SMEs	Export Volume (Million USD)	Number of SMEs	Export Volume (Million USD)	Number of SMEs	Export Volume (Million USD)
2009	23.954	17.562	15.717	25.493	5.143	17.620	44.814	60.675
2010	23.229	18.552	17.170	27.866	5.371	21.752	45.770	68.170
2011	25.046	20.435	19.167	34.663	5.730	25.164	49.943	80.262
2012	27.207	31.376	20.195	36.942	6.297	26.960	53.699	95.278
2013	28.786	27.050	21.871	36.458	7.050	26.243	57.707	89.751

source: TUIK Exports

It should be noted that since enterprises with less than 250 employees are classified as SMEs, SME export figures includes export volumes of foreign trade subsidiaries of big corporations. This classification bias explains why trade sector's export numbers are twice that of manufacturing sector's in some data sources. In order to gather more realistic data on SME exports an initiative should be taken to include financial parameters collected via Entrepreneur Information System in addition to employee numbers to exclude aforementioned subsidiaries that are not technically SMEs.

Exporting products and/or services and positioning on the global value chains are two possible ways of internationalization for Turkish SMEs. In the second option, if SMEs collaborate and integrate with enterprises that have an international competitive advantage, securing a position on the higher value-added levels will be facilitated which in turn will increase export volumes reached. However, this process needs to be carefully planned as any wrong decisions or moves would eliminate the company from the international market.

Turkish SMEs aspiring to internationalize are not sufficiently aware of support programs offered by government and non-government institutions. Lack of information results in an inevitable reluctance towards internationalization especially in micro and small enterprises. A more proactive outreach program to encourage SMEs to obtain information and education before they can consider internationalization is needed. Moreover, majority of Turkish SMEs have a passivist attitude towards international expansion and development. The main reasons for this attitude are narrow vision of the management, noncompetitive product lines, inconfidence, lack of competent personnel, financial constraints, lack of knowledge and the pressure of keeping up with day-to-day workload of the enterprise. Elevating the competitiveness of SMEs in the global arena requires the commitment of the firm in addition to outside support. Business owners are reluctant to invest the time and money into long-term goals and are more concerned about immediate capital accumulation. Therefore, there are almost no SMEs with successful global presence both in terms of internationally recognized brands, high value-added products and market expansion. Therefore, providing support to match SMEs with their target markets and potential strategic partners is needed once an initial education of business owners is completed. Some of the issues to be addressed in such programs are the importance of manufacturing and exporting of final products identical to the samples sent, adhering to shipment deadlines, and quality standardization.

Share of high technology products in total exports is provided by TUIK on a monthly basis. It is a significant indicator since one of the recent targets is to increase the share of these products in total exports which has never reached above 4,5%. This objective has to be tackled on various fronts: The import dependency of raw materials and parts should be reduced and R&D and innovation efforts of SMEs should be supported.

To sum up, authorities have identified internationalization as the first strategic purpose of the SME Action Plan and have stated this purpose as “Improving production and management skills of SMEs and their innovative and high value-added product/service production capacities as well as increasing their competitive power in the global market.” The following targets were deemed to be essential in reaching the ultimate goal of increased SME internationalization:

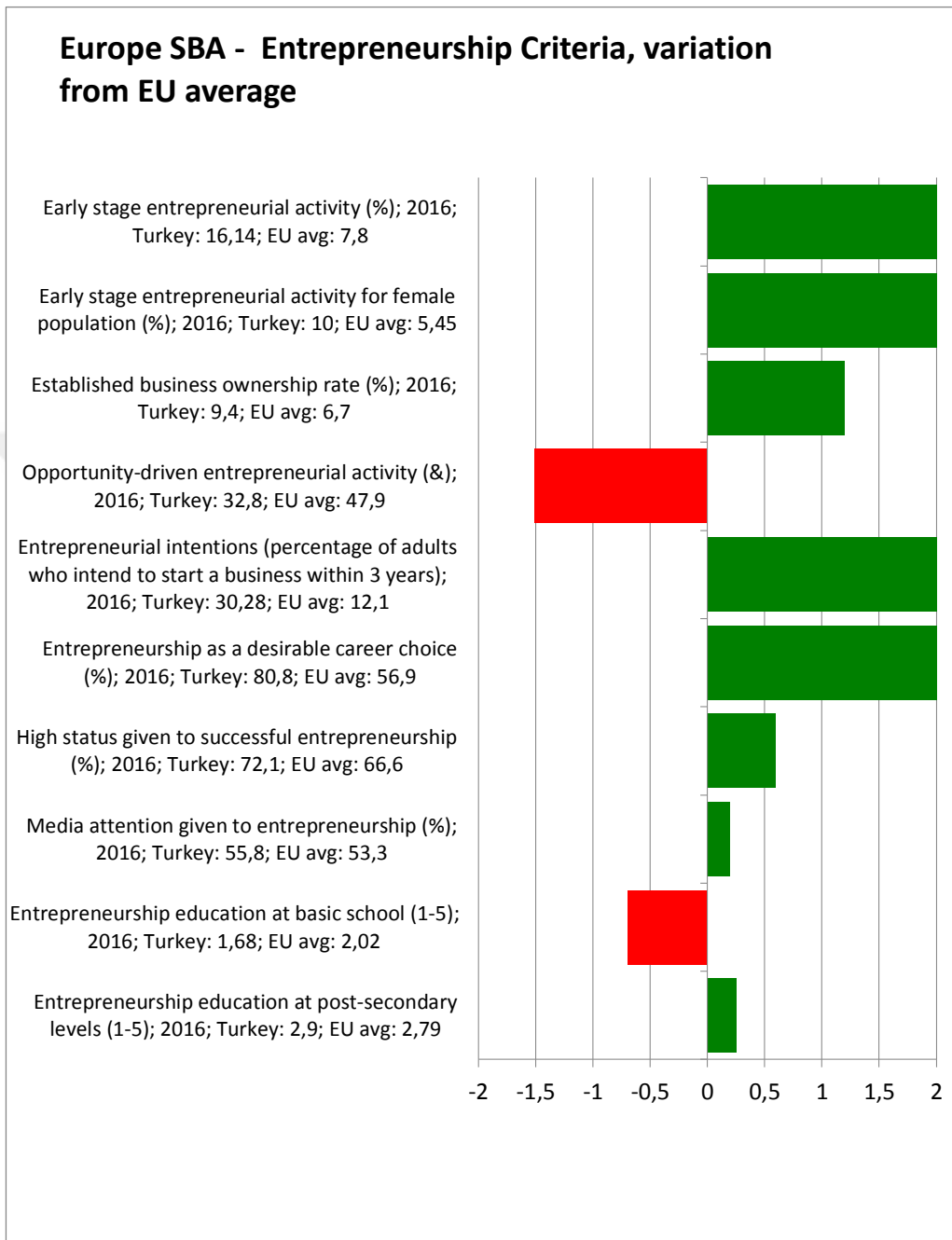
- Development of R&D and innovative activities and their transformation into economic values will be ensured.
- Access to financing will be facilitated.
- Contribution will be provided to improve the production and management skills and collaboration cultures of SMEs in order to increase their shares in economy and their level of efficiency.
- Opportunities and abilities of SMEs to access foreign markets will be improved to ensure their internationalization.
- Supports for issues with priority in the national policy documents will be improved.

It is apparent from the goals listed above that internationalization problems of SMEs have other underlying reasons such as underdeveloped entrepreneurship culture, lack of commitment to innovation and having limited access to finance. These constraints will be discussed in detail along the lines of SBA criteria in the following sections.

A developed entrepreneurship culture is one of the most essential elements of successful SME internationalization. Turkey’s comparatively younger demographics is an advantage from this perspective and Turkey’s SBA scores demonstrate an undeniable potential to make further progress. Consequently, Turkey has fared better than its European counterparts in comparative reports. Figure 8 compares Turkish SMEs to the European average with respect to issues related to entrepreneurship. The only area Turkey fares worse than the EU average is opportunity-driven entrepreneurial

activity as of 2016. This figure indicates that Turkish SMEs are either reluctant to seek opportunities or do not know how to identify such opportunities. On the positive side, early-stage entrepreneurial activities stand at 16.4% overall and 10% among females, more than double those of Europe. Entrepreneurship is viewed as a desirable career choice by 80% and 30% of adults aspire to start a business in the next 3 years. Entrepreneurs are respected by 72% and media coverage stands at 56%.

However, lack of knowledge on proper business planning and budgeting prior to establishment of an enterprise greatly reduces the odds of success. Shying away from being an entrepreneur because of the risks involved is a common situation. Inability to obtain credits has also been a deterrent since banks are reluctant to extend start-up credit lines to new businesses unless a personal collateral is provided. Turkey possesses some unique characteristics which are also apparent in the management of SMEs. Some SMEs aspire to grow and reach a level that would either make them attractive to investors or a major player in the industry, while others are looking to sustain or improve their present position and provide its owners a decent level of income. The latter objective is especially true for micro-enterprises that operate in relatively less sophisticated industries.



Source: EU SME Fact Sheet 2016 - Turkey

Figure 8: Comparison of Entrepreneurship between Turkey and EU Average

The high costs associated with starting a business and a complex registration process is another factor of low entrepreneurship levels. According to World Bank Doing Business Report 2017-2018, Turkey ranks 60th out of 190 countries in terms of ease of doing business. Although this is an improvement from the previous years' ranking, registration process is still cumbersome. Bureaucracy and level of “red-tape” is high and a more SME-friendly business environment with respect to other issues such as legislative procedures need to be established. Turkey has reduced the number of procedures required to start a business considerably in the last decade and has managed to reach the Eastern Europe and Central Asia average of 6 procedures.

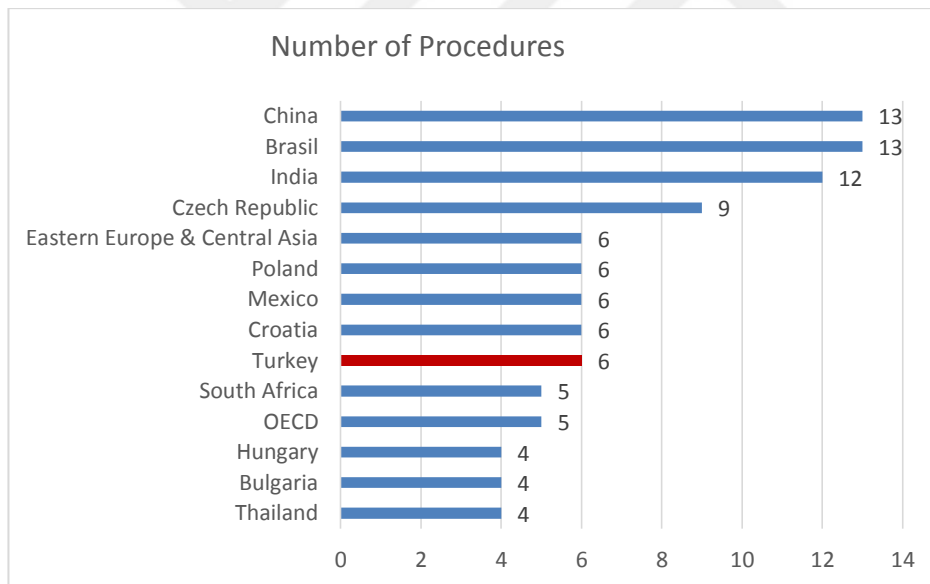


Figure 9: Number of Procedures, World Bank Doing Business Report, 2017-2018

Cost of starting a new business as percentage of GDP per capita is quite high in Turkey which is why younger generation with limited personal resources largely depend on external funding or government support before establishing an SME. In fact, the paid-in minimum capital requirement, which is the amount that the owner/entrepreneur needs to deposit in a bank or a third

party before registration or up to three months after incorporation, currently is 2,500 TL. This figure is one fourth of the total capital required for incorporation which is 10,000 TL. The paid-in minimum capital stands at 7,8% of the total GDP per capita. Other costs associated with incorporation are roughly about 11% of GDP per capita and places Turkey as one of the higher-cost countries and well above Europe and Central Asia average which is only 7%. (Worldbank, 2017-2018)

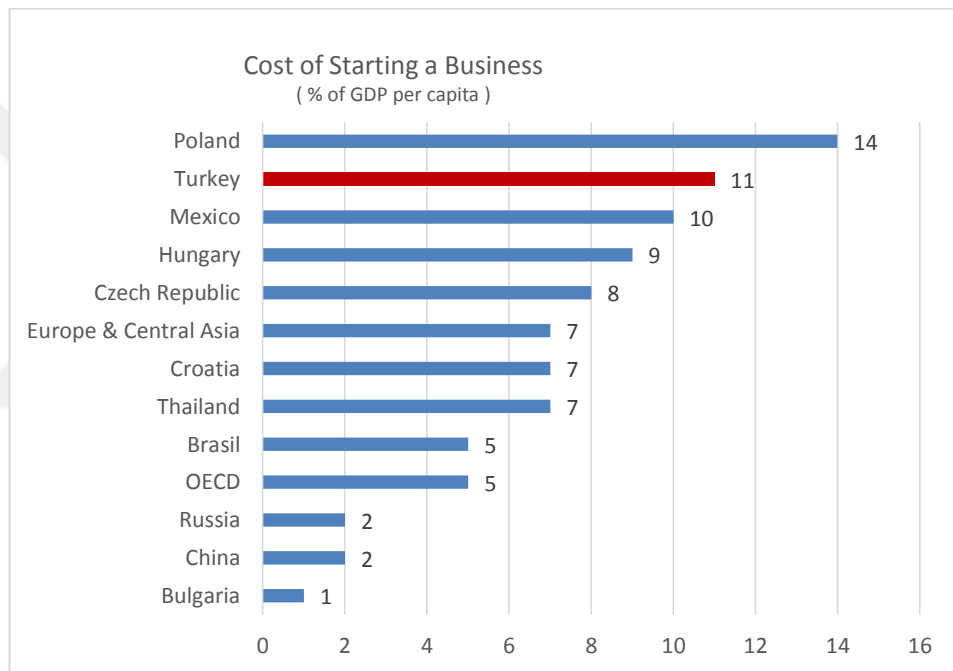


Figure 10: Cost of Starting a Business, World Bank Doing Business Report, 2017-2018

However, as of 2017 various institutions are making a notable effort to encourage entrepreneurship by relaxing credit requirements, setting up collateral funds and providing extensive educational programs for present and future entrepreneurs. In particular, KOSGEB and TUBITAK have been working towards forming new funding mechanisms, support for female and unemployed prospective entrepreneurs and extensive training sessions.

Entrepreneurship which had been largely excluded from the secondary and tertiary education curricula previously is gradually being implemented into education starting with classes on entrepreneurship in universities.

“Technoentrepreneur Support Programme”, which targets innovative future entrepreneurs and SMEs was implemented by the Ministry of Science, Industry and Technology. The Ministry transferred the implementation of the program to TÜBİTAK in March 2016. TÜBİTAK also created 25 Technology Transfer Offices (TTOs) in different universities. Training sessions and support for new entrepreneurs have also been improved by KOSGEB with the adoption of the ‘Entrepreneurship Support Program’. The ‘Technology Transfer Accelerator (TTA) Fund Turkey’ was implemented by the European Investment Fund (EIF) on behalf of the Ministry of Science, Industry and Technology. It was created to promote the commercialization of investment opportunities of universities or research centers, proof-of-concept projects and Intellectual Property (IP) assets/projects. As a result, two venture capital funds became operational.

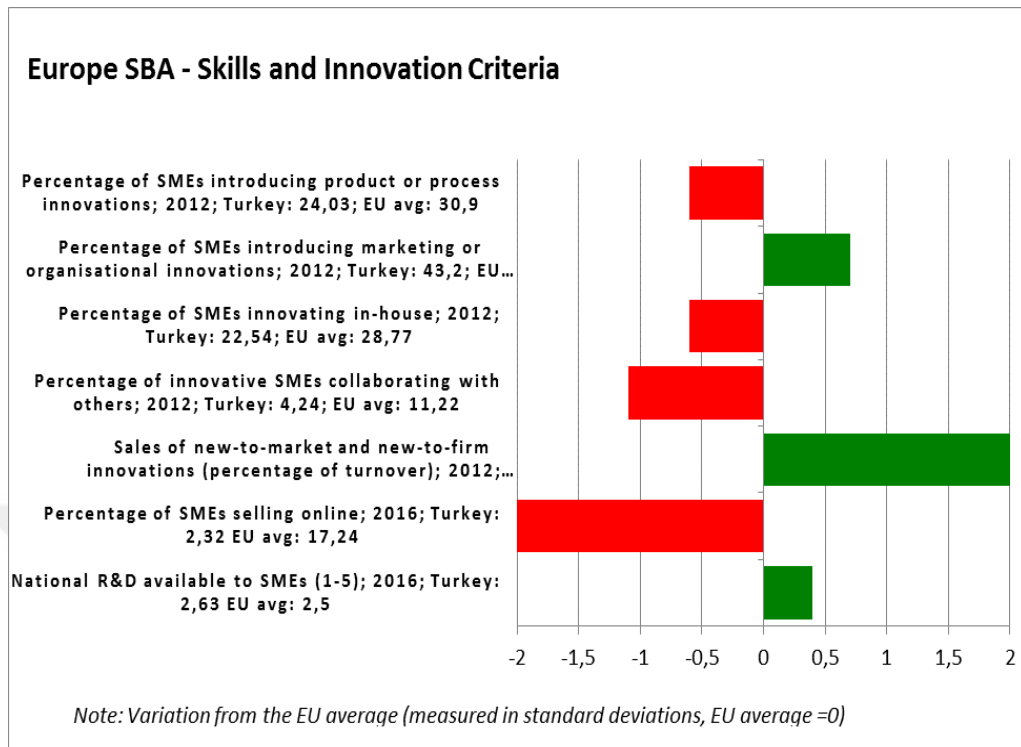
Entrepreneurship has been one of the three areas of focus in KOSGEB’s Strategic Action Plan 2016-2020. The following are the targets determined to reach the strategic purpose of “Spreading entrepreneurship culture, improving entrepreneurship and ensuring the sustainability of enterprises”.

- The spread of entrepreneurship culture will be ensured.
- New enterprises with a high chance of survival, having the potential of creating growth and employment will be supported.
- Special target groups will be supported.
- The development of mechanisms, which will support entrepreneurs, will be ensured.

Encouraging entrepreneurship among women through micro-credits is also being addressed by the authorities since percentage of women-owned enterprises could be further increased.

In addition to entrepreneurship, innovation and commitment to technology ensure SMEs to secure competitive advantage in the international markets. However, Turkish SMEs fall behind in innovation and technology criteria of SBA mainly because of lack of know-how, low investment in R&D and low level of technology utilization. Insufficient capital resources as well as reluctant owners contribute to low technology characteristic of firms. Manufacturers are content using existing technology rather than upgrading it. Data on technology levels of SMEs show that Turkish SMEs mostly operate in low-tech environment and there is a meaningful relationship between the size of the SME and the level of technology.

Figure 11 is the score card from the EU Commission's SME Fact Sheet 2017 and highlight the problems related to technology and innovation that need to be tackled. Low innovation levels are worth mentioning since only 24% of SMEs introduced products or processes and 22,5% innovate in house and 4% collaborate with others. These figures are 31%, 29% and 11% in Europe, respectively.



Source: SBA Fact Sheet Turkey - 2016

Figure 11: Comparison of Skills & Innovation Turkey - EU Average

The low technology level of Turkish manufacturing SMEs poses serious setbacks for a meaningful presence in international markets. Only 9,4% percent of all SMEs and 17 – 18% of SMEs with more than 20 employees are involved in high-tech and high-medium tech sectors and manufacturing processes. The majority of SMEs in all categories are classified as being low-tech. As a matter of fact, low technological levels are typical of larger enterprises with more than 250 employees as well.

Table 9: Proportion of SMEs in manufacturing industry by size class and technology level, 2014

Size	High Tech	High-Medium Tech	Medium-Low Tech	Low Tech	Total
1-19	0,2%	8,3%	31,1%	60,4%	100%
20-49	0,9%	17,6%	28,4%	53%	100%
50-249	1,5%	17,4%	31,4%	49,7%	100%
250+	2,6%	18,8%	24,7%	54%	100%
SME (1-249)	0,3%	9,1%	31%	59,7%	100%

Total Enterprises	0,3%	9,1%	30,9%	59,6%	100%
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Source: TUIK – SME Statistics 2016

SMEs in developed countries have already upgraded to Industry 4.0 processes that integrate robotics-based production with all other operational activities of the plant while most Turkish SMEs have not even started using advanced manufacturing technologies. Instead of automation, a small scale Turkish manufacturer would rather utilize labor force in its production than update its machinery and equipment. The main motive behind this is the fact that the return on investment (ROI) would take too long and investment in machinery and equipment is not justifiable. One factor that extends ROI beyond reasonable limits is the low value added of products.

While falling behind in manufacturing processes, Turkish SMEs have shown significant improvements in communication technology usage as shown in the Information and Communication Technology (ICT) Usage Survey. 93.5% of all SMEs that have more than 10 employees have internet access, 95,8 % use computers, 65,2% have web-pages and 85,9% use internet-based communication with government agencies. The commercial implications of broadening internet access and computer usage are apparent in sales figures where 11,6% of SMEs received product or service orders through their web pages or electronic document interchange (EDI) in 2015. Still, there is definitely room for growth especially in the e-trade segment.

Recent statistics indicate that SMEs accounted for 17,7% of total R&D investments which totaled 20 billion 615 million TL in 2015. Total personnel employed in R&D in full time equivalent (FTE) terms was 122,288 of which 27,5% were employed by SMEs. However, it should be noted that recent legislation requires all SMEs to staff at least one R&D personnel but this person is engaged in activities other than R&D within the firm either because of budget restrictions or lack of facilities. Therefore, the figures above do not

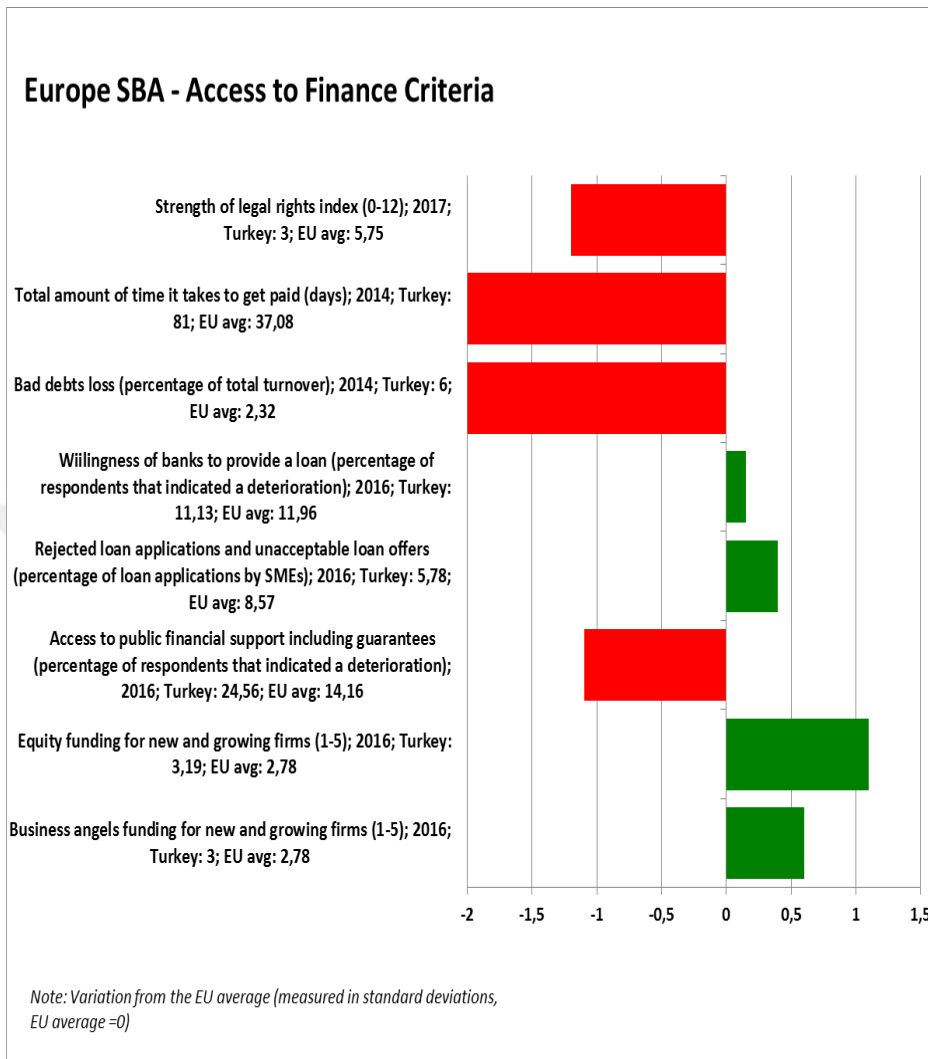
reflect the R&D commitment of SMEs. Creating a false impression of innovative vision has become a trend among SMEs and lack of innovation on SMEs' part clearly proves this. In addition to developing strategies on paper, a step-by-step plan, a proactive involvement and guidance of the government is definitely needed for progress. Within this context, several initiatives, which are briefly summarized below, have recently been taken.

The technology development centers (TEKMER), which are established by KOSGEB, provide support for R&D, innovation and industrial implementation activities. University-industry collaborations, chambers of industry and trade, and technoparks are collaborating towards reaching national goals of increasing innovation and R&D research. Currently, there are 41 TEKMERs all over Turkey and 75 R&D and innovation collaborations making the total of supported university-industry collaboration protocols 116. As of 2014, there are 486 workshops 254 of which are occupied. KOSGEB has drawn attention to the fact that majority of SMEs are not informed about the laboratory services offered below market prices. The number of SMEs that utilized metal and plastic laboratory testing services were 5,011 in 2011 which later reached 6,283 in 2014. However, number of tests conducted decreased from 70,694 to 63,610 in the same period (SAP, 2016-2020).

Limited access to finance has many negative effects for SMEs as it hinders their ability to progress in a multitude of areas such as internationalization, innovation and technology. Being an OECD country, Turkish SMEs are expected to obtain loans from external sources more easily than SMEs in non-OECD countries according to OECD 2006 report. Despite the high share of SMEs in total number of enterprises, workforce and output, their share in credit utilization is low. Financial management problems and informality issues are regarded as the main causes of this phenomena as small business owners may have compliance issues and be reluctant to share financial information which potentially may result in investigation of their transactions. Basel I and Basel II reporting standards that Turkey adapted in

2012 also contribute to the increased difficulty of new enterprises to access loans from banking institutions. These standards dictate how firms should modify their record keeping and books to ensure all financial statements provided to other parties are uniform and comparable. In addition to transparency, a limited range of products and services offered in financial markets is another obstacle reducing SMEs' access to finance. Borrower/lender relationships, collateral issues, transparency problems, asymmetric information and monitoring also contribute to the problem of obtaining financing. The low equity levels typical in SMEs cause SME credits to linger around 23-25%. Alternative finance sources such as angel investors and venture capital companies have been not only insufficient but also inaccessible for a high number of SMEs. Government led initiatives such as credit guarantee funds are currently the only attainable option for majority of SMEs.

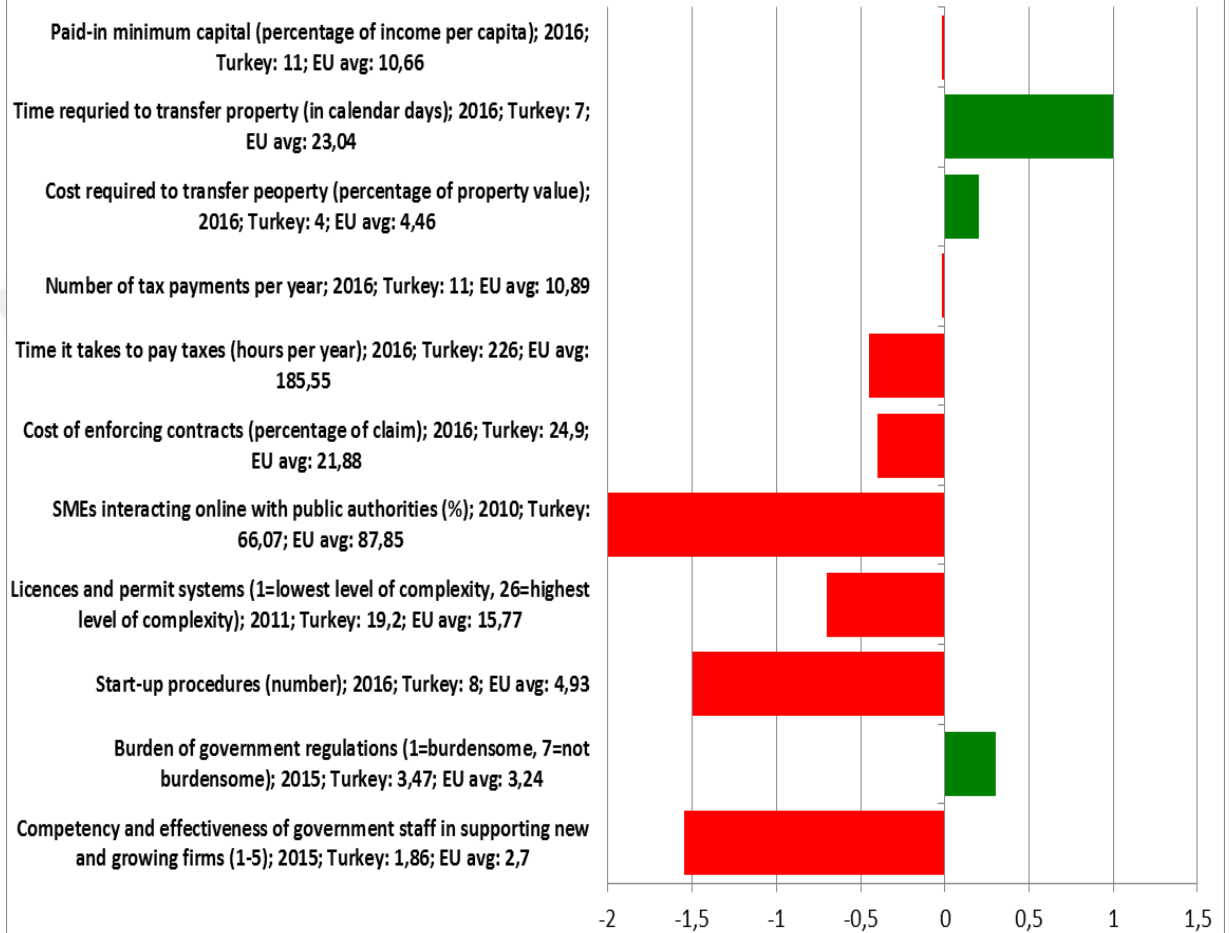
Financial literacy of SME owners is limited mainly due to lack of secondary education coverage of this topic. Government has launched informational campaigns on different products and their costs, but application of this information by SMEs is limited. In addition, as per SBA score card depicted in Figure 12, one of the most problematic areas for SMEs is the number of days to get paid which averages around 81 days compared to 37 days in Europe. Bad-debt loss which is 6% is also three times that of Europe. Apparently, SMEs face difficulties in collecting what is due to them and this creates cash-flow problems for the already tight-budgeted SMEs.



Source: SBA Fact Sheet – 2016 Turkey

Figure 12: Access to Funding Comparison Turkey - EU Average

## Europe SBA - Responsive Administration Criteria



Note: Variation from the EU average (measured in standard deviations, EU average =0)

Source: SBA Fact Sheet – 2016 Turkey

Figure 13: Miscellaneous Factors

Government and KOSGEB collaborate to increase SMEs' access to finance through various programs as summarized Table 10. SMEs need to be registered with KOSGEB, comply with reporting standards, and have no outstanding tax due to apply to any of these programs.

Table 10 SME Funding Programs

Fund Name	Date of Establishment	Budget
Credit Guarantee Fund (Kredi Garanti Fonu- KGF):	1993	41 billion TL (2014)
KOBİ Venture Capital Partnership (KOBİ Girişim Sermayesi Yatırım Ortaklığı – KOBİ A.Ş):	1999	4,5 billion TL (2014)
Istanbul Risk Capital Enterprise (İstanbul Risk Sermayesi Girişimi - iVCi):	2007	155 million Euros (2017)
Turkish Growth and Innovation Fund:	2016	200 million Euros (2016)
KOBİGEL-SME Development Support Program:	2018	700 million TL (2018)

Credit Guarantee Fund (KGF) was first established in 1993 after a technical collaboration agreement between Germany and Turkey. The main objective of the fund is to provide a collateral for SMEs that apply for loans from financial institutions. It has become a major source of financing with its budget of 41 billion TL in 2014. There are 27 banks and 14 leasing companies that collaborate with KGF to meet credit demands of SMEs. The target market of KGF are SMEs that have no possibility of obtaining loans from banks through regular application procedures due to short history of the SME, previous financial troubles, lack of credit history, poor credit rating, absence of personal and/or institutional collateral, and low equity and/or capital. KGF negotiates with financial institutions for lower interest rates and longer payback periods since through KGF's guarantee risk of financial institutions is greatly reduced. KGF is less selective compared to other programs with respect to product, sector and potential. Nevertheless, women and young entrepreneurs are positively discriminated. In 2017, out of the 5.2 billion TL of approved

surety volume 32% belong to micro-enterprises, 42% belong to small enterprises and 36% are for medium-size enterprises (KGF 2017). Table 11 illustrates the extraordinary growth in KGF equity and treasury backed loans. 3 major industry segments benefit considerably more than others where trade and service sector has 43% share, manufacturing has 32% and construction has 13% share in total guaranteed amount of 199,8 billion TL. A regional breakdown reveals that Marmara region dominate with a 43% share in total and followed by Central Anatolia, Aegean and Mediterranean regions that range between 13%-16%. These figures indicate that SMEs in less developed regions still have little or no access to finance despite the government initiatives.

Table 11 KGF Guarantee Volume

Dates	Number (Granted)	Number (Used)	Loan Amount (Granted) Billion TL	Loan Amount (Used) Billion TL	Guarantee Amount (Granted) Billion TL	Guarantee Amount (Used) Billion TL
1994-2015	24,085	17,674	15,1	9,7	10,9	7,2
2016	23,365	19,506	9,6	6,7	7,4	5,1
2017	314,239	297,682	264,9	208,1	238,8	187,5
1994-2017	361,689	334,862	289,6	224,5	257,1	199,8

Source – KGF Activity Report 2017

KOBİ Venture Capital Partnership (KOBİ Girişim Sermayesi Yatırım Ortaklığı – KOBİ A.Ş) was established in 1999 to provide financial support for entrepreneurs that have unique business ideas, products and/or services with high competitive advantage and potential. KOBİ A.Ş. either becomes a partner in the enterprise with up to 49% share or acts as a consultant and trainer. In addition to capital injection, KOBİ A.Ş. uses its resources to identify target markets, develop strategies and expand business networks of SMEs that partner with KOBİ A.Ş. Several big institutions such as KOSGEB, TOBB, Halk

Bankası, TESK and 16 Chambers of Commerce have stakes in KOBİ A.Ş. As of 2014 the budget of KOBİ A.Ş. is about 4,5 billion TL.

Istanbul Risk Capital Enterprise (İstanbul Risk Sermayesi Girişimi - iVCi) was established in 2007 with the main objective of acting as the “first fund of funds” and is a co-investment program that ensures a healthy growth of risk capital segment in Turkey. iVCi is mainly concerned with those enterprises that have a cutting-edge technology, are innovative and have high potential of reaching international markets. KOSGEB and European Investment Fund (EIF) are the major stakeholders in iVCi. An elite group of private investors also provide funds to iVCi which in turn funds other funds whose numbers increased from 4 to 10. iVCi has enabled 50 other funds to become operational and is increasingly contributing to development of SMEs with global vision. As of 2014, 19 SMEs and 5 small scale energy projects were supported. Turkish Growth and Innovation Fund support rapidly growing innovative SMEs with high profitability ratios. KOBİGEL which is an SME development support program was initiated to provide holistic support to increase the additional value and competitiveness of SMEs in the economy.

Lending in Turkey grew steadily over the 2007-2016 period with the exception of a small decline of 1,6% in 2009. Table 12 and Figure 14 shows the outstanding business and SMEs loans for the past ten years. The growth rate in SME loans stands at 8.2%. As business lending to firms of all sizes grew larger than the SME lending, the share of SME loans in the total business loans fell slightly.

Table 12 - Outstanding SME Loans

TL million	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Outstanding Business Loans SMEs	76.521	84.605	83.271	125.468	162.803	199.743	271.421	333.278	388.749	420.539
Outstanding Business Loans Total	190.623	250.318	262.724	353.236	459.003	528.846	715.465	888.648	1.100.093	1.314.364
Share of SME loans	40,1%	33,8%	31,7%	35,5%	35,5%	37,8%	37,9%	37,5%	35,3%	32,0%

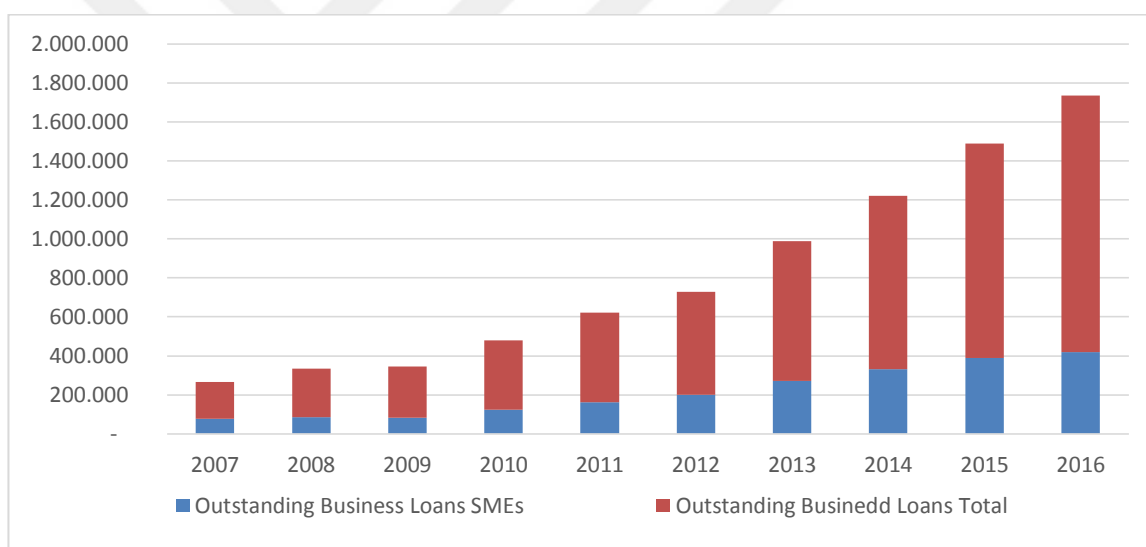


Figure 14 Outstanding SME Loans vs Total Loans from Banking Institutions

Table 13 depicts the growth of other financing options. Venture and private equity investments show an erratic pattern; between 2008 and 2011 investments increased by more than 600% for three consecutive years and peaked in 2011. Non performing SME loan rates ranged between 3,1% and 4,9% between 2007 and 2016 with the exception of 2009 when a peak of 7,64% was recorded. In 2012 the government enacted a law to stimulate the development of business angel industry. The law established the framework

and the provision of generous tax incentives for licensed business angels. A regulation regarding funds of funds which enables Treasury to transfer capital to fund of funds was also introduced.

Table 13: Other Financing Options

TL million	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Government Loan Guarantees SMEs	53	285	565	939	1.123	1.114	1.061	1.392	1.641	5.318
Government Guaranteed Loans SMEs	75	403	791	1.302	1.622	1.553	1.467	1.888	2.334	7.188
Direct Government Loans SMEs	552	842	997	855	1.174	928	2.632	1.709	1.764	1.749
Total	680	1.530	2.353	3.096	3.919	3.595	5.160	4.989	5.739	14.255
Non Performing Loans Total	3,8%	3,7%	4,9%	343,0%	2,3%	2,8%	2,7%	2,3%	2,7%	2,9%
Non Performing Loans SMEs	3,6%	4,8%	7,6%	4,5%	3,1%	3,2%	3,2%	3,3%	3,9%	4,9%
Venture Capital and Growth Capital	13.676	854	6.316	47.553	373.204	110.097	335.549	124.397	135.308	343.192

Source: OECD - Financing SMEs and Entrepreneurs 2017

Government guaranteed loans have more than tripled in 2016 mainly because of a campaign initiated by the government. The purpose of the campaign was to supply SMEs in financial distress with emergency funding. The intention of the government in providing cash flow to the market was to ease the stagnation in economic activity. Government has initiated another program for distribution of guaranteed loans through KGF and banking institutions in 2017 and has recently announced in 2018 that a third program is underway.

It is highly likely that the government's initiatives of increasing financing options are not translating into a financially healthier SME sector. There is strong evidence that majority of SMEs have not exactly used these funds to pay their various creditors including suppliers but have rather invested the money in foreign exchange. The main motive behind this was to benefit from fluctuations in the currency market and hedge themselves against increases in the cost of imported production inputs such as raw materials and parts.

Interestingly though, when SMEs flocked to financial institutions to apply for credit majority of applications were rejected leading to chaos and anger among SMEs. Ataç (2017) has explained this situation in his article as follows: SMEs are responsible for the payback of capital to the lenders and KGF has guaranteed only the interest payments. Lending institutions are hardly "big brothers" to hand out funds. They require that the borrowers meet minimum credibility standards and have no outstanding debt. KOSGEB naively assumed if they provided a document of eligibility to banks they would not carry out an internal assessment of eligibility. Naturally this was not the case and some SMEs will have to clear outstanding debt and improve their credit ratings to qualify for the "no-cost" ("no-interest") funds.

The timing of the above-mentioned programs raise questions about their real intention though. For the most part, they are strategically announced close to elections both in 2017 and 2018. Almost all critics are agreeing that these, while helping SMEs to some extent, are mostly election investments to maximize votes from the huge electoral base SMEs represent.

Another concern about such programs is whether they actually solve problems of SMEs. Government's no-interest credit programs do not really work because handing out no cost credit or money to SMEs do not address the underlying reasons of this distress. Money and/or funds are another source just like human resources, infrastructure, facilities, or strategic alliances. It is not as

easy to convert money into other resources and there is no guarantee that firms that have the financial means will find the best information, people or the strategic partner. Firms should evaluate whether to apply for credit just as carefully as when they invest in machinery or hiring and it would be a mistake to get a loan just because it is cheap or free. Moreover, extending credit to firms just because they are in financial distress would mix causes and effects of the distress since financial distress is not a reason but is an outcome. It would be unproductive to give credit to firms that do not meet their manufacturing and marketing goals and it would delay the inevitable.

This is perfectly demonstrated in Turkey. A quick overview of several indicators reveals that the number of enterprises that use credit doubled from 1.5 million to 3 million in the last 5 years. Total value of SME credits reached 430 billion with 174 billion for medium sized, 142 billion for small and 112 billion for micro enterprises. As of January 2017, 314, 739 firms are under execution orders (icra takibi). This number increased by 147,000 in the last year only and increase in credit lines is 37%. The non-performing loans increased from 5 billion 260 million to 22 billion since 2012. Of this figure micro enterprises accounted for 7,825 billion, medium enterprises 7,363 billion, small enterprises 6,831 billion. On the other hand, number of people employed by SMEs decreased by 156 thousand. Therefore it can be concluded that, in actuality the SMEs could not convert the cash inflow into jobs or better management practices. As most critics agree, handing out money to SMEs without educating them on how to run their business more efficiently and profitably actually does more harm than good for Turkish SMEs.

Turkish SMEs have demonstrated their potential despite the many adverse conditions they have to operate in. However, there are some major obstacles for them to be more competitive globally. Financing and innovation are the two major factors that inhibit SMEs. While government has recently recognized the need to provide support for the SME sector, the progress is slow. The support mechanisms are not producing desired results since they are

rather superficial, populist and short-term oriented. A truly international SME presence in the global markets seems to be possible only if SMEs manage to integrate into global value chains with high value added and innovative products.

### 3.2 Political Economy of SMEs in Turkey during the AKP rule

AKP won the elections in 2002, only 15 months after its establishment, and has been in power since then. The public had been overwhelmed with the 2001 crisis and conflicts within the coalition government led by Bulent Ecevit. As a matter of fact, both the regular people and the business world longed for political and economic stability and AKP seemed to be the answer. However, within AKP's first couple of years the economic and social transformation of Turkey started with small and unalarming steps. The fundamentals of the economic restructuring process of 2001, which aimed to bring economic stability and ensure separation of politics and economy, started to be undermined. Similarly, the government intervention that was supposed to be kept at minimum increased considerably over time. With each election won, especially the 2007 one, the boldness of AKP in terms of aligning its conservative ideology with national political and economic policies became even more apparent and reached a point where it was impossible to leash.

Cemgil (2016) attributes the electoral success of AKP to several factors. Firstly, none of the previous governments were able to address the "the social question" of Turkey (Cemgil, 2016) as successfully as AKP. The concept refers to the broken state-society relations going as far back as the early days of the Republic. The religious majority had been largely ignored, sidelined and was not properly represented as Turkey struggled to rise from its ashes. A secular, nationalist development strategy required fast modernization of the state and while doing so an elite class including military, early industrialists, and politicians emerged and continued to dominate state policy until AKP's rule. Secondly, AKP has a carefully crafted "reproduction strategy" (Cemgil,

2016) which refers to “political survival” and every action the government has taken including foreign and economic policies, while seeming erratic and incoherent, actually ensure the continuity of this strategy. Thirdly, especially in their first five years of rule, AKP managed to gain support domestically and internationally with their economic performance, relatively friendly relationships with a wide range of countries, commitment to EU membership and democratization. AKP insisted and tried to prove over and over again that they were by no means a threat to the secular regime and that they were equivalent to conservative parties in Europe. With AKP, Turkey aspired to be the “model” moderately conservative, democratic Muslim country for the troubled Middle East/North Africa region (Cemgil, 2016).

Anatolian SMEs were the perfect opportunity to market AKP’s vision of “moderate Islam” and the “Turkish Model”. The concept of “Anatolian Tigers”, businesses with high growth potential owned by conservative businessmen, gained popularity. Anatolian Tigers are businesses that are aggressive and competitive while also being non-reliant on state support. Prior to the strengthening of these businesses, industrial production was dominated by large enterprises in a few industrial centers. Eventually, there was a noticeable growth in industrialization of some Anatolian cities resulting from the driving force of Anatolian Tigers which gradually secured a prominent place in the economy. However, the main motive behind the over-enthusiastic support of these businesses was largely overlooked by the international and national media which focused on SMEs’ contribution to economy rather than their role in the capital accumulation of the Islamist sector. Moreover, due to their organic ties with eminent government figures and agencies, this sector’s influence in government’s foreign policy and strategy grew. The ultimate goal was to halt westernization of Turkey but it was rarely discussed in popular media.

Government encouraged industrialization in Anatolia first started in 1960’s via village cooperatives funded by savings of Turkish immigrants in

Europe. Regional development programs followed in the 1970's when worker companies were founded, but due the economic conjecture of the period, the overall investment in the sector was reduced. The Anatolian SMEs stagnated until the 1980's when the government adapted neo-liberal policies. As increasing exports became the main focus of national economy, some but not all Anatolian SMEs operating in popular sectors such as textiles, construction and service thrived and were able to reach international markets. By 1994, the share of Anatolian SMEs in total exports had increased to 48%, realizing a 17% growth from what it was in 1980.

There were many factors that contributed to the growth of Anatolian SMEs. Firstly, neo-liberal government policies going back to 1980's had a crucial role as import and export regulations were modified to allow importing inputs of production and exporting final products. Secondly, growth of Middle Eastern market and establishment of Interest Free Banks (IFB) was a major driving force. With their Islamic principles, IFB's attracted many national and international conservative investors who preferred to stay out of traditional banking sector and became the main source of finance for Anatolian firms which later became powerful corporations. However, these firms opted out of industries that required a long-term commitment, skilled labor and high-tech investments and preferred ones that produced fast cash flows such as consumer durables and super-market chains (Hoşgör, 2014:222). Thirdly, religious orders had a profound impact on Anatolian SMEs. These religious orders were aware of the urgent need of capital accumulation to gain power and invented some unconventional ways to collect money especially from unsuspecting donors (mostly Turkish workers in Europe) who thought they were donating money for charitable causes. Another way was to form companies such as Kombassan that had complex ownership structures where investors would receive shares of profit instead of shares of ownership in the company. As a result, number of firms with thousands of investors with stakes in profits but not in assets increased substantially. These organizations while belonging to different

religious sects had one aspect in common: their remarkable ability to form close-knit networks of investors, suppliers, distributors and buyers. Islamic brotherhood was the common ground of all the players in these networks. Islamic rhetoric was always used to attract more people and organizations into their networks. The religious networks eventually expanded into media and education which fortified their effect on Turkey's social transformation into a more conservative society. However, as the driver companies of religious sects grew into giant corporations and integrated into capital markets -which they had previously vilified- more modest SMEs with similar Islamic values were somewhat left behind.

As a result of government initiated support primarily during AKP rule, a new group of powerful enterprises and business leaders, almost all of which were AKP supporters emerged thus leading to a political polarization both in the business world (Buğra, 2002:51) and in the society (Ozturk O, 2014:202; Gurel B., 2014:26).

On one side of the spectrum were secular business associations such as TUSIAD and TURKONFED and on the other side were MUSIAD and their satellite organization TUSKON. Meanwhile, a segment of the regular Anatolian folk prospered creating a new class in Turkish society: Turkish Islamist bourgeois. Gürel (2014:35) argues that this development is similar to the one that Iran experienced in the last days of Pehlevi reign. Islamists that were sidelined by seculars in terms of economic power had finally found the means to claim some of the wealth as Iran became an Islamist Republic almost overnight. However, in Turkey the transformation was a much longer process going back to 1960's (Ozturk O, 2014:189).

There was a power struggle between chambers of commerce and industry in order to control TOBB (Union of Chambers and Commodity Exchanges of Turkey) which had a lot of influence and power in foreign exchange allocations and import quotas of the time. Naturally, whichever group controlled TOBB enjoyed more preferential treatments. These divergences led to the first separation in the business world and those groups

that were unsatisfied with TOBB's performance in protecting their interests formed other alliances.

One such movement has particular importance in the history of Islamic bourgeois when in 1969 Erbakan managed to convince Anatolian chambers to unite within TOBB and elect him the president of TOBB. He was not exactly the most desirable figure to occupy such an influential position because of his Islamic rhetoric. However, by the time he was forced to resign he had already succeeded in creating a brotherhood among conservative Anatolian SMEs that continues to this day. Before AKP, in 1970's and 1980's, the only champion of this emerging class was Erbakan who capitalized on the Anatolian SMEs in order to extend his electoral base (Savran, 2014:73). This segment had been largely ignored and excluded from Import Substitution and Export Orientation growth models (Karadag, 2010). Erbakan eventually formed the first Islamist party of Turkey and became a major figure in Turkish politics (Ozturk, 2014:194). Naturally, Erbakan was seen as a threat to the secular values of the Republic and his political career was obstructed multiple times through military coups, prohibitions and jail sentences. Nevertheless, he prevailed and ultimately managed to expand his conservative Islamist electoral base which enabled his party to participate in government coalitions and became Turkey's prime minister for a brief period. The seeds he planted in those days constitute most of AKP's electoral base today.

Having lost control of TOBB, large corporations founded TUSIAD to protect their interests and to distinguish themselves from SMEs that TOBB represented (Ozturk, 2014:207). TUSIAD championed the classic capitalist framework of minimum government involvement and discretion as intended in 2001 reforms, close relationships with developed Western countries, labor unions and a formal social policy. TUSIAD's members are among the most powerful conglomerates of Turkey and represent the business elite of Istanbul, Ankara and Izmir. TURKONFED, on the other hand represents over ten thousand small SMEs and are supported by TUSIAD (Buğra, 2002:112).

Before AKP, this business elite and their networks controlled most of the capital in Turkey and had been given privileges for the sake of industrialization by previous governments.

Opposite to TUSIAD were associations such as MUSIAD and their satellite organization TUSKON. MUSIAD mostly represents small-medium size Anatolian businesses whereas TUSKON's members are associated with the Gulen movement. These two organizations although much smaller in terms of firm size get their strength from their huge number of members (Tanyılmaz, 2012:165). MUSIAD's origins go back to 1990's but their public visibility increased substantially during AKP rule. The development of MUSIAD and its members during the AKP rule is worth mentioning. A review of its members summarizes the socio-economic transformation the country has gone through. When MUSIAD was first established in 1990, only 8 of its members were among the 500 largest industrial corporations of Turkey. This number had increased to 31 by 2009. However, Ozturk (2014:182) argues that their share is actually not as "spectacular as it seems". Most SMEs associated with MUSIAD were enterprises founded after 1980 with less than 50 employees, located in thriving Anatolian cities such as Denizli, Kayseri, Konya and Gaziantep and primarily operated in textile, construction, food and services sectors and they still are (Ozturk, 2014:186; Hoşgör, 2011:220).

Some of these SMEs grew enormously into big corporations in the last decade thanks to their close relationships with AKP. Islamic norms shaped their approach to industrial relations as well. One of the primary concerns of these conservative associations was to ensure that government intervention served their own interests and marginalized their liberal rivals and the environment was ideal to realize their goals (Buğra, 2002:85).

MUSIAD's most significant mission is to provide an outlet for Anatolian SMEs, protect their interests and assist them in expanding their businesses nationally and internationally. MUSIAD promotes a "global Muslim business

network” (Hoşgör, 2011:226) and assists its members in making global business connections primarily in Middle East and North Africa (MENA) countries. Welcomed by the AKP government, this regional expansion resulted in a trade volume increase from 7,3 million USD in 2002 to 64.2 million USD in 2014 (Sen, 2015). In this regard, MUSIAD’s approach is similar to that of religious fractions since both championed national and international collaboration among Muslim firms regardless of nationality. In addition to MUSIAD’s networking, Turkish Airlines added new routes to the region and foreign trade offices were expected to pursue deals and agreements. These efforts had considerable impact on the internationalization of Anatolian SMEs. However, the newly-popular MENA market had much lower purchase power than Turkey’s traditional trade partners. SMEs enjoyed high export volumes and market share in a time when demand from the west stagnated due to global crisis. Not challenged by a sophisticated demand from the MENA market, SMEs produced familiar, low value-added products and did not make any effort to invest in product development and innovation.

MUSIAD promotes the concept of classless society where there is harmony between the business owners and the workers, but they are not exactly champions of the working class since they urge workers to identify with the goals of their employers while also making personal sacrifices in terms of wages, benefits and social security. Neo-liberalism while giving rise to conservative and Islamist bourgeois, is actually a blow to the working class which had lost its “militancy and became less combative” (Ozturk, 2014:203). As a result, memberships in worker unions decreased considerably while more submissive unions such as Islamist HAK-İŞ and Türk-İş promoted by MUSIAD increased their memberships from all segments of the labor force. Gürel (2014:27), stresses that this new bourgeois is not any different than the liberal capitalists in their suppression of the working class. Cemgil (2016) also argues that AKP targeted organized leftist labor and “replaced public welfare with religious benevolence and charity”. According to Gülalp (2003), political

Islam has actually adapted perfectly to capitalism's abuse of labor as SME owners with Islamist tendencies were able to both reach labor and decrease its value while elevating themselves to higher income segments. For the SMEs and larger enterprises, these policies led to a competitive advantage in the global markets since cost of labor was kept at minimum.

It should be noted at this point that capital fractions cannot be confined to two broad categories of secular liberal conglomerates and conservative Islamists SMEs. There are overlapping segments within each group who are in legitimate competition with each other. It would be misleading to categorize Istanbul based firms as being secular and out-ward oriented and Anatolian ones as conservative and inward-oriented when studying the ever-lasting rivalry between the two. As conservative firms grew and prospered their religious tendencies and rhetoric was greatly reduced. Moreover, some conservative Islamic firms are quiet successful exporters operating in diversified industries. (Ozturk, 2014:209; Hoşgör, 2011:245). Similarly, as Bayırbağ (2011) indicated in his case analysis of Gaziantep, local bourgeois of an Anatolian town may be influential enough to ward off interventionist government practices that favor a particular capital fraction.

MUSIAD and Islamist capital firms had gone through a period of shrinking following the February 28 1997 process as they were charged with anti-secular activities and illegal capital accumulation. Islamist firms were also excluded from all military and public tenders together with other measures all of which had a profound effect on their sources of income. Some of the larger Islamic corporations could not survive this period and went bankrupt. Activities of IFB's were also curtailed prohibiting them from opening new branches and their special status and privileges were revoked. The repercussions of February 28 measures were far reaching and Hoşgör (2014:240) points out that the financial crisis of February 2001 was mostly caused by the strict limitations on IFB's activities and eventual bankruptcy of İhlas Finance which held about 40% of all IFBs' assets. These developments

forced Islamic capital to modify its strategies. A general toned-down business rhetoric with less emphasis on Islamic norms was adapted and previous strong opposition to the EU membership was replaced with a pro-EU approach. The Asian crises of 1997/1998 undoubtedly necessitated a reevaluation of the then-promoted East Asian business model such as that of Malaysia. From the perspective of SMEs, opportunities and chance to overcome various barriers via EU membership were recognized once again (Hoşgör, 2014:243). MUSIAD and Islamic capital made an impressive come back during the AKP rule while IFB's also managed to strengthen their position and double their market share (Hoşgör, 2014:224).

AKP was undoubtedly supported by MUSIAD and conservative Anatolian businesses, hence following their election AKP awarded these businesses with numerous preferential treatments. An analysis of the period reveals that many regulatory changes that were passed actually served mainly the purpose of enabling government intervention in the economic environment and transferring of wealth to enterprises which were ideologically closer to AKP. A public administration reform that decentralized government involvement in local administrations enabled municipalities to award contracts to conservative businesses (Hoşgör, 2011:244). The paradox here is that AKP has always positioned itself as a champion of free market economy where Turkish businesses are expected to prosper with their savvy business practices rather than government support. Contrary to self-regulating characteristics of free market economy, AKP has always interfered or manipulated market conditions to ensure that its supporters benefited more than any other business. Sectors that offer high profits such as construction, infrastructure development, energy, and mining were especially closely controlled by the government. As a result, those businesses that demonstrated loyalty to AKP grew and prospered at unprecedented rates further strengthening AKP's base financially.

In order to facilitate its intervention and use of preferential discretion, AKP used its regulatory power to pass additional laws that reduced the

autonomy of many agencies that are supposed to protect public interest. Public Procurement Agency whose mission is to investigate public tenders and Privatization Agency were two of these key agencies that lost autonomy. In 2011, the final blow to autonomy came when all agencies were placed under the authority of related ministries increasing AKP's power to direct capital accumulation towards their cohort of supporters. Furthermore, judicial system, especially higher courts were also sidelined with controversial amendments to the constitution after the referendum in 2010 (Buğra, 2002:83).

European guidelines suggest that extremely large government contracts and tenders be divided into smaller parts so that they can be undertaken by SMEs. The rules excluding smaller companies from tenders on the basis of their annual turnover figures have recently been relaxed across Europe. In theory, this is a viable strategy to distribute the income more equally between SMEs and larger corporations. However, AKP government was reluctant to modify Public Procurement Law (PPL) during the harmonization of Turkish law with European legislation process because of the pressures from Anatolian SMEs which had a major role in electoral success of AKP. These firms which have been complaining about the unjust distribution of resources during the 1980's and 1990's assumed that with the election of AKP, it was their turn to be favored by the government although they have criticized previous governments for discrimination. These groups strongly objected to the new legislation on public procurement on the grounds that they had no means to compete with larger corporations and demanded that SMEs are excluded from the legislation's scope. AKP was also aware that if public procurement law was adjusted to harmonize with European legislation, government's ability to intervene in tenders would be greatly hindered. Consequently, PPL was amended more than two hundred times and numerous exception and exclusion articles, which were customized according to major tenders, were added. A large number of public institutions were also excluded from the PPL and its sanctions (Gürakar, 2018:28).

Public procurement is an important source of income not only for big corporations but also for SMEs in Turkey. There are over one hundred thousand public procurement tenders every year and agreements are signed with the winners the majority of which are SMEs. However, public procurement is hardly a transparent process in Turkey and there are numerous allegations of corruption and preferential treatment of government supporters. It is widely acknowledged that AKP government has utilized public procurement as a means of increasing capital accumulation of its electoral base. Gürakar (2018) has proven that more than half of all the publicly procured tenders were awarded to companies which are politically affiliated directly or indirectly with the AKP government. In Turkey, goods, services, and construction contracts can be procured in three different ways which are through procedures dictated in PPL, direct procurement, and as specified in exemptions and exclusions under Article 3 of PPL. PPL has enabled open, restricted or negotiated bidding. During 2005-2016 period of all the procurement 68% were open-bids, 8% were negotiated, 4% were restricted, 11% were exclusions and 9% were direct procurements. . Similarly, the share of open-bids decreased from 71% in 2005 to 53% in 2016 while the share of other bids increased from 29% in 2005 to 47% in 2016 (Gürakar, 2018:115).

Open tenders are accepted as being the least intervened method while restricted and negotiated ones are open only to pre-determined companies. Direct procurement is also a source of concern since after an amendment to PPL in 2003, procurements are no longer required to be advertised and competitive bidding process is therefore not obligatory. The procuring authority is free to choose the firm they would like to award the contract. This gives local and central government unlimited discretion in the selection of suppliers which are naturally supporters instead of opposers of AKP. Direct procurement peaked in 2011 when its share reached 18,5% of all procurement with a 14,2 billion TL contract value. However, following the corruption crisis of 17-25 December and a negative mention in the European progress report

caused this share to decrease to 2%. The total value of negotiated and restricting tenders has also shown an enormous increase from 768 million TL in 2003 to 21,7 billion TL in 2016 (Gürakar, 2018:121).

An analysis of the big winners of the AKP period reveals that companies that have been founded after 1990 which are mainly Anatolian SMEs were awarded contracts totaling 110 billion TL of the total contracts totaling 296 billion TL. Same companies keep winning government tenders and this has been criticized by opposers of the government but the owners of these companies have developed tactics to avoid attracting attention to this fact. Changing the names and titles of companies frequently and entering into bids with different companies owned by the same group/owner are some of these tactics. Some company owners have opted for the second option also to ensure that their chances of winning a bid is increased since their various companies participate and bid differently in the same tender (Gürakar, 2018:39).

To conclude, the majority of changes in PPL serve the purpose of increasing the authorities' discretion, channeling of funds to firms in congruence with government and decreasing competition. Companies associated with AKP are the clear beneficiaries of the amendments and of those tenders where competition is compromised. Similarly, local AKP officials frequently have stakes in companies that win many tenders. Decreased level of competition results in huge public losses due to overpriced procurement. Favoritism distorts not only judicial and political balance but also supervisory capacity of the Public Procurement Agency.

The above-mentioned changes in public procurement mechanisms caused SMEs to divert from their original lines of businesses towards sectors that are frequently procured by government because of the high and easier profits available. With such opportunities in the domestic market SMEs that once aspired to export and grow internationally set aside these goals and jumped on the bandwagon to accumulate capital as much and as fast as they can. Long-term planning and investment in R&D and innovation were also postponed for

an indefinite period of time. Undoubtedly, this trend has long-lasting implications. Sectors that require a long-term commitment such as high-medium technology ones lost their feasibility leading to a loss of competitive advantage in the international arena. It will be a long while before SMEs catch up with their international competitors. This situation contradicts all the ambitious targets announced by the government.

## CHAPTER 4

### CONCLUSION

This thesis aimed at evaluating the internationalization level of Turkish SMEs and the role of government policies since 2000 on development of SME sector. SMEs contribute to Turkish economy enormously through their employment creation of about 9 million jobs which is 74% of work force and a share of 52,8 % (93 billion Euros) in gross value-added, but most do not benefit as much from their endeavors. SMEs battle to survive on many fronts and face numerous challenges which can be alleviated by public assistance. SMEs have been the underdogs of the economies not only in Turkey but also in all other countries. As globalization's negative effects on SMEs started to be apparent, global awareness and assistance campaigns became obligatory and international institutions participated in efforts to improve conditions for SMEs by providing guidelines for governments. European Small Business Act is one of these guidelines that Turkey by acceding confirmed its commitment to bettering the conditions of SMEs. Within the framework of SBA, internationalization is promoted to strengthen SMEs and increase their resilience against fluctuations in domestic economies. This has positive implications for Turkish SMEs since there is an untapped potential for growth if more SMEs opened up to international markets. The current share of SMEs in foreign trade numbers is low compared to other countries but with better guidance and long-term planning a much higher income can be generated. This

situation coincides with government's ambition to increase value of Turkish exports up to 500 billion dollars by 2023. With only 5 years to target date government has aggressively begun to assist SMEs with various programs.

Achieving high internationalization rates is a formidable task since there are many factors that affect progress. First and foremost is the chronic financial distress SMEs deal with on a day-to-day basis. Shortage of capital prevents SMEs from investing in areas such as R&D, modern technology, upgrade of existing machinery and equipment, education and skilled labor. In order to provide financial relief government has been initiating multiple low or no interest loan programs for the past 5 years. In theory, these programs were expected to yield results but in reality, they had an adverse effect on SMEs. SMEs are in more debt than ever, cannot pay off their debt and are on the verge of bankruptcy with many of them in execution courts against their creditors. A second area that SMEs should be supported in is innovation and technological investments. Turkish SMEs chronically produce low value-added products because they do not invest enough in developing innovative, high-tech products. Lack of skilled personnel, infrastructure and narrow-minded business owners prevent SMEs from integrating into global value chains with higher value-added products. Government and several other institutions such as TUBITAK assist SMEs to make the leap into being more research and innovation oriented but the number of SMEs that actually take advantage of these programs is unusually low. The public education system does not promote creativity and curiosity, and since majority of SME owners are products of this system, the low innovation levels are not that surprising. The government should actually start investing in future SME owners by providing students with an enriching and stimulating education system.

The setbacks experienced by SMEs are the result of inconsistent and incoherent government policies as this thesis aimed at proving. SMEs together with their employees, suppliers, owners and their families constitute such a big portion of the population that the government has been devising strategies that would please them in the short-term. The same targets for SME development

are being reworded and incorporated into strategic action plans but in the end handing out loans is the only concrete action that has been taken. Government has achieved its purpose of securing more votes from the SME sector with the loan programs at the expense of long-term, sustainable development. Under these circumstances, expecting a strong and healthy SME presence in international markets would be utopic.

Moreover, the current government has been consistently using its power to ensure that its constituents benefit from all government-initiated programs and public procurement more than other SMEs. Government tenders, cheap credits, grants were mostly distributed among SMEs that openly supported the government. Government has also created a more profitable domestic market with its public procurement policies so most government-affiliated SMEs entered sectors such as construction where they can enjoy positive discrimination rather than focus on their original sectors. Many establishments collected the loans and government payouts but have not used them to strengthen their competitive advantage. Instead, an unprecedented capital accumulation among government supporters occurred in the last decade transforming the Turkish society. A new affluent and conservative bourgeoisie class emerged shifting Turkey's direction from the west to the east. Turbulent political relationships and decreasing trade volumes with Turkey's biggest market, Europe necessitated exploration of alternative markets. Instead of Europe, Middle East, North Africa and Asia have gained more importance in Turkey's exports. However, these new markets do not offer as many opportunities as Europe in terms of integration into value chains. Again, this strategy will also cause Turkey's internationalization targets to be negatively affected.

A comparison of internationalization strategies discussed in Chapter 2 and strategies of Turkish SMEs show that Turkish SMEs are mainly exporters and importers thus being in less sophisticated stages of internationalization. However, there is undeniable "network" effect especially among more conservative SMEs. As highlighted earlier, Anatolian SMEs get their strength

not from their competitive advantage but from their vast and inter-connected networks reinforced by their business associations, chambers of commerce, relationships with government, business-to-business trade among themselves, and government pursued international contracts. Other advanced methods of internationalization such as FDI, INVs and born-globals are far from reach for Turkish SMEs as there are almost no SMEs with such sophisticated and competitive global products and brands. Only larger corporations have been able to internationalize at these levels.

The argument set forth in this thesis could further be enhanced by a quantitative investigation that includes first-hand impressions of SME owners via one-on-one interviews which would reveal the actual impact of government policies on SME performance and their effect on the economy as a whole. The effects of attempted military coup in 2015 and dissolution of Gulen backed support mechanisms on SMEs and Islamist capital would also complement the information provided in this research.

In conclusion, SME policies serve an ulterior agenda of the government and while it seems many programs are being devised to benefit SMEs, in the long-run the negative effects of these biased policies will be more apparent. In order to curtail these effects, internationalization of Turkish SMEs should be realistically evaluated with respect to global competitive advantage. This thesis demonstrated that there is a fundamental discrepancy between set internationalization targets and government policies. The collaboration between universities, government, and SMEs should be enhanced with a more wide-spread support for R&D, product development and advanced manufacturing techniques such as Industry 4.0. Customized strategies in terms of improving market conditions and level of support for each sector should be devised since all sectors are at different stages of development. SMEs regardless of political orientation should be encouraged to collaborate, take advantage of each other's strengths and divisive policies should be abandoned. If these measures are taken the desired internationalization levels for Turkish

SMEs and ambitious export targets would become an attainable rather than utopic goal.



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