RESEARCH NOTES

Explaining foreign direct investment in Turkey's tourism industry

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The purpose of this research note is to examine foreign direct investment in the tourism industry of Turkey and the relevance of international business theories in explaining that investment. A survey of transnational corporations in Turkey's tourism industry provides a systematic inventory of their type, home country, operational form, motivation and source of financing. Theories of foreign direct investment have considerable explanatory power as regards the growth and development of tourism in Turkey. The combination of theory and empirical work not only offers new findings, but also lays foundations for future research.

Relating the major theories of the transnational corporations (TNCs) to foreign direct investment (FDI) in tourism has thus far received scant attention in the literature. This is in good part due to difficulties in obtaining information and data. The purpose of this note is to analyse the growth of FDI in the Turkish tourism industry and examine to what extent these developments can be explained by the major theories of TNCs.

Income from international tourism has become the most important item in Turkey's balance of payments after exports in recent years, increasing from $327 million in 1980 to $4,321 million in 1994. Its ratio to total merchandise exports also grew steadily, from 11 per cent in 1980 to almost 25 per cent in 1994 (Turkey, Ministry of Tourism, 1995, p. 93). Concurrently, FDI in tourism grew much faster than that in the other industries of that economy. While, in 1983, tourism attracted 4.7 per cent of total FDI in Turkey, that share rose to 16.3 per cent in 1990 before slowing down in the

early 1990s (Turkey, State Planning Organization, 1994, p. 64). The hotel industry was by far the largest recipient, with a 96 per cent share of all FDI in tourism.

Transnational corporations in Turkey's tourism

A postal questionnaire survey was carried out in 1992 to gather data going beyond the array of publicly available information. It consisted of twelve questions on key variables related to tourism TNCs, such as the form and extent of involvement, effects of government policies, sources of financing and motivations. A high response rate was obtained from the transnational hotel chains (8 out of 16 responded). The response rate of the domestic companies, 4 out of 24 (16 per cent), was acceptable. Reports of the Government of Turkey and, in some cases, interviews were used to supplement the information gathered whenever possible.

The tourism industry comprises diverse firms and organizations that contribute to meeting the needs of the tourist. However, this study, like some other major studies, singles out three types of direct contributors: hotels, airlines and tour operators. Most tourism activities take place in the tourist-receiving country. However, the marketing, buying and selling of tickets for transport, or of the whole holiday package, take place in the tourist-generating country. The form of operation in these three distinctive major subsectors of the tourism industry is quite different since each of them has its own particular characteristics and structures.

Hotel TNCs engage in a wide range of equity and non-equity ventures and specific cooperative arrangements. The dominant form of international activity is not through FDI, but through minority equity participation and non-equity forms, such as franchising and management contracts. The survey of 16 transnational hotel chains in Turkey made it possible to classify 40 of their 43 establishments by form of involvement. The majority of the firms (with about 55 per cent of the hotel rooms) had equity interests in varying proportions. The hotel chains that had entered Turkey before 1980 had either majority equity or comprehensive leasing agreements to ensure management control. There seems to be a tendency among TNCs towards smaller or no equity interest in recent years. Most recently, the most prominent hotel chains committed to either a small equity interest or no equity at all. The Club Méditerranée, the largest of the foreign chains, owns 100 per

cent of Akdeniz Turistik Tesisleri, a company that has been operating since 1968. Of the four properties operated by the Club Méditerranée before 1980, three were leased and one was wholly owned. Like several other chains, Club Méditerranée also assured management responsibilities with no equity interest in the 1980s. Etap Hotels also operate largely with leased properties. The United States chains, which had initially preferred large equity investments or leasing when opening their first hotels in Turkey, shifted increasingly to management contracts with a small equity share as a form of operation in recent years.

The international airline business tends to be dominated by wholly owned State and private corporations. In some cases, the private and public sectors join together to operate a national airline. However, there are considerable ownership and other links between airlines and other related tourist businesses, as well as among the airlines themselves (UNCTC, 1982, p. 35). These links with other tourist businesses cause airlines to go into joint ventures, minority-owned operations and cooperative technical agreements.

In the past decade, some European airlines and other travel companies have shown an interest in forming joint ventures in charter business with the Mediterranean countries, particularly Spain and Turkey. This phenomenon has been viewed by North European carriers as protection against the possible market sharing of charter demand on a bilateral basis (Smith, 1991, p. 11). Four such charter airlines operate in Turkey. Sun Express was formed by Turkish Airlines, Deutsche Lufthansa and a number of other tourism companies. Transwede of Sweden went into partnership with the Turkish private sector to set up one of the first charter airlines in Turkey, Sultan Air, to meet the increasing demand from Europe; Sultan Air also runs a first-class service to and from Europe under the VIP Air brand name. Another joint venture by Aeroflot of the former Soviet Union and the Turkish private sector, Green Air, has aimed at bringing travellers to Turkey from Eastern Europe (Baki, 1990, p. 64). Aer Lingus, with its affiliate, Pegasus, has also become involved in a charter airline in Turkey (Smith, 1991, p. 12).

In general, tour operators serve mainly domestic customers who wish to take a vacation abroad. Unless the size and the number of inclusive tours from the tourist-generating country increase substantially and the tour operators do not tend to integrate vertically, they run their business almost entirely in the tourist-generating country. As the market extends and the foreign tourist-operating business grows, vertical integration with tour-operating firms and hotels in the tourist-receiving country becomes attrac-

tive. In this case, the foreign tour operator establishes an affiliate in the destination country to organize local ground arrangements, and the local firms are left with a minimal tour-operating business (UNCTC, 1982, p. 45). However, the existence of vertically integrated tour operators may be beneficial during economic downturns, since these firms would do their best to increase the utilization capacity of their facilities. This could be one of the reasons why Tantur, the Turkish affiliate of TUI, was awarded a prize by the Ministry of Tourism in 1991 for bringing the highest number of tourists into the country in a year adversely affected by the Gulf Crisis (Altin, 1991, p. 6).

A large number of tourists from an origin country is thought to motivate that country's investors to invest in their most popular destinations. When demand is already present, investors desire to have a share in various subsectors of the composite tourist industry. Airlines and land carriers, tour operators and travel agents, as well as hotel developers and managers, may have something to gain. This is also true for Turkey. Investors in all major subsectors of tourism are from countries that are also the main originators of tourists.

As far as the motives for FDI in the tourism industry are concerned, the single major motivation is the growing popularity of Turkey as a tourist destination. The incentives provided by the Government seem to be effective in attracting investments to Turkey, as half of the companies studied cited it among their major motivations to invest in Turkey. The answers to the financing questions strengthen this assertion since they reveal that all (except Japanese investors) have increasingly used Turkish credit sources to finance their investments.

Theories on transnational corporations

Several strands of theory can help to explain the role of TNCs and FDI in tourism (in Turkey and elsewhere), although little use has been made of them.[1] Their starting-point is conventionally dated to Stephen Hymer's doc-

[1] Examples include the work of Dunning and McQueen on the international hotel industry (1981, 1982), McQueen (1983), Buckley and Papadopoulos (1988) on FDI in tourism in Greece, Ajami (1988) on tourism TNCs in Belize, Davé (1984) on United States TNCs in hotels and a review article by Zammit (1981) on TNCs in developing countries' tourism. Specific applications of transaction-cost economics to tourism are given by Buckley (1987) and Tremblay (1990).

toral dissertation written in 1960 and published in 1976. Hymer began with the proposition that, in order to compete with indigenous firms, which possess innate strengths such as knowledge of the local market, business conditions and culture, foreign entrants must have some compensating advantage. This proposition puts FDI theory into the context of the theory of industrial organization. In particular, the focus moves to the role of imperfect markets because, in a perfect market, FDI could not exist. The major criticism of this part of the theory was its failure to explain how firm-specific advantages are created. Since the cost of acquiring these advantages was ignored, the theory overstates the average profitability of firms exploiting them (Buckley and Casson, 1976, pp. 68-69). Proprietary knowledge (owned and controlled by individual firms) is important in tourism. The brand images of hotels, airlines or tour operators are crucial since tourism is an "experience good", often consumed in an unfamiliar environment, and its value cannot be assessed at the time of its purchase (McQueen, 1989, p. 288). Hence, a trademark may serve as a guarantee if the tourist product is bought from a supplier with a good reputation.

The second shortcoming of the Hymer approach arises from the neglect of the ownership-advantages acquisition costs. Given the advantages that enable a firm to invest abroad, it remains to be proved that FDI is the preferred means of exploiting an advantage. The basis for this decision is profitability. The choice between FDI and its alternatives (exporting and particularly licensing) turns out to be analytically crucial. It is essential to integrate approaches based on market imperfections (or market power) with those based on internalization to deal with these issues (Buckley, 1990). The difficulties of extracting returns from licensing argue in favour of FDI. Transaction-cost economics have been applied to the tourism-transaction chain in order to explain packaging in the industry and the relationships among tourism service providers (Buckley, 1987). When duly augmented, the fundamental propositions of the theory of TNCs, as expounded by Hymer, still have relevance to the explanation of tourism FDI—although they pay insufficient attention to location factors.

H. G. Grubel (1972) concluded that greater risk reduction was attainable by investing in an internationally diversified portfolio with the same expected rate of return as that from an investment in a diversified United States domestic portfolio. Also, foreign investment returns would give rise to substantial gains in welfare to wealth holders. This model falls short, however, when the economic cycles of the industrialized countries, which invest in others, behave increasingly almost in unison, thus leaving insuffi-

cient room for international diversification (Geyikdagi, 1982, p. 129). Transnational hotel chains may consider adding new properties in different countries to diversify their existing asset portfolios in order to reduce risks. However, the risk-diversification approach gives only a partial explanation of certain activities of tourism TNCs.

According to the product-cycle theory (Vernon, 1966, 1974 and 1979), FDI is a natural stage in the development of a product from its birth to its maturity and eventual decline. Firms innovate where demand is strong and are given incentives to do so by the patent system. They then reach out to foreign markets first via exporting, followed by FDI as the most effective means of foreign market control. In the final stage, they invest abroad in countries with low-cost labour in order to reduce the costs of producing standardized products. The direct applicability of the product cycle model in tourism has been to the "resort cycle" (Butler, 1980) rather than to business strategy. However, it does focus attention on the reaction of firms to changing patterns of demand and thus to a dynamic factor. The role of new product innovation, foreign market-servicing strategies and cost effectiveness are all factors considered by product-cycle models; but tourism TNCs must consider these simultaneously, not consecutively.

The internalization theory states that market imperfections create incentives for firms to find internal solutions by bringing under common ownership, and controlling, activities that are linked by markets. While the avoidance of imperfections in the external market brings about benefits, internalization has certain costs (higher resource and communication costs than a corresponding external market) that may offset the potential benefits. Internalization is undertaken up to the margin where the costs and benefits are equalized, thus directing the firm towards an optimal scale (Buckley and Casson, 1976, p. 33).

The internalization approach serves remarkably well in explaining the vertical and horizontal integration of tourism services. The integrated control of the various stages of tourism activity—transporting, accommodating and servicing tourists—enables tourism TNCs to plan, coordinate and regulate the flow of tourism services. While providing ease of accessibility to tourists by selling a single composite product, TNCs achieve economies of scale (a high load factor on transport vehicles and high occupancy rates in hotels) and reduce costs. The internalization of the transaction flows enable TNCs to monitor and control the quality of services, which is often difficult to achieve through external contracts.

The eclectic theory of John H. Dunning (1981, 1988, 1989) is an attempt to pull together the various strands of explanation for the growth and activities of TNCs. It concentrates on ownership effects, internalization strategies and location costs. Its concentration on location costs is welcome given the fact that other approaches may underplay the role of location elements. The relevance of these factors in the tourism industry can hardly be overstated. The traditional theory of TNCs examines location only in terms of costs, usually labour costs. In tourism terms, culture, climate, traditions of hospitability and other intangibles must be included.

According to the eclectic theory, tourism enterprises with headquarters in one country will undertake production outside their national boundaries whenever they have competitive or ownership advantages over firms of other nationalities, and find it profitable to combine their mobile assets with the immobile factor endowments located in foreign countries. They internalize the market for these assets in order to secure the full economic benefits from them and become transnational. The ways of achieving the internalization advantages are quite different in the context of international tourism, especially in the case of hotels, from manufacturing and other service industries. While *de jure* control over resources (a 51 per cent or more equity stake) is assumed to be necessary for control in most foreign affiliates, many of these benefits are obtainable by some form of contract in the hotel industry. In fact, de facto control may be achieved through contracts that usually authorize a TNC to "supervise, direct and control the management and operation of a hotel" (Dunning and McQueen, 1981, p. 205). The remainder of this article explains the findings of this study within the eclectic theory framework.

Ownership issues

The tourist product is an "experience good": customers do not see the product they purchase, but instead rely on the guarantee of the supplier. The reputation of a tour operator or the brand image of a hotel chain itself provides such a guarantee (Dunning and McQueen, 1981, p. 202). Therefore, a trade mark is an important ownership advantage for a tourism TNC. When asked about motivations for investing in Turkey, some respondents gave answers that were pertinent to this issue. Such answers as the "need for reputed 5-star hotels in business centres" and the "desire to extend the hotel's reputed service to loyal customers visiting Turkey" indicate that local

partners (or owners), as well as TNCs themselves, make use of this advantage.

The knowledge of what to produce is usually gained as a result of operating in the same market (as both tourists and tourism TNCs are from the same or similar developed countries). For example, a hotel chain can make this knowledge, which was built up in the home market, available to a new hotel at a much smaller transaction cost than would be the case for other new entrants into the hotel business (McQueen, 1983, pp. 145-147). An examination of the home countries of the tourism TNCs in Turkey shows that the TNCs most likely to be involved in international tourism (especially in the hotel sector) are those from countries that generate more tourists and have a well developed local hotel industry.

Like TNCs in manufacturing, those in the tourism industry realize economies of scale arising from their larger size. Unit costs are lower in providing air transport in larger airplanes, or in accommodation by a large hotel compared to a small one (Dunning, 1989, p. 28). In Turkey, the transnational hotels are much larger than the local ones, and tend to benefit from larger economies of scale. In one of the interviews, the public relations manager of a leading hotel chain said that, since they ordered large quantities, a manufacturer produced all the furnishings and accessories as specified by the hotel. This direct purchase from the manufacturer can decrease costs substantially.

Location elements

The first and most obvious location advantages are all the factors determining the size and growth of tourism demand to a particular place (Dunning and McQueen, 1981, p. 205). Twelve of the fourteen respondents to the survey gave "the growing popularity of Turkish tourism" as their primary motivation for investing in Turkey.

The second major location advantage is the general infrastructure for tourism (Dunning and McQueen, 1981, p. 205). The Government of Turkey has invested large amounts of capital, especially after 1980, to open new roads (especially in the coastal areas) and new airports, and to provide infrastructure (such as water supply, electric and telecommunications facilities) in the tourist regions (Geyikdagi, 1992, chap. 6). These efforts helped eliminate hesitations on the part of investors.

The third location advantage is the availability and quality of inputs, including personnel (Dunning and McQueen, 1981, p. 205). Again, the questionnaire survey provides an explanation. All of the hotel respondents stated that they had no problem in finding hotel supplies locally. Although a few in the tourist regions commented on the difficulty of finding qualified employees in certain specialities, they resolved the issue by training their employees. Few TNCs in this survey paid attention to the low labour costs.

The policy of the host government towards FDI in general is another major location factor. Turkey's open FDI policy and its generous incentives to attract FDI appeared to be successful in the 1980s (Geyikdagi, 1992, pp. 184-195). Eight of the TNCs responding to the survey stated the enticing role of incentives and the favourable investment climate in Turkey.

Another factor affecting FDI is the general political, social and economic stability of the host country. Foreign investment inflows suffered severely during the political turmoil a few years before the 1980 military intervention in Turkey. When the ensuing political stability was combined with a set of economic measures to attract FDI, foreign capital inflows rose sharply. Three of the TNC respondents gave affirmative answers, but emphasized the negative impact of the 1991 Gulf War when they were asked whether their investment had met their general expectations.

The international organizational configuration of tourism

Transnational corporations internalize the market for firm-specific assets outside their national boundaries in order to capture the full economic benefits for them. The extent of internalization is related to the degree of control of the foreign operations. The form of control may be influenced by home and host country-specific variables, as well as industry-specific factors. In manufacturing industries and in the majority of service industries, owning 51 per cent or more of the equity in a new operation provides control over the use of firm-specific assets. In tourism, however, particularly in the hotel subsector, de facto control can be secured through a contract with-

out equity involvement. According to the eclectic theory, the choice between equity and non-equity involvement is influenced by the type of the industry (Dunning, 1989, pp. 51-53). Airlines and tour operators usually acquire control by obtaining an equity stake. Hotel TNCs obtain control over the assets they transfer with or without equity involvement. The data for Turkey seem to be consistent with these observations. While hotels related to tour operators (like Iberotel, Robinson Club and Club Méditerranée) have held equity stakes more often than the average, some others (like Swissotel, Kempinski and Novotel) manage hotels for other investors without any equity stake.

Some of the factors influencing the form of TNC involvement depend on home and host country-specific variables (Dunning, 1989, pp. 53-54). For example, in a country with a strong indigenous hotel sector, management contracts and licensing agreements are more common than in those that lack such an experience. In Turkey, all sorts of forms of involvement are available. However, as in other parts of the world, contractual involvements are becoming more frequent. This may be due to the willingness of TNCs to be involved in a developing tourist market while avoiding the risks related to equity. Another host country-specific factor is government intervention (regulations and restrictions) in the economy. While the Government of Turkey encourages FDI through generous incentives, it does not put restrictions on other forms of involvement (Geyikdagi, 1992, pp. 184-188).

Summary

In the first section of this study, TNCs in the Turkish tourism industry were examined. Despite the relatively small size of the sample population, it was possible to get a systematic inventory of TNCs by type, home country, operational form and motivation. The next section examined some of the major theories of TNCs and applied them to FDI in the tourism industry in Turkey. These theories have considerable explanatory power as regards the growth and development of tourism in Turkey. The theory and empirical observations presented here could, in turn, form the basis for future research in this area. ■

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