Improving the quality of business investment in Turkey

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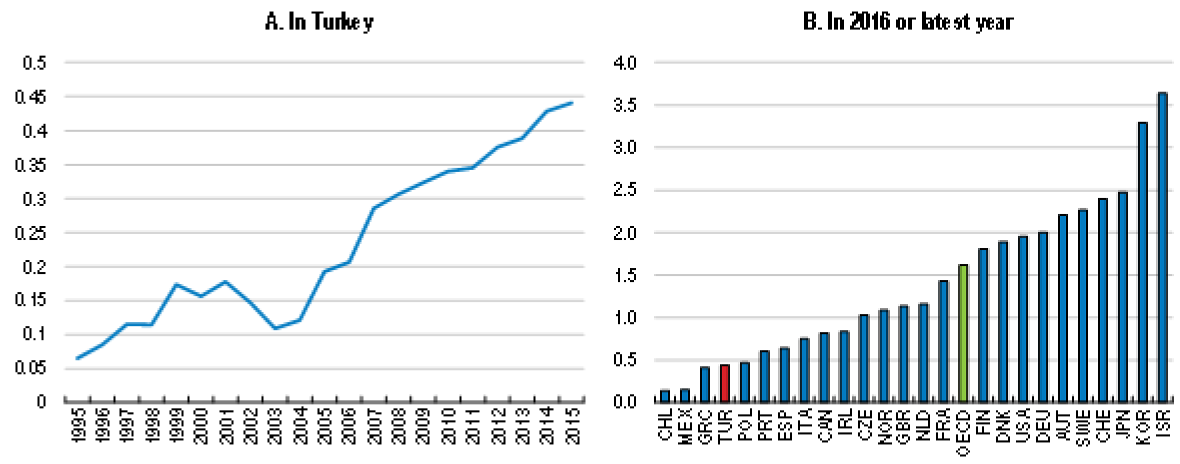
Turkey’s business sector exhibits one of the highest investment rates among OECD countries. However, the 2018 Economic Survey of Turkey (OECD, 2018) suggests that the quality of investment could be enhanced by overcoming the fragmentation of the business sector and by improving the current business environment. A comprehensive micro dataset allowed to distinguish four types of firms whose investment dynamics and challenges differ: i) small businesses with a high degree of informality, ii) medium-sized family firms, iii) large listed corporations, and iv) skilled young start-ups. There is room for increasing the share of knowledge-based and long-term investments – notably innovation, training, digitalisation and R&D investments – in all these types of firms at lower and internationally competitive investment costs.

The small informal businesses – which employ the largest share of Turkey’s labour force – have very limited access to bank credits and no access to external equity capital as of today. Their ability to fund long-term knowledge-based assets is highly restricted. Medium-sized family firms which have played a central role in Turkey’s strong growth over the past decade are better endowed, and keener, to invest in long-term assets, but are over-leveraged vis-à-vis domestic banks, which restricts their additional investment capacity. Domestic bank loans are also typically of short maturity and entail roll-over risks for the financing of long-term investments. Even so, the majority of family firms refrain from reaching out to securities markets and to external shareholders. Large, listed firms have, in contrast, a good access to national and international debt and equity securities markets, but Turkey’s high risk premia increase their cost of financing above international competitors’. The last group of young skilled start-ups is backed by myriad government incentives at their phase of emergence, but need more risk-sharing and long-term private capital to continue to expand.

Business spending on R&D is low but rising

In percentage of GDP



Source: OECD (2018), Main Science and Technology Indicators (database).

Cultivating Turkey’s equity eco-system would help these different types of firms to develop their long-term, knowledge-based, productivity-enhancing investments. Some obstacles include limited financial transparency of firms, incompatibilities between local and international governance standards, complex and frequently changing tax and subsidy systems, and too restrictive labour market rules which reduce the flexibility of firms and amplify investment risks in the formal sector. The modernisation of the business environment in all these domains would accelerate the emergence of more equity-specialised financial intermediaries, accounting experts, legal and financial advisors, research analysts and market makers. The development of this eco-system is essential for improving mutual confidence between all types of enterprises and potential investors from their local, national and international environments.

The modernisation of the business environment has been ranking high on the government’s agenda for some time. Domestic and regional geo-political circumstances have so far limited progress, and even led to setbacks in some areas such as the rule of law, judiciary independence or the fight against corruption. With the tempering of political uncertainties after the June 2018 elections, a window of opportunity opens for resuming the reform process. The OECD Survey suggests that a three-fold modernisation strategy emphasising i) the formalisation of informal and semi-formal businesses, ii) the introduction of more state-of-the-art management and digital skills in all types of firms, and iii) the rebalancing of financing structures from debt to equity would help the entire business fabric to upgrade the quality of capital formation. Progress would not only contribute to the rebalancing of growth through a more productive and internationally competitive business sector, but also to social inclusion and cohesion through the creation of high-quality formal sector jobs in the entire country.

Find out more:

OECD (2016), *OECD Economic Surveys: Turkey 2016*, OECD Publishing, Paris.

OECD (2018), *OECD Economic Surveys: Turkey 2018*, OECD Publishing, Paris.