STRATEGIC CHANGE OR DEJA VU?

WHY DO BUSINESS GROUPS STILL UNRELATEDLY DIVERSIFY IN EMERGING MARKETS?

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ABSTRACT

This study builds an integrated and nuanced theoretical framework and formulate several testable propositions that explain how several economic and behavioral factors at the environmental and firm-levels can affect the likelihood of business groups' unrelated diversification as emerging markets advance. The study also seeks to explain the heterogeneity of strategic behavior in restructuring process within the population of business groups by suggesting that the degree of unrelated diversification depends on several firm-specific factors (i.e., scale and scope, owning a financial bank and the strenght of distribution network) whose origin lie at the founder characteristics (i.e., merchant vs. industrialist background, risk taking propensity) and the entrepreneurs' strategic choices at the time of founding and in early years of the group's development. The theoretical arguments are illustrated with empirical evidence from the restructuring process of four major Turkish business groups that differ in terms of key theoretical dimensions, such as scale and scope, resources, and founder characteristics.

What determines the scope of the firm over time is one of the most fundamental questions in strategic management research (Rumelt, Schendel, & Teece, 1994; Peng, Lee, & Wang, 2005). Within the boundaries of corporate scope research, whether related or unrelated diversification creates more value has perhaps attracted the most attention. While most research evidence highlights the superior performance outcomes of related diversification (e.g., Rumelt, 1982; Montgomery & Wernerfelt, 1988; Palich, Cardinal, & Miller, 2000), the existence of countrary evidence in empirical studies (e.g., Michel & Shaked, 1984; Chatterjee, 1986; Khanna & Palepu, 2000; Villalonga, 2004) and the continuous thrive of big conglomerates such as General Electric, Siemens, and ITT over decades make the logics behind the value creation potential of unrelated diversification as unclear or inconsistent.

One specific context this question remains particularly puzzling is emerging markets where unrelatedy diversified business groups, "loose constellations of firms spanning a wide variety of manufacturing and service industries held together by common ownership or informal control ties" (Koch & Guillen, 2001: 78), have continued to be leading economic players for decades. The value creation potential of unrelatedly diversification in emerging markets has traditionally been considered as resulted from the market failures and high transaction costs (Khanna & Rivkin, 2001) and the opportunities created by the selection environment (Guillen, 2000; Koch & Guillen, 2001). Advancing market institutions, coupled with reduced transaction costs and reduced uncertainty, are expected to trigger corporate restructuring, which mostly involves "acquisitions or divestitures to develop a new configuration of the lines of business" (Bowman & Singh, 1993: 6; Chung & Luo, 2008). During the corporate restructuring process, institutional economics and resource-based views, the dominant views in extant research, predict that business groups will reduce their scope, become more relatedly diversified, and start to develop product, market, and other innovative capabilities (Khanna & Palepu, 2000; Kock & Guillen, 2001; Hoskisson, Cannella, Tihanyi, & Faraci, 2004; Hoskisson, Johnson, Tihanyi, & White, 2005).

As expected, as a result of the governments' switch to more liberal policies that support free trade and foreign direct investment, and concomitant advancements in macro-economic and institutional environments in the last decade or so, many business groups in emerging markets have been going through strategic restructuring process (Yiu, Lu, Bruton, & Hoskisson, 2007; Chung & Luo, 2008). However, the nature of strategic change is quite different than what the theories have predicted, as many business groups continue to diversify unrelatedly (Colpan & Hikino, 2008; Karaevli, 2008). Although countries such as South Korea institutionalized policy reforms particularly aimed at the structure and governance of business groups, extensive unrelated diversification of business groups remains the rule rather than exception and there is no sign that the dominance of these widely diversified groups in the economy will decline (Delios & Ma, 2010).

The paradoxical nature of these findings and recent trends have triggered debate among researchers as can be seen in Colpan's (2010) following statement: "...all these elements of liberalization and an increasingly competitive market, coupled with consequitive financial crises, should theoretically have created an environment for the dissolution of diversified business groups, or at least accelerated strategic reform for a more focused business portfolio, where each group possess competitive resources and capabilities" (p. 522). Ironically, however, she continues to argue, business groups continue to thrive by remaining as extensively unrelatedly diversified entreprises and have even increased their power in emerging markets, such as East Asia, Latin America, and Turkey.

This paper seeks to resolve this theoretical and empirical paradox by offering a more integrated and nuanced framework that explains how certain economic and behavioral factors both at the environmental and firm-level of analysis can be drivers of unrelated diversification as markets advance. The study suggests that increased opportunities for buying and selling businesses, and the context and path-dependent resources of business groups that are still valuable, rare, and inimitable are the main sources of economic drivers for unrelated diversification in the current circumstances of the emerging economies. Although prior research has focused on the effects of the lessening of transaction costs, an equal emphasis has not been given to the fact that the development of economic and institutional environments creates new economic opportunities, such as privatization and deregulation that can mostly be capitalized by these groups.

Second, despite the extant theories' focus on their economic properties, business groups are also social entities (Bugra, 1994; Granovetter, 1995) and their strategic behavior is influenced by the goals and interests of controlling family shareholders and perceptions of key stakeholders. The primary financial goal of the controlling family shaeholders at the maturity stage of business groups is wealth preservation and keeping the control in the family, rather than creating new wealth through growth by innovating and developing product-market specific capabilities. The wealth preservation can mainly be achieved through diversifying risk into different product-markets and geographies, and this strategy fits well with the new opportunities emerged during the liberalization process. Furthermore, in the face of increasing competition, behavioral factors will be even more influencial in business groups' decisions to unrelatedly diversify, because protecting their power, legitimacy, and visibility will be all related to their size and scope. Above all, their value in relation to various stakeholders (i.e., their brand image for customers, their political power as big employers in relations with the government, and their negotiation power over foreign alliance partners) is determined by how big and diversified they are.

Although these economic and behavioral factors predict that business groups will continue to make unrelated diversification even as markets advance, they do not fully explain the heterogeneity of strategic behavior within the population of business groups. Prior research indeed treats business groups as homogeneous entites, and little attention has been paid at human agency and firm-level factors (Chung, 2005; Guillen, 2000). This study also seeks to overcome this issue by suggesting that the strenght of unrelated diversification depends on the following firm-specific factors: size and scope of the business group and scale in existing industries, owning a financial bank or not and the strenght of its distribution network. I further argue that the origin of these firm-specific factors lie at the founder characteristics (industralist vs. merchant background, risk propensity) and those entrepreneurs' strategic choices at the time of founding and in early years of the group's development.

In summary, bringing insights from institutional and strategic choice perspectives into related research on institutional economics and resource-based view, this study seeks to build an integrated and nuanced framework and formulate several testable propositions that explain how economic and behavioral factors at the environmental and firm-levels can affect the likelihood of business groups' unrelated diversification in emerging economies as markets advance. I illustrate my theoretical arguments with comparative case examples of four major Turkish business groups (Koc, Sabanci, Eczacibasi, and Borusan Holdings), which differ in terms of key theoretical dimensions (e.g., size and scope, resources, family background characteristics). Turkey, as a mid-sized emerging economy, which has been going though major transformations in economic and institutional environments in the last decade, is an interesting empirical setting since currently there is a major gap in the literature about the strategic behavior of firms in medium-sized emerging economies that are positioned in between the advanced economies and the biggest emerging markets such as China and India.

THEORY AND PROPOSITIONS

Diversification Strategies in Emerging Markets

Unrelated diversification, a firm's entrance into business segments or industries which show no direct relation to its current businesses in terms of resources and capabilities, has been conventionally vieved as destroying value in advanced markets. However, the same strategy has continued to create value in late industrializing countries, or mostly known as emerging markets, for decades. The dominant perspectives, institutional economics and resource-based view, offer alternative explanations regarding why unrelated diversification has created value in emerging markets for so long.

Based on the institutional economics view, unrelatedly diversification is a direct respose to market failures and high transaction costs (Khanna & Rivkin, 2001). Market inefficiencies and institutional voids- such as the absence of regulatory systems, contract-enforcing mechanisms, specialized intermediaries- increase transaction costs in external capital, labor and product markets (Khanna & Palepu, 1997). When generalized resources or skills such as brand names, distribution networks, and plants and project execution capabilities can not be exploited through market transactions, firms are motivated to develop their own internal markets (Ghemawat & Khanna, 1998). The value of internal markets and the intermediary role of business groups between the external environment and the affiliated firms increase as the group diversifies into unrelated businesses (Khanna and Palepu, 2000a). Furthermore, under such uncertainty, reducing risk through diversifying resources into different product markets is another critical way of creating value from unrelated diversification.

The resourced-based view suggests that these economic-political circumstances and the associated high uncertainty do not typically motivate entrepreneurs to take a long-term perspective and develop technological and market-based capabilities that are prerequisities to reap economies of scope in related diversification. However, the same circumstances allow these small number of entrepreneurs to develop and maintain more generic resources (i.e., brand name) and capabilities (i.e., leveraging local and foreign contacts, establishing close relations with the government which is the main allocator of capital as well as the main generator of both the opportunities and threats) (Kock & Guillen, 2001). These are generic in the sense that they are not industry-specific and can be applied to diverse product and geographical markets. In these circumstances, business groups will benefit from repeated industry entry (Guillen, 2000; Kock & Guillen, 2001) to exploit these generalized resources and capabilities. However, these resources and capabilities as drivers of unrelated diversification will be valuable, rare, and inimitable as long as market failures, such as governments' restrictions on foreign trade and investment continue to exist (Guillen, 2000).

It appears that although the institutional economics and resource-based views differ in terms of the main drivers of business groups' unrelated diversification at first place, they hold similar assumptions regarding the necessity of market failures and institutional voids in maintaining the value creation potential of unrelated diversification in emerging markets. Accordingly, when market institutions develop, coupled with reduced transaction costs and reduced uncertainty, both views predict similarly that business groups will reduce their scope, become more relatedly diversified, and start to develop product and market based capabilities (Khanna & Palepu, 2000; Kock & Guillen, 2001; Hoskisson et al., 2004; 2005).

The Drivers of Unrelated Diversification as Markets Advance

As noted above, the institutional economics view has identified high transaction costs resulted from market inefficiencies and institutional voids as the main drivers of unrelated diversification in emerging markets. Based on this perspective, business groups as unrelatedly diversified firms will create value as long as their role as intermediaries between inefficient markets and their affiliated firms continues. Khanna and Palepu (1999) argue that in the transition period where the development of intermediaries not completed, but new opportunities emerge as markets liberalize, business groups may increase their scope since they continue to create value as intermediaries. However, with the further improvements of markets and institutions, their intermediary role will decrease, and as a result, business groups will reduce their scope and become more relatedly diversified by divesting their unrelated businesses (Khanna & Palepu, 2000).

Although it provides important insights for the strategic behavior of business groups in the transition period of emerging markets, I suggest that this perspective is incomplete, since business groups' strategic choices are affected by several economic and behavioral factors that extend beyond their institution substitution effect. Indeed, instead of witnessing a clear increase in their scope, the trends we see in the corporate strategies of business groups have been decribed as "select and focus" in Korean chaebols (Hoskisson et. al., 2005), "choose and focus" in Japanese keiretsu firms (Schaede, 2008) and "multi-focus" in Turkish family holdings (Karaevli, 2008). In other words, they typically focus on a selected number of businesses, which include some of their existing businesses and new ones, while exiting from some other businesses. However, their portfolio remains as largely unrelatedly diversified, and new businesses that they enter are mostly unrelated to their existing and previous businesses. The next section seeks to explain the theoretical logic behind these trends and why they continue to diversify unrelatedly as markets advance.

Economic Factors. Although prior research has focused on the effects of the lessening of transaction costs, an equal emphasis has not been given to the fact that the development of economic and institutional environments creates new economic opportunities, such as privatization and deregulation that serve as the motivators of further diversification in unrelated ways and can mostly be capitalized by these business groups. For example, governments' switch to more liberal policies that support free trade and foreign direct investment, privatization of many state-owned businesses, and deregulation of several industries, create new attractive business opportunities in industries such as energy, banking, and communications (Ramamurti, 2000). The diversification logic of business groups has traditionally been being the first mover in high-profitable industries, independently from whether their resources and capabilities fit with the requirements of the industry. From this respect, based on McGahan and Porter's (1997) criteria, business groups diversify by the logic of "industry selection" rather than "creating synergy" through diversifying into related industries. It seems that as long as these new opportunities exist in the environment, they will not feel the urgency to change their diversification logic.

Furthermore, besides the opportunities for the acquisition of companies in new opportunity markets, the development of financial markets and increased foreign investments create opportunities for these business groups to find buyers for their existing companies in the industries that they want to exit more easily. Particularly in mid-sized emerging markets, where there are not sufficient scale advantages in many sectors, excess generic resources and free cash, gained through exploiting their traditional business segments with limited growth opportunities and/or selling their unprofitable businesses motivate business groups to invest into these new opportunity businesses and markets even if they are unrelated to their existing portfolio.

In addition, despite the lessened transaction costs and increased competition, the diversification logic of business groups does not have to change since their generic resources, such as brand name, broad customer base in diverse settings, good relations with and power over suppliers, still have multiple uses, and can be leveraged in new opportunity contexts and continue to create entry barriers for more focused and foreign firms. These resources have been accumulated through a context and path-dependent process and, therefore, are still imperfectly mobile (Peteraf, 1993). With these valuable, rare, and still inimitable resources, they can find the best allies that have complementary industry-specific resources and capabilities to acquire the necessary product and market capabilities to compete in new industries. Furthermore, they can still attract and retain scarce managerial talent, whose interests are more aligned with diversifiying their human capital as being employed by firms that have businesses in diverse and fastly growing sectors. All these discussions suggest the following proposition.

> ***Proposition 1:*** As markets advance, the likelihood of a business group's unrelated diversification is positively associated with the amount of opportunities for buying and selling businesses in the environment, and the amount of context and path-dependent resources and capabilities of the business group.

Behavioral Factors. Furthermore, although the extant research that builds on institutional economics and resource-based perspectives focus on their economic properties, business groups are also social entities (Bugra, 1994; Chung, 2005; Hoskisson et al., 2005; Yiu et al., 2007), and social and political factors significantly shape their growth and change processes (Bugra, 1994). Therefore, their strategic choices are influenced by noneconomic factors such as the interests and goals of the controlling family shareholders and perceptions of key stakeholders.

From the perspective of controlling family shareholders, in the face of increasing competition and altered economic and institutional circumstances, and at the maturity stage of their enterprises, wealth preservation, a philosophy that it is more important for not to lose money than it is to make money, takes precedence over other dimensions of performance such as wealth creation through growth by innovating and developing product and technical capabilities (Dyers, 1986; Carney & Gedajlovic, 2003). One means of diversifying risk while maintaining family control is to diversify at the product-market level (Carney & Gedajlovic, 2003).

Furthermore, in an increasingly competitive environment and improved markets, business groups that do not typically have product and market-based capabilities are likely to put heavier emhasis on how they are perceived by key stakeholders. Operating in many sectors of the society provides them, in Carney's (2007) terms, the "reputation premium" that may be a major source of sustained competitive advantage in the new realities of the environment. For example, a business group's influence on government policies is partly depended on how big an employer that business group is in an emerging economy where there is typically high rate of unemployment. Furthermore, because of their place in the society as big employers and tax payers, their brand value, mostly reflects the customers' trust, is positively affected by their visibility, associated with their scale and scope. Attracting and retaining managerial talent, which is still a relatively scarce resource in emerging markets, are easier as long as they protect their size and scope, since being employed by the biggest firms is considered as a source of status and prestige at the individual level (Su, Bird & Blair, 2009).

All of these discussions suggest that business groups' power, legitimacy, and visibility in the eyes of various stakeholders are largely determined by how big and diversified they are. From an institutional logics perspective, it follows then that since reducing the scope is typically accompanied by downsizing, it signifies a business group's losing its power and legitimacy (Chung & Luo, 2008). Based on these discussions, I suggest the following proposition.

> ***Proposition 2:*** As markets advance, the likelihood of a business group's unrelated diversification is positively associated with the strength of controlling family shareholders' goals of wealth preservation and protecting/ increasing their power, legitimicy, and visibility in the eyes of key stakeholders.

Moderating Role of Firm-Specific Factors

The extant theory and empirical research on business groups in emerging markets has focused on explaining the importance of business groups in an economy and the effects of macro factors, such as political-economic conditions and state policies on business groups' overall strategy at the population level (Guillen, 2000; Chung, 2005; Usdiken, 2008). However, there are significant firm-level differences within the population of business groups that affect their individual strategies. Accordingly, although in general the economic and behavioral factors discussed so far serve as the major drivers of unrelated diversification as markets advance, I suggest that the degree of a business group's unrelated diversification will be dependent on several firm-specific factors.

First, this study suggests that the size and scope of a business group, and its scale in existing industries affect the degree of the business group's unrelated diversification. A firm's previous investments and its repertoire of routines constrain its future behavior (Teece et al., 1997). According to real options framework, investments carry “expansion options” or latent growth opportunities within them, which lower the cost of entry into other product-markets and increases the chances for competing future first-mover-advantages in multiple product-markets (Vassolo, Anand & Folta, 2004). Therefore, the sequential discovery of expansion options can positively affect an organization’s diversification performance (Ng, 2007). The implication of this for business groups in emerging markets is that business groups that expanded into diverse business setting at earlier stages of their development will likely to be advantageous in later years in capitalizing new investment opportunities as they emerge, even if those opportunities are unrelated to their current portfolio.

From an organizational learning perspective, the benefits of larger scope for further unrelated diversification can be explained with reference to “absorptive capacity” arguments. Draw on Penrose (1959), an organization absorptive capacity refers to its ability “to recognize the value of new information, assimilate it, and apply it to commercial ends” (Cohen & Levinhal, 1990: 128). A large scope of a firm implies a broader and more diverse knowledge base, which further increases an organization’s absorptive capacity to assimilate market opportunities (Cohen & Levinhtal, 1990), and can enhance the firm’s capability to further diversify into unrelated product markets (Lane, Koka, & Pathak, 2006; Ng, 2007). Furthermore, a higher level of absorptive capacity allows a firm to more fully capture the benefits of simultaneous exploitation and exploration (Rothaermel & Alexandre, 2009).

Since expansion into similar product lines can be basis for expansion into other product lines (Kali, 1998), scale and scope typically co-evolve, and scale in existing industries also positively affects the degree of unrelated diversification. Firms can use profits in industries where they have scale advantages to invest in new promising markets or sell those businesses at a higher price to finance their new investments in the promising markets. In other words, businesses with scale advantages can serve as “cash cow” business units to allow unrelated diversification activities as opportunities emerge.

Furthermore, larger scale and scope are positively associated with organizational size, which has additional benefits during portfolio restructuring process. Large firms have more slack resources to initiate strategic change in response to shifts in environmental demands (Bourgeouis, 1981) and are more capable of taking advantage of the opportunties to enter new markets (Haveman, 2003). Slack resources in larger firms buffer them from environmental risks and threats, and allow firms to experiment with new products and markets (Hannan & Freeman, 1989). Furthermore, large firms can exert more influence both on their task and institutional environments, and can overcome entry barriers (Ranger-Moore, 1997). In other words, larger groups can strenghten their position by shaping the emerging economic and institutional environments and, therefore, capitalize on the opportunities created by the liberalization process (Carney, 2004; 2007). All of these discussions suggest the following proposition.

> ***Proposition 3:*** As markets advance, the degree of unrelated diversification is positively associated with the business group’s size and scope, and its scale in existing industries.

Second, this study suggests that financial bank ownership of a business group affects the degree of the group’s unrelated diversification. In general, financial resources are the most flexible resources since they can be used to buy all other types of productive resources (Chatterjee & Wernerfelt, 1991). Financial resources can be grouped either as external funds (e.g., new equity and possibly high risk debts) or internal funds (e.g., liquidity at hand and unused debt capacity to borrow at normal rates) (Chatterjee & Wernerfelt, 1991: 35). In most emerging markets, many business groups own a bank serving as the main source of internal funds. If the level of stock market development is not sufficient to obtain the equity financing externally, group banks play a critical role in financing growth choices of holding company and the affiliated firms. Having a group-affiliated bank enhances the use of internal capital markets through relaxing the restrictions on fund transfers and enables risk-sharing among affiliated firms (Gonenc, 2009). In other words, business groups that own banks can take more risks since the group-affiliated bank can provide buffer and risk-sharing benefits for the affiliated firms when they are faced with increased competition (Hoskisson et al., 2004). Even though raising external funds has become easier as financial markets advance, having a financial bank reduces the coordination costs and provides the business group flexibility in financing new acquisitions and mobilizing financial resources into those new businesses.

Furthermore, as market institutions develop and investment environment becomes lucrative, banking and financial services sector emerges as one of the most profitable businesses in emerging markets (Ramamurti, 2000; Economist, March 13, 2010). Therefore, owning a financial bank and related financial services could serve as a typical "cash cow business unit" in the portfolio of a business group that generates high profit margins and is responsible for a large amount of the business group's operating revenues and profit. This generates cash for acquisitions in areas where the growth potential is high, but the business group's market share is currently not high. Therefore, when a business group owns a financial bank, cash is likely to be generated more easily for financing new acquisitions in new unrelated businesses, even though they need significant funds such as in the case of energy and telecommunications.

With the increasing foreign competition in banking and the newly emerging capital market alternatives such as mutual funds and venture capitalist funds, the incentives of group banks are also aligned with unrelated diversification strategy of the group. Indeed, both the theoretical arguments (e.g., Hoskisson et al., 2005) and empirical evidence (e.g., Ramaswamy et al., 2002; Lee & Petitt, 2004) support this argument. Banks derive a significant part of their income from the interests on loans they offer to companies or fee income in response to meeting financial needs of the companies they invest (Ramaswamy, Li, & Veliyath, 2002). Furthermore, since most acquisition activities are financed through debt, banks encourage expansion even in unrelated ways through acquisitions since they make their earnings on the size of deals rather than the profitability of the investments in the long run (Lee & Petitt, 2004). Therefore, when a business group owns a bank, strategic restructuring is likely to result in a more unrelated type diversification, since unrelated diversification increases the number of firms through which a bank might create business (Hoskisson et al., 2005).

In addition to direct financial benefits, a group-affiliated bank can also serve as the source of customer data base and distribution channel through which business groups can create synergy among diverse businesses. Since reaching to in-depth customer information is still more difficult in emerging markets due to fewer number of market research firms and firms' less developed marked-based capabilities, customer data bases of large retail banks where they track sophisticated personal information on customers in loan applications, deposits, etc. can be a valuable, rare, and inimitable resource that create synergy with other businesses. Furthermore, from the customers' perspective, easy access to financing options in buying products and services creates additional benefits. Affiliated firms can make alliances with the group bank to offer more integrated products and services where easy financing is part of the value package. This creates value for the business group even their businesses may be unrelated to each other in general terms. All of these discussions suggest the following proposition.

> ***Proposition 4:*** As markets advance, the degree of unrelated diversification is positively associated with the business group's financial bank ownership.

Third, this study suggests that a business group's strength of the distribution network affects the degree of the business group's unrelated diversification. Establishing strong distribution channels helps business groups to overcome product market failures and to implement horizontal or vertical diversification strategies, and therefore, is considered as one of the most critical resource that builds over decades (Li, Ramaswamy & Petitt, 2006). Furthermore, access to distribution channels is one of the most critical entry barriers for firms that attempt to enter into new product and geographical markets (Porter, 1980). Therefore, local firms that control distribution channels erect high market entry barriers for multinational firms in emerging markets. Since establishing one's own distribution network typically takes long years, and available distribution channels are typically controlled by a few powerful firms, mostly by big business groups, even if markets liberalize, it is still difficult for foreign firms to enter into those markets unless they make an alliance with a local business group that controls or has access to distribution networks. Furthermore, during the liberalization process, most opportunities emerge in consumer markets (Ramamurti, 2000), where the strenght of the distribution channel particularly creates a great deal of value for firms.

All of these discussions suggest that unlike advanced markets, where reliable distribution channels in the market are more widely available, accessing to distribution channels creates a valuable, rare, and costly to imitate advantage in emerging economies even as markets advance. Therefore, as new opportunities emerge as a result of privitization and deregulation during the liberalization process of emerging economies, business groups with strong distribution network will likely to have an advantage over others in terms of capitalizing those opportunities emerging in diverse product markets. These discussions lead to suggest the following proposition. Based on these discussions, I suggest the following proposition.

> ***Proposition 5:*** As markets advance, the degree of unrelated diversification is positively associated with the strength of the business group's distribution network.

Although all of these firm-specific factors are suggested to significantly affect the degree of unrelated diversification of a business group as markets advance, they are not always mutually exclusive from each other. For example, business groups with larger size and scope may be more likely to own a financial bank and have a stronger distribution network. I suggest that the main reason for this is that the origins of all these firm-specific factors lie at the founder characteristics and those entrepreneurs' strategic choices in early years of their enterprises' development. Since the focus of this study is the business groups' strategic choices at their last stage of development, it is beyond the scope of this study to fully explain how those origins influence the evolution of their diversification process. However, in line with Chung's (2005) arguments, I suggest that entrepreneurs' characteristics and contextual factors at the time of business groups' founding interact to shape the group's diversification pattern. More specifically, business groups with larger size and scope are more likely to be founded by merchants with less formal education, but who have typically high apetite for risk taking and money making. On the other hand, less diversified and relatively more focused groups are more likely to be founded by highly educated entrepreneurs with industrialists backgrounds, who are typically more cautious in risk taking. The founders' characteristics and their early decisions affect the groups' strategic choices at later stages of the group's development, because of the imprinting effects of the founder for the later generations of the founding family who are still the controlling shareholders in many family business groups and the path-dependent diversification pattern that has been affected by the firm's initial investments and accumulated resources.

CASE ILLUSTRATION: TURKISH BUSINESS GROUPS

Macro-Economic and Institutional Changes in Turkish Business Environment

Founded as Turkish Republic in 1923 in remnants of Ottoman Empire, Turkey, located at the intersection of Asia and Europe with 73 million population, is a medium-sized emerging market and the 17th largest economy in the World with nominal GDP of $632 billion in the year 2009 and a GDP growth rate of around 10.5% as of the first two quarters of the year 2010 (source: CIA World Fact Book). The liberalization efforts of Turkish economy started in early 1980s when export oriented policies gradually started to replace import substitution policies that dominated the economy in previous decades. After long years of instability including a severe currency crisis in 1994, the government signed the Trade Union Agreement in 1996 as part of a requirement to comply to the European Union integration process. This required the implementation of neo-liberal policies, which started to lift heavy restrictions on foreign direct investment and free trade. However, a comprehensive liberalization program and the fundamental changes in market institutions did not get fully undertaken until after the severe financial crisis that Turkey experienced in 2001 and the new single party government that started to rule the year after. The financial crisis was mainly caused by expansive related lending and tunneling underpinned by weak regulation and enforcement (Ararat, 2010) and resulted in the devaluation of Turkish lira 31% against American dollar in just two days, the 10% contraction of Turkish econonomy in one year, bankruptcies of many financial banks and small enterprises with massive layoffs particularly in the banking sector, and huge profit loss of even the biggest companies (Onis, 2006; Karaevli, 2008).

However, the year 2001 is also considered a real turning point in Turkish economy, since the financial crisis prompted significant financial sector and corporate governance reforms (Ararat, 2010). As a result, a modern legal framework with the establishment of the Banking Regulation and Supervision Agency provided a strong ground for the emergence of a robust banking industry (Ugur & Ararat, 2006). For the non-banking sector, the Capital Markets Board of Turkey issued Corprorate Governance guidelines in 2003, which included recommendations for voluntary adoption of best practices in corporate governance, which then became mandatory for the listed companies in Istanbul Stock Exchange by the end of 2009 (Ararat, 2010).

In the meantime, the increased power of International Monetary Fund (IMF) against local interest groups and populist policies resulted in strict budgetary enforcements that led inflation to drop to single digit numbers the first time in 30 years. Furthermore, IMF induced stabilization reforms accelerated the transition to free-market regime through policies of privatization and deregulation in major industries, such as energy and telecommunications. With IMF enforcements, the Central Bank of Republic of Turkey has emerged as a more independent and powerful player in regulating financial markets. The government, who had been a major actor in Turkish economy in terms of being the main resource allocator and the creator of both the opportunities and uncertainties for decades (Bugra, 1994; Colpan, 2010), has started to assume its new major role in economy as the “regulator of markets”.

All of these advancements in economic and institutional spheres significantly increased the confidence of foreign investors in Turkish economy, which in turn increased the foreign direct investments (FDI) inflow from 1.1 billion in 2002 to 22 billion in 2007, with the total FDI Turkey attracted between 2002-2009 worth $83 billion. As of November 12, 2010, foreign investors owned 53.65 percent of the shares transacted at the Istanbul Stock Exchange with the total market value reaching 68.42 percent. All of these foreign investments, either in the form of FDI or portfolio investments make Turkey the 15th most attractive destination for investment in the world. (Source: Central Bank of Republic of Turkey).

Taken together, in the last decade, the structural reforms in banking and capital markets, restructuring of state-owned enterprises and privatization, deregulation in communication and energy sectors, the stabilization of the macro-economic conditions including drastically decreased inflation and interest rates, and increased fiscal discipline significantly reduced transaction costs and uncertainty in Turkey. As a result, these macro-economic and instititutal changes have been accompanied by significant investment opportunities and increased competition in Turkish business environment.

Diversification Strategies of Turkish Business Groups

Similar to other emerging markets, Turkish economy is characterized by the two-pillar large-enterprise structure with strong presence of diversified business groups and state-owned enterprises (Bugra, 1994; Colpan, 2010). While family-controlled business groups typically exhibit a pattern of unrelated diversification, state-owned enterprises adopted a product-focused growth. Family-owned Turkish business groups are the main drivers of Turkish economic development since the Second World War. Historically there are many commonalities between Turkish business groups and those in other emerging economies, particularly South Korean chaebols (Goksen and Usdiken, 2001). The founding family members of business groups essentially control the strategy and operations of the entire business group through a holding company, which is a legally independent entity with two major roles: owning and controlling operating units as subsidiaries, which are themselves legally independent firms with their controlling shares held by the parent holding company; and coordinating and managing the activities of those subsidiaries for operational efficiency (Colpan, 2010). While imperfect markets and industrial policies of governments have created incentives for capitalizing on opportunities in diverse industries, uncertainty induced by inconsistent and arbitrary changes of governments has created the risk reduction rationale of unrelated diversification in Turkish family holdings (Bugra, 1994; Colpan & Hikino, 2008; Karaevli, 2008).

Besides their dominance in Turkish economy for almost five decades, Turkish family holdings represent more than large economic enterprises, namely, they are social entities as well. Therefore, their strategic behavior can only be analyzed in relation to both economic and non-economic factors. For example, Bugra (1994)'s analysis suggests that "Turkish holding company forms an integral part of the Turkish society and reflects the typical characteristics of the social and political framework of entrepreneurship in this country" (p. 171). As noted so far, the lack of commitment to a particular branch of industry is one of the main characteristics of business behavior in Turkey. According to Buğra (1994), a related feature of the business mentality in the country is that it is dominated by "a commercial rather than an industrial outlook" (p. 63), which she explains in reference to the social origins and career backgrounds of the business class. Based on Bugra's (1994) interpretation of Kerwin (1951), the trading nature of Turkish industry inhibits industrial development in a way that the goals of abnormal returns and rapid amortization undermine long-term commitment to industrial activity, largely because social backgrounds of businessmen support the development of commercial skills. In relation to this, Bugra (1994) further discusses that unlike Schumpeterian entrepreneurship whose role is defined by technological innovation, entrepreneurial function in a Turkish holding company has more to the with financial management and manipulation of the policy process (p. 220).

Furthermore, early studies reviewed by Bugra (1994) indicate that the initial investment funds raised by the family, solidarity of family members and their desire to maintain the family's control over the business activities of the enterprises are important factors in the development of Turkish business groups. The organizational form of holding company that centralize the diverse operations was indeed considered as a respond to those needs of maintaining family control when founders wanted to make sure the continuity of family control after themselves. Bugra (1994) further discusses that when traditional family structures erode, new mechanisms to sustain family control may emerge. In this realm, we see a lack of a clear-cut distinction between private wealth of the founding family and capital of the enterprise in Turkey, which is argued by Bugra (1994) as money belongs to the boss and not to the company. In addition to maintaining family control, protecting the size and and multibusiness character of holding companies has been important for the founding family since their firm's size and scope have traditionally enabled them to enjoy important advantages in their relations with state authorities during their foundation and growth stages (Bugra, 1994).

Despite these commonalities that shed light on the nature of business environment in Turkey, Bugra discusses that the social backgrounds, career orientations and personalities of entrepreneurs were quite different, which shaped their early strategic choices and consequently had significant effects on their strategic behavior in later stages. For example, based on her arguments, the natural inclination of self-made merchants like Koc and Sabanci, with no or little formal education and foreign language knowledge was largely effective in development of businesses mainly as commercial enterprises. I suggest that these origins led to significant differences at the firm level that enhance or hinder their strategic choices during the recent strategic change process.

The financial crisis of 2001, the subsequent macro-economic and institutional reforms, and resulting heightened competition in the domestic market triggered corporate restructuring in many Turkish business groups. The limited scale in the domestic markets and weaker product, technological, and market-based know-how and organizational capabilities put them at a competitive disadvantage vis-à-vis global foreign players, which have larger scales, superior product, technological, and market-based know-how and capabilities. Therefore, in the process of becoming integrated into an increasingly interconnected global economy, corporate restructuring was critical to the survival, growth, and profitability of Turkish business groups. Then, the important question remains for business groups in emerging markets, which is whether the extensive product diversification can be sustained in these markets that are developing rapidly in their economic and institutional environments (Delios & Ma, 2010), has been waiting for an answer in Turkish context as well.

The following section seeks to illustrate how the characteristics of Turkish business groups and business environment in Turkey, described so far, shape the current strategic choices of these large enterprises by focusing attention on four major business groups: Koc, Sabanci, Eczacibasi and Borusan Holdings, which are considered among the leading economic players and the most well-known business groups in Turkey. Based on the autobiographies of four founders: Koc (1979; 2006; 2008), Sabanci (1985; 2004), Eczacibasi (1982), and Kocabiyik (2004), and the analysis of these founders and founding conditions of the holdings in reference to the economic and political framework of Turkey by Bugra (1987, 1994), first, a brief summary of each group, including the short history, founder's background, and the holding's diversification pattern from early to recent years, is presented. Then, some illustrative evidence on the investigation of the corporate restructuring process of these four major Turkish business groups by the current author is provided.

Strategic Change Processes of Four Major Turkish Family Holdings

Based on Colpan and Hikino's (2008) listing, among the top 50 largest economic players, 28 are diversified business groups, with Koc Holding as the largest and Sabanci Holding as the 3rd largest economic player of Turkey. Eczacibasi Holding and Borusan Holding are listed as the 30th and 47th, respectively. While there are certain commonalities between these four business groups, i.e., all are founded in early decades of the Turkish Republic (between the 1920s and 1950s), family controlled, well-regarded by key stakeholders in Turkish society and diversified, they also differ significantly with respect to key dimensions such as size and scope, diversification pattern, resources and capabilities, financial bank ownership, distribution network strength, and founder background.

Koc Holding. Koc holding was founded by Vehbi Koc, who was a son of a small grocery store owner in central Anatolian town Ankara, which had become the capital city after the foundation of the Turkish Republic. Koc had high appetite for commerce and left high school for working with his father and pursuing interests in making money. Early businesses, most of them were initiated as a result of close contacts with government officials and early business with minority businessmen, included retailing, contracting in government projects, and distribution of oil, gas, and motor vehicles. Koc diversified into unrelated businesses rather early (operating in four or more 2-digit SIC industries). During those years, Koc Holding was widely diversified to operate businesses in diverse settings such as automotive, household appliances, textile, food processing, retailing, construction materials and mining, energy, trade and tourism, and finance and banking. After the financial crisis of 2001, Koc Holding decided to focus on four major unrelated businesses: household appliances, automotive, finance and banking, and energy. They have started to sell their big businesses in retailing and insurance.

Sabanci Holding. Sabanci Holding was founded by Haci Omer Sabanci, a villager with no formal education from a central Anatolian town, Kayseri, who went to a relatively rich Southern Anatolian town, Adana, to seek wealth by capitalizing on opportunities provided by cotton farming and industry. He started with small commercial dealings which created opportunities for later alliances in industrial enterprise development. Unlike Koc family, although Sabanci family did not have direct contacts with high government officials during early years, they had close relations with state bankers and military officers, which served to multi-purpose for them, such as the acquisition of financial advice, getting access to government credit, source of managerial personnel which was in short supply, and smoothing relations with the military which was thought to be very helpful during periods of military takeover. The early industries they invested include textile, commerce, banking and insurance, and tire production. Under the leadership of Sakip Sabanci, one of the sons of Haci Sabanci who had been the chair of the holding since its founding until his death in 2004, Sabanci group diversified into unrelated businesses rather early, similar to Koc holding's diversification pattern. During those years, they followed a widely extensive diversification pattern to operate in businesses such as cement, trade and tourism, car, bus, and truck manufacturing and distribution, food, retailing, and chemicals. After the portfolio restructuring process, Sabanci Holding's current portfolio includes the following major unrelated businesses: cement, tire and automotive parts, finance and insurance, retailing, and energy. They sold their businesses in chemical products and food, and started to exit from textile, trading, and some other small scale businesses.

Eczacibasi Holding. The founder of Eczacibasi group is Nejat Eczacibasi, who had a PhD in chemistry and came from a very well-established and educated family in Western part of Turkey. His father was a chemist and an owner of a laboratory. In other words, Eczacibasi's career path continued a familiar line of business which was related to his father's field of activity. Eczacibasi's early business activities included production of cod liver oil and baby food, drugs by using a very basic technology, electrolytic copper for the needs of Army, and porcelain cups. Their biggest investment was the establishment of a factory producing generic drugs under foreign license in 1950 with industrial credit provided by the newly established Turkish Bank for Industrial Development. In later years, they extended their businesses to production of ceramics, paper products, and bathroom and kitchen fixtures. From Eczacibasi's perspective, these lines of activities are related to original line of specialization through their hygiene-related character and all reflect the public image of the company, which is revolved around the last name "Eczacibasi", meaning "the head of pharmacists". During recent years, there have been changes in Eczacibasi's business portfolio as well, although they do not consider themselves as going through a major restructuring process. Eczacibasi holding sold their generic drug business to a global company, which helped them to finance their growth strategy in their kitchen and bathroom manufacturing business through developing their design capability and buying international brands, such as Villary Boch. Their current portfolio includes the bathroom fixtures manufacturing and personal care manufacturing and distribution as major lines of businesses. Recently, they have been venturing into growing in investment banking sector as well.

Borusan Holding. Borusan Holding was founded by Asim Kocabiyik, who was born in a central Anatolian town Afyon and then came to Istanbul for pursuing a college degree in Economics. Although their first business was steel trading and exporting of agricultural products, Kocabiyik was a believer of industrial development and the group's industrial investments started with the establishment of pipe factory in 1958. This was followed by steel and machinery manufacturing. Although the holding diversified into businesses in distributorship, integrated logistics, and telecommunications after 1980s, the focus of the holding remained as pipe and steel production. During the restructuring process, Borusan holding made major investments in energy business, and their current portfolio includes steel production, energy and distributorship as major unrelated businesses and logistics as a related major business.

The Table 1 summarizes the relations between the key charactericteristics of these four major Turkish family holdings and the existence in and the degree of the unrelated diversification of their current portfolio as the macro-economic and institutional environments have been advancing in Turkey.

Insert Table 1 about here

Although empirical evidence is scarce on the strategies of Turkish business groups, based on recent studies (Colpan & Hikino, 2008; Karaevli, 2008) and the preliminary findings of current investigation, it is clear that Turkish business groups remain as unrelatedly diversified in the new circumstances of the environment. More specifically, this investigation suggests that the current corporate startegy of all holdings can best be described as "multi-focus" diversification strategy, which is basically selecting a number of businesses, both old and new, to grow, by exiting industries that are no longer profitable for them, and entering new, potentially more profitable industries. The new industries they enter are not necessarily related to their existing portfolio, and there is no indication that they will focus on one core business in the future by developing product and technical-based capabilities at the global level. Instead, they continue to ally with foreign firms who have those product and industry-based capabilities, such as in the case of Sabanci and Borusan Holdings' big energy ventures, both of which have become joint ventures with big foreign energy companies. But at the same time, as opposed to their past practices, the holdings have started to exit from some of their traditional businesses, either because they are no longer profitable for them or to finance their big initiatives in new opportunity markets. For example, Koc Holding sold their big and highly profitable retailing company, Migros, to a foreign private equity firm to finance their acquisition of Tupras, a previously state-owned energy enterprise that has been a monopoly in its sector.

All of these discussions suggest that they still diversify by the logic of "industry selection" rather than "creating synergy", as we see also in Table 1 that their resources and capabilities are still quite generic, and not industry-specific. However, these resources and capabilities still create a valuable, rare, and inimitable advantage for them in critical matters such as protecting/gaining customer trust, negotiation power against the government and foreign alliance partners, and finding and retaining managerial talent.

Although opportunities in the new environment and their context and path-dependent resources and capabilities have led these groups to remain as unrelatedly diversified, as proposed in the theory section, the degree of unrelated diversification differs among these Turkish business groups. While Koc and Sabanci Holdings, large and widely diversified groups, focus on four or more businesses and grow in all of these sectors by making very significant investments, Eczacibasi and Borusan's degree of unrelated diversification is relatively lower as the number of their unrelated major businesses remains fewer. Although it was not the focus of this study, the results also suggest that there are differences with respect to internationalization of the holdings as well. Koc and Eczacibasi seem to have stronger efforts at internationalization compared to Sabanci and Borusan holdings, particularly in the household appliances business of Koc Holding and the bathroom fixture products business of Eczacibasi Holding.

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TABLE 1. HOLDING CHARACTERISTICS AND UNRELATED DIVERSIFICATION

	Koc	**Sabanci**	**Eczacibasi**	**Borusan**
Resources & Capabilities	Reputation and brand name, distribution, financial capital, IT management	Reputation and brand name, operational effectiveness, financial capital	Brand name, brand making, service, design, supply chain management	Brand name, alliance making, service
Diversification scope	Wide	Wide	Narrow	Narrow
Financial bank ownership	Yes	Yes	No	No
Distribution network strength	High	Medium	High	Low to Medium
Founder background **Risk taking propensity of shareholders**	Merchant/ less formal education High risk taking propensity	Merchant/less formal education High risk taking propensity	Industrialist/high formal education Low risk taking propensity	Industrialist/high formal education Low risk taking propensity
Any unrelated diversification in the new environment	Yes	Yes	Yes	Yes
Degree of unrelated diversification (Number of unrelated major businesses)	4	5	2	3