



INTERNATIONAL CORPORATE TAX - GLOBAL TEAM

Playing a long game

A study of the foreign investment plans of Turkish businesses between 2009 and 2014

KPMG IN TURKEY



Contents

Introduction	1
Commentary	2
Flight to safety	2
Russia leads the table	2
A cautious approach	5
Reasons for choosing different countries	6
Tax systems matter	7
Turkish business playing a long game	8

Across KPMG's global network of member firms, we have 22,000 tax professionals. The insights they offer – both in local tax knowledge and cross-border tax skills – can provide organizations, large and small, with an advantage in the immediate and long term. Drawing on the experience of our people and multi-disciplinary approach, we are able to help our firms' clients to think beyond the present, see beyond borders and achieve long-lasting success.

Introduction

For the past two years, KPMG's global tax practice has been investigating the changing pattern of global investment flows through a series of research projects.

The first of these, in early 2008, looked at capital flows on a global scale. It concluded that there was a general move away from investment in the US and towards investing in the Asia-Pacific economies, with Europe maintaining its pivotal position. This view was broadly confirmed by subsequent research studies from KPMG looking at capital flows among the countries of the Middle East, and in Latin America.

But these investigations took place before the global financial crisis of 2008/09 and the subsequent widespread recession. Therefore there is a need to find out whether investment intentions have changed as a result of the recession; beginning with a survey of CEOs and CFOs in Turkey.

As a rising regional power, with strong links to the Asian economies combined with aspirations to join the European Union, Turkey is in a unique position to reflect the changing balance of economic influence and opportunity.

The results of our survey show that Turkish business is forging important connections with the developing economies of Eastern Europe, North Africa and the Middle East, but is still to make its mark in the Asia Pacific region and the Americas. Many Turkish companies are building links which should be of great value in future, but they are acutely aware that doing business outside their region requires care and preparation, especially when it comes to tax matters.

We hope this study will be useful to anyone with an interest in the progress of international trade among Turkish companies. It provides a forward thinking, global perspective on today's investment trends, and is intended to add value to any discussion of how the Turkish economy could develop in the next five years.



Ferruh Tunç
Chairman and Senior Partner
KPMG in Turkey



Wilbert Kannekens
Global Partner-In-Charge
International Corporate Tax -
Global Team

Commentary

Our research was undertaken among 50 senior corporate decision makers representing a wide range of sectors, with annual global turnover ranging from 100m Turkish Lira to more than 500m Turkish Lira. In telephone interviews conducted during August and September 2009, these people were asked a series of questions, including where they choose to locate their businesses, what affects their decisions on location, where they expect to be investing in the next year, and where in five years from now.

Flight to safety

The immediate impression given by their responses is of a group of people much concerned by the potential impact of the recession on their businesses. Four out of 10 said that the recession has made them change their investment plans so that they are now investing more at home in Turkey than they do abroad.

At the same time, around a third (30 percent) say that they are increasing their foreign investments, and 16 percent say that this recession has made no difference to their investment plans. But the countries chosen as places to invest show a clear desire to stay reasonably close to home, and a majority of these investments will be into countries where the Turkish companies already have holdings.

Russia leads the table

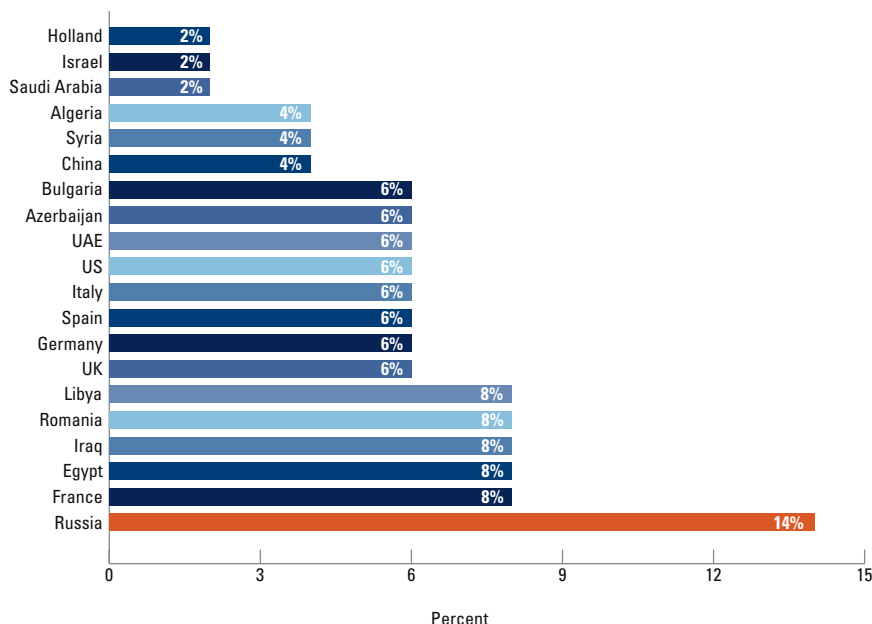
The clear favorite among respondents as a destination for investment both now and in the short to medium term is Russia.

It leads the table for current investments, with 30 percent saying they have holdings there, takes the largest share of investments planned for the year ahead, with 14 percent saying they will invest, and is also the leader for investments over the next five years, again being the choice of 14 percent.

Second for current investments is Germany, chosen by 18 percent. But Germany is clearly falling out of fashion as a place to invest, having been Turkey's leading international trading partner. Looking a year ahead, it is joint third for investment, behind France, Egypt, Iraq, Romania and Libya and alongside the UK.

Turkish companies will be investing in a wide range of countries next year. In most cases they will have invested in these countries before.

Top countries that will receive Turkish investment next year - Russia is number one.

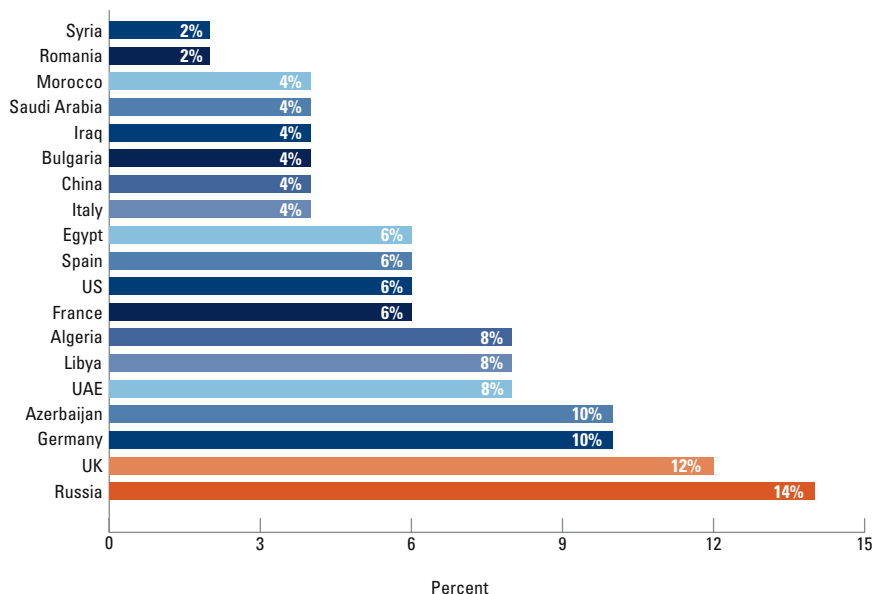


Source: Playing a long game, KPMG Turkey 2009

Five years ahead, it is the UK which, as the choice of 12 percent, is clearly in second place after Russia, followed by Germany on 10 percent.

In the next five years, Russia remains the most popular country for investment.

Top countries that will receive Turkish investment in the next five years



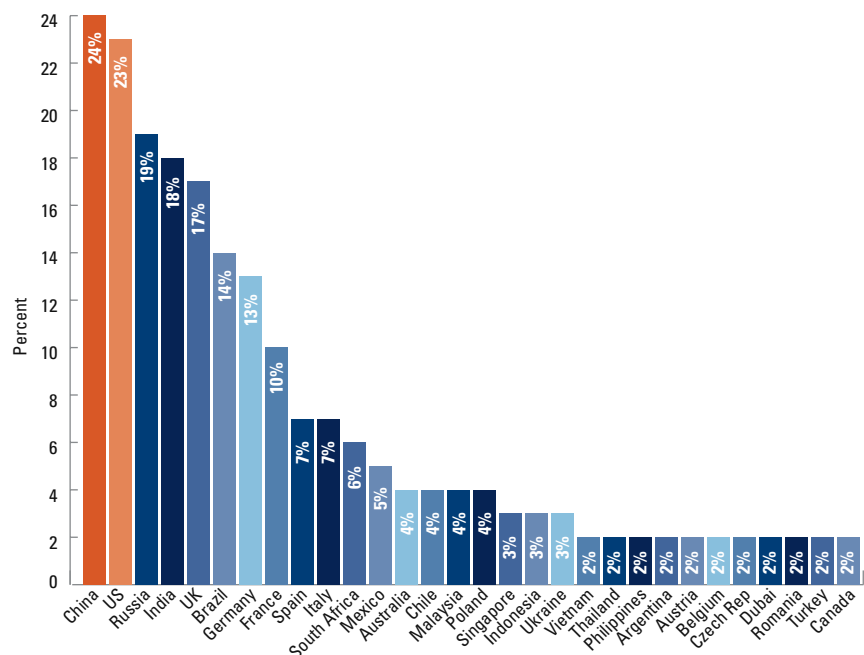
Source: Playing a long game, KPMG Turkey 2009

But what is most interesting about the declared investment plans of the Turkish businesspeople surveyed, is how different their patterns of investment are from those of the European, US and Asia-Pacific investors surveyed in our earlier research projects.

A common pattern among international investors is to have a large holding in the US, but to have plans to reduce this in favor of increased investments in China, India, and to some extent in Europe.

Globally, in five years, China will receive the most investment, closely followed by the US.

Countries where respondents to KPMG's Global Capital Flows Survey are expecting to make an investment in the next five years



Source: Global Capital Flows, KPMG International, 2008

By contrast, Turkish investors are enthusiastic for the emerging economies of Eastern Europe, North Africa and the Middle East. In particular, the countries of the Middle East are a popular investment destination for Turkish construction companies, and for textile manufacturers looking for more efficient locations for their factories.

Azerbaijan, the United Arab Emirates, Libya and Algeria are also high on the list of countries chosen for investment in the next five years, but in the short term they tend to come in behind the more established European economies like France, Spain, Germany and the UK.

The US does appear, but as a relatively minor recipient of investment both in the short and medium term. With the exception of China, the Asia Pacific economies do not feature at all.

A cautious approach

A clue to this pattern of investment may lie in the responses to questions on whether foreign investments would be the first time the respondents had invested in these countries, or would follow existing investments.

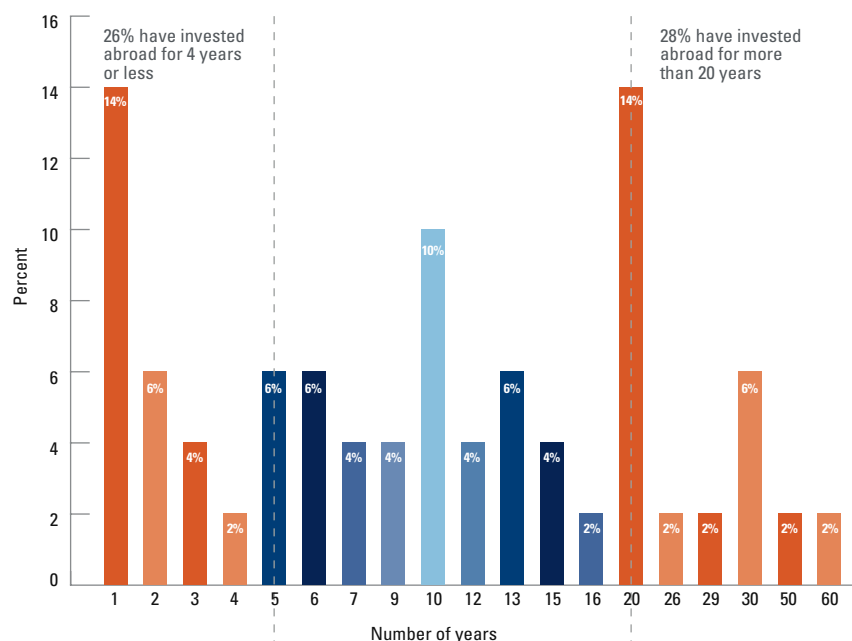
Looking a year ahead, 58 percent said that their investments would not be the first time they had ventured into these countries. Looking five years ahead, this rose to 65 percent.

These figures are roughly similar to those among respondents in our global survey. But given the relatively restricted list of countries chosen by our Turkish respondents as places to invest, the Turkish survey does paint a picture of an economy looking to establish itself carefully and with minimal risk in a region that it knows well, perhaps before venturing more widely.

Within that picture, there are, of course, variations. Just over a quarter (26 percent) of respondents said that foreign investment was relatively new to them, having invested abroad for four years or less. About half of these (14 percent) said they have only started investing abroad in the past year. By contrast, 28 percent have invested abroad for more than 20 years. Many of these older investments will have been in the late 1980s, during the wave of investment that followed the liberalization of the Turkish economy.

These cross-border investments tend to be either very recent or very well-established.

Length of time (in years) of investment abroad



Source: Playing a long game, KPMG Turkey 2009

But both groups seemed united in their cautious approach to controlling overseas ventures. Whereas joint ventures are a popular means of managing foreign ventures among businesses outside Turkey, here only 16 percent of respondents chose this as their preferred option.

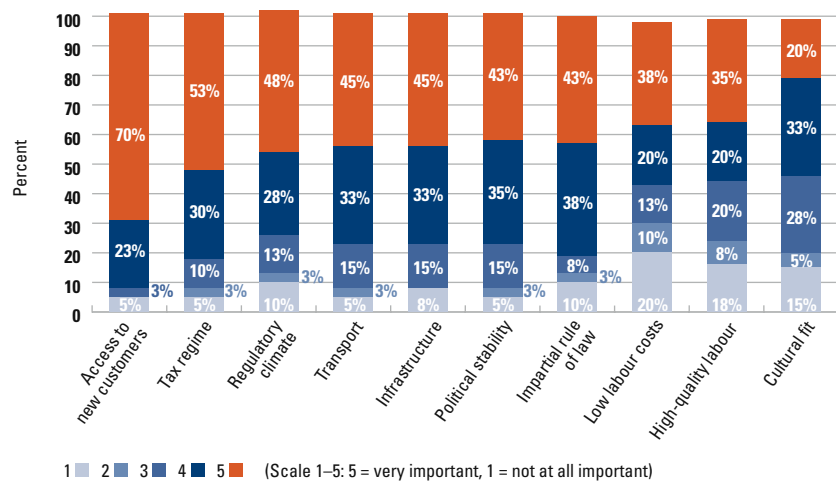
More popular by far is holding investments in a subsidiary or a branch of a Turkish entity. Between them, these two options were chosen by 44 percent of respondents.

Reasons for choosing different countries

The most significant reason for choosing to invest in a particular country, for all the companies surveyed in our global and regional surveys, including Turkey, is access to new customers. Seven out of 10 respondents in Turkey said this was very important in their decision, making it the most important factor by far.

70% of Turkish companies investing abroad are particularly interested in how they can access new customers.

Most important factors in choosing where to invest abroad



Source: Playing a long game, KPMG Turkey 2009

Turkish businesses then chose the tax regime as second most important, followed by the regulatory climate, transport, infrastructure and then political stability.

This contrasts strongly with the views recorded among investors in our global survey, for whom political stability was the second most important attribute after access to new customers, with the tax regime well down the list, after the regulatory climate and impartial rule of law.

Even in Latin America, political stability was rated third most important after access to customers and regulatory climate, with tax regime fourth.

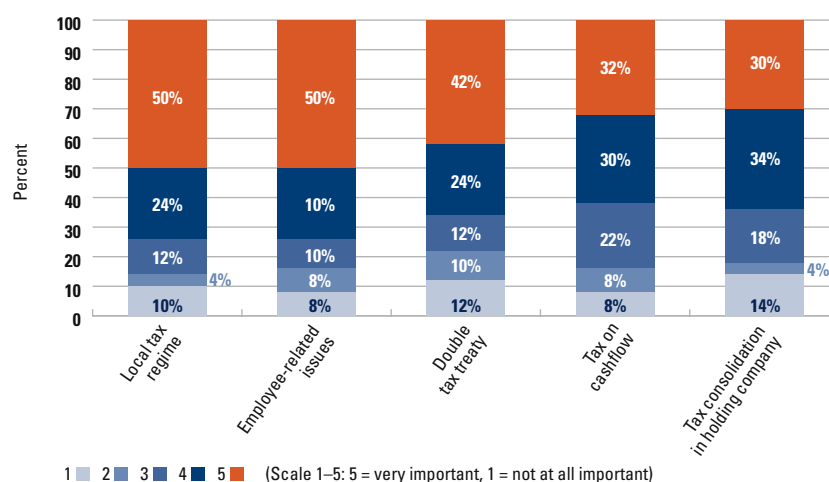
Given the political history of some of the countries that are high on the list of places to invest for Turkish companies, from an international point of view it may seem surprising that political stability is so low down the list of key attributes. But Turkey itself has not been immune from political instability, so it may be that Turkish business is sufficiently accustomed to operating with the prospect of political uncertainty not to see potential problems in this area as a reason to avoid investment.

Tax systems matter

Tax considerations were second on the list for Turkish businesses when choosing a particular country, but they topped the list, alongside employee issues, when selecting a suitable structure for investments.

The local tax regime and employee-related issues are the most important factors in selecting an investment infrastructure.

Most important factors in selecting investment structure



Source: Playing a long game, KPMG Turkey 2009

These considerations have taken on a new significance for Turkish business following the introduction, in the Turkish Tax Code of June 2006, of new Controlled Foreign Company (CFC), transfer pricing and anti-tax haven rules. The responses to this study show how important these matters have become in determining the structure of investment in foreign companies.

They can only grow in importance as many Turkish businesses seek a greater share of global markets. International companies are already dealing with global trends towards greater tax transparency, more co-operation between tax authorities, and more reliance on transfer pricing regulations to secure a country's revenues. A sound and defensible policy on tax is now widely seen to be absolutely necessary for successful cross-border trading.

Turkish business playing a long game

In summary, foreign investment made by Turkish business appears to be a curious mixture of long established relationships and new ventures into countries in the region, especially Russia.

What makes Turkey stand out is its position as a key link between emerging economies in Eastern Europe and Asia, and the old economies of the EU. This position is reflected in the current and future pattern of investments, with a clear short-to medium term trend away from the old economies and towards investing in the economies of the Balkan States, North Africa and the Middle East.

Should Turkey achieve its aim of becoming a member of the EU, its position as a link between these regions will be significantly strengthened and it will have a major advantage in accessing the growing markets of Russia and the surrounding states. It could be that Turkish business is developing for itself a set of contacts and holdings which could prove extremely valuable in the years to come.

Contact

Ferruh Tunç

Chairman and Senior Partner

KPMG in Turkey

Tel: +90 (212) 3177450

e-Mail: ftunc@kpmg.com

Wilbert Kannekens

Global Head of International

Corporate Tax

Tel: +31 20 656 16 19

e-Mail: kannekens.wilbert@kpmg.nl

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2009 KPMG Yetkin Yeminli Mali Müşavirlik A.Ş., the Turkish member firm of KPMG International, a Swiss cooperative. All rights reserved.

Originally produced in Turkey.

KPMG and the KPMG logo are registered trademarks of KPMG International, a Swiss cooperative.

Designed and produced by KPMG LLP (UK)'s Design Services.

Publication name: Playing a long game

Publication number: RRD-163660

Publication date: October 2009