Why Do Foreign Banks Invest In Turkey?

Aysan, Ahmet Faruk and Ceyhan, Sanli Pinar

2006

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AHMET FARUK AYSAN & ŞANLI PINAR CEYHAN
Department of Economics, Boğaziçi University, Turkey

Corresponding Author: Ahmet Faruk Aysan
Boğaziçi University
Department of Economics
34342 Bebek, Istanbul, Turkey
Phone: 90-212-359 76 39
Fax: 90-212-287 24 53
ahmet.aysan@boun.edu.tr

Abstract

Sound macroeconomic policies, increasing global liquidity and higher real returns in developing countries played an important role in canalizing capital towards developing markets. Recent improvement in the developing Turkish economy brought the issue of foreign entry to the foreground. High growth potential backed by an increasing population, falling inflation rates and the birth of the mortgage sector made Turkey an ideal place to expand into. This article is not concerned about whether foreign entry is good nor does it discuss the subsequent effects. Rather, it attempts exclusively to shed light on the motivations behind entry to Turkey utilizing recent entry cases.

Key Words: Globalization of Banking, Turkish Banking Industry, Foreign Bank Entry
JEL Codes: F20, F36, G0, G21

WHY DO FOREIGN BANKS INVEST IN TURKEY?

1. Introduction

Recently, financial markets of developing countries have been receiving high amounts of funds thanks to their successful economic policies, increase in global liquidity, and relatively lower real returns in developed countries. It is forecasted that in 15 years mega banks will emerge in global scale, and foreign penetration will preserve its importance. In this kind of an economic picture, Turkey, as a developing country, has been among the major actors with an increasing amount of foreign entry.[1] In fact, in 2005, foreign capital inflow to Turkey's banking sector amounted to approximately six billion dollars and the growth rate of the banking sector is forecasted to be eight percent on average in the next 15 years. Latest figures show that foreign asset share (participation banks included) in the Turkish financial sector is 17.5 percent as of May, 2006.[2] Foreign share in consumer credits is found out to be 42.6 percent while they occupy 41.7 percent share in the mortgage sector. Additionally, foreigners have been net debtors with debts to banks and to other financial institutions constituting 48.2 and 45.7 percent of the sector, respectively.

In the literature, it is mostly the case that foreign entrants introduce their relatively higher-level technology to the host country market. However, this study shows that the entrants also expect to benefit from the technological potential of the Turkish financial sector. In fact, one factor creating synergies between NGB and Finansbank is the optimization of the Southeastern European cost base in areas such as IT. In addition to technological improvement, foreigners choose Turkey as a base to increase their product and service range. This is evident in the decision of NBG to purchase part of Finansbank attracted by its high quality retail products like consumer loans and insurance.

Not only does Turkey have a geo-strategic advantage due to its position at the intersection of Europe and Asia, but it also has a promising financial market with an increasing population of approximately 70 million as of the end of 2005 and GDP growing at 4.3 percent per year on average between 2001 and 2005. Especially the improving macroeconomic picture of Turkish economy reflected in single digit inflation numbers and declining interest rates is a frequently pronounced reason for foreign bank entry into Turkey. The improvement in the banking sector can be seen in Table-1. Taking 1999 as the base year, for which the index is 100, one facet of improvement is shown to be the increasing profitability in the sector from 93.6 at the end of 2000 to 107 in May, 2005 with a small decrease following the 2001 crises. The same pattern is also observed in the other indicators. Financial strength, for instance, increases moderately after the crisis period reaching to 110.5 in May, 2005 from 97.4 at the end of 2001.

Insert Table-1

When the improving Turkish financial sector is compared to those of the European countries in terms of the asset share of banks with foreign capital in the banking sector, it can be seen that the share of 15.8 percent lies below all but Spain and Germany, with 9.7 percent and 10.5 percent, respectively, indicating the high growth potential in Turkey. The details are depicted in the Table-2. Among the countries listed, some late comers to the European Union, namely Litvania, Hungary and Slovak Republic attract attention with more than 90 percent asset share as does Luxemburg with a corresponding number of 94.7.

Insert Table-2

In this study, without exception, all the entrants to the Turkish banking sector express their desire to benefit from the high growth potential in the Turkish financial market. Real GDP growth is forecasted to be 2.1 percent for Europe, 4.3 percent for the Central and Eastern European countries while a similar figure for Turkey is five percent. Moreover, statistics showing this potential such as a more-than-74 percent-CAGR (Compound Annual Growth Rate) in total assets in the period 1997-2005 was what increased Dexia's appetite for Denizbank. Another mostly cited entry reason is to increase profits escaping from the low profit-financial sector of the parent country. For instance, Fortis, which was an already profitable company, increased its profits by 93 percent after the purchase of 89.3 percent of Dışbank shares.

Of course, a bank on its own right is not the ultimate target of foreign entrants. A more important reason of entry is to gain market share in the host country banking sector. This is evident again in the purchase of Dışbank shares by Fortis who could reach more than 1.000.000 new customers, approximately 120.000 new small enterprises and 10.000 new medium-sized enterprises.

High amounts of foreign capital channeled into Turkey after the amendments in the Banking Law in 1984. As the foreign exchange market increased in depth, foreign share and competition in the Turkish financial sector increased. Increase in the number of banks in the Turkish banking sector was accompanied by higher international trade and investment. In fact, the purchase of Garanti Bank shares by GE was accompanied by 1.8 billion dollars of investment, supporting the relationship between trade and investment. With the recent changes in the Banking Law, sympathy towards Turkish financial market increased thanks to foreign investment becoming in line with global standards.

Being among more than a hundred countries that will put into practice the Basel II Requirements, Turkey will experience an economic environment with an improved supervision in the banking sector after the new accord becomes effective in 2008. The capital adequacy ratio for the Turkish banking sector, which was higher than the legal limit with 24.2 percent as of the end of 2005, will decrease to 16.9 percent with the new arrangement. This prospect will also increase foreign appetite.

Behind foreign bank entry to Turkey, there lies also a demographic reason. People living in different parts of Turkey earn very diverse levels of income and this inequality has given way to migration especially from the Eastern parts of Turkey to big cities whose income per capita is above Turkey's average. This, coupled with the high population of Turkey, resulted in housing problems, and up until very recently, banks were not dealing much with the financing of housing. However, the improving macroeconomic performance in Turkey made it possible for banks to provide mortgages, creating a baby sector with long way to grow.

This paper is organized as follows: While analyzing the issue of foreign entry, in the second section, we will be looking at the pull and push factors mentioned in the literature, and attempt to find correspondences for the Turkish case. The third section deals with the Turkey-specific pull factors covering seven foreign entry cases, the foreign banks being National Bank of Greece (NBG) and EFG

Eurobank from Greece, Fortis from Netherlands, Dexia of Belgium, General Electric (GE) from the United States, HSBC of England, and UniCredito from Italy. The last section concludes.

2. Underlying Reasons of Foreign Bank Entry

Countries may welcome foreign bank entry either as part of their liberalization process as in Korea, Thailand and China, or when they have high amounts of debt. They finance economic growth at a minimum cost during sudden stops as in the East Asian crisis period when low prices attracted foreign entry.[3] Specifically, due to the insufficiency of the domestic banks during the process of recapitalization of joint venture banks, the Indonesian government increased the foreign ownership share from 85 percent to 99 percent. In addition to the increase in number, foreign banks also started to be treated like their domestic counterparts.[4] Similarly, National Bank of Poland tried to consolidate banks in trouble regardless of being domestic or not, and this gave way to foreign entry as long as foreigners could help in restructuring domestic banks.[5]

Increasing foreign trade, improving the technological infrastructure of the domestic banking sector, and increasing the product and service variety are among the expectations of the host country from internationalization. High profit potential (as a result of low level of competition) as well as the low market value of Latin American banks (which make it less costly to gain a high market share), and the Latin American banks' providing increasing returns to financial institutions (because of high intermediation margins) were what pulled foreigners to the host country financial market.[6] While expanding their customer base, foreign banks in Korea were attracted by the fact that they would be treated even better than their domestic counterparts in some banking operations.[7] Moreover, the Single Market Program and the introduction of Euro led to a single banking sector in Europe and entry barriers were eliminated increasing the foreign share in the sector.[8] For the case of Europe, Table-3 compares domestic and foreign banks according to some selected ratios, and indicates the stronger standing of banks with foreign capital. It is shown that nonperforming loans to loans ratio for the banks with foreign capital are lower than those for domestic banks, with figures 1.83 versus 3, respectively. While expenses-to-costs ratio is very much close for the two kinds of banks, profitability ratio of 0.56 for banks with foreign capital exceeds 0.5 of domestic banks. Moreover, tier-1 ratio [9] for domestic banks is found out to be less than that of banks with foreign capital.

Insert Table-3

A different view on the issue comes from Coppel and Davies (2003), Weller (2001) and Berger et al. (2000) who suggest that deregulation is what attracts foreign entry. [10] Indeed, the low level of foreign entry to the Asian financial markets relative to the Eastern European and Latin American markets is a result of the protectionist economic policies to safeguard the Asian banking sector. [11] As another example, following the initiation of the Convertibility Plan in 1991, Argentina eliminated capital controls, giving way to an increase in the foreign share of the banking sector. Similarly, the process of privatization of the state-owned banks, called PROES, was effective in pulling foreign banks to Brazil. [12] Furthermore, financial liberalization period started in Mexico with the privatization efforts in 1990s. [13]

In addition to the above factors, low profits and regulatory restrictions in home country lead to foreign penetration acting as the "push" factors. [14] Indeed, increasing market competition and thus decreasing profits in the European monetary and economic union, and political and regulatory factors imposing limitations to mergers and acquisitions were two factors pushing European banks abroad. [15] Table-4 lists some other variables motivating EU banks to open abroad. As the net interest margin or the share of net interest income in average assets increases in the EU countries, for instance, EU banks decrease their shares in other countries. On the contrary, increase in total assets, net income or operating income do the reverse effect increasing the share in foreign countries.

Insert Table-4

Buch (2000), Green, Murinde and Nikolov (2002) and Lensink and Hermes (2002) suggest that foreign banks go after their customers. [16] In fact, investments of US and Japanese banks, for instance, were found to be positively correlated to the non-bank foreign investments, supporting this view. This has been possible and much easier due to globalization and the removal of entry barriers along with the reforms facilitating their entrance into the host country market.[17] In the past, multinational banks mainly worked for home country customers and provided local firms with access to international financial markets. However, Du (2003)[18] found that while lending, foreign banks give priority to the borrowers other than the ones from the home country. Today, main purpose of these multinational banks is diversification and integration to domestic markets.[19] Risk diversification is possible unless the foreign and domestic markets' business cycles are positively correlated, an example being the expansion of a European bank into Latin America which experience recessions at different times.[20]

3. What is the Reason of Foreign Penetration into Turkey?

While analyzing the case from the Turkish perspective, we will be looking at the pull and push factors listed in Table 5 in detail. Seven foreign entry cases have been covered in this study and the related banks are shown in columns. The observations we have gathered from various issues of newspapers and internet sources are summarized in the table. For instance, high amounts of debt and increasing foreign trade are factors common to all the cases, supporting what Kraft (2002)[21] suggests.

Insert Table-5

Upon foreign entry, it is usually the case that the host country expects to benefit from the superior technological base of the prospective entrants.[22] What we have found out in the Turkish cases, however, is that the reverse could also be the case, in other words, the entrant might be looking for technological improvement after the entry. In fact, NBG, EFG Eurobank, GE and HSBC entered into Turkey hoping also to benefit from the better technological infrastructure that their Turkish partners have compared to their own technology base. Specifically, one factor creating synergies between NGB and Finansbank is reported to be the optimization of the Southeastern European cost base in fields like information technologies. Additionally, GE, which operates in areas from energy, airplane engine, health technology to engineering, suggests that with its superior technological infrastructure Garanti Bank provides a sound base for GE to grow.[23]

Foreign banks are also expected to enhance the product and service variety in the host country banking sector.[24] As in the above discussion, this expectation is shared by the entrants making them choose Turkey as a country to expand into. Finansbank is an example which attracted NBG with its high quality retail products such as car loans, consumer loans, insurance, and checks. HSBC, which provides services such as stock-broking, fund management and investment, insurance, pensions, credit cards to personal, corporate and institutional customers in Turkey, pursued to increase product and service variety through the purchase of Demirbank.

One finding in this study is that without exception, all the banks included reported a desire to take advantage of the high growth potential in the Turkish financial market.[25] Indeed, foreign banks experiencing slow growth in their home countries search for new markets such as the Central and Eastern European market which have high growth potentials marked, for example, by high appetites for credit.[26] Turkey's economy with its increasing population is the biggest and fastest developing one in Southeastern Europe which increases the importance of Turkey for NBG. In accordance with this finding, the high growth statistics such as a more-than-74 percent-CAGR in total assets for the period 1997-2005 was what increased Dexia’s appetite for Denizbank.

Another pull factor we analyze is the low competition level in the financial sector of the host country as Kraft (2002)[27] suggests. Banks stuck at low profit levels due to high degree of competition in their parent countries look for markets with low competition and thus high profits. For instance, stimulated by the strong profit potential, Fortis chose Turkey where there were few foreign competitors and low banking penetration relative to its Western counterparts.

Many foreign banks expand into Turkey intending to buy not merely a Turkish bank but market share, the latter being more difficult to acquire than the former. Indeed, the fact that foreign entrants aim at increasing their customer base, suggested by Kraft (2002)[28], is proved by their inclination to acquire banks with high number of branches. For instance, by purchasing 89.3 percent of Dışbank shares, Fortis could reach more than 1.000.000 new customers, approximately 120.000 new small enterprises and 10.000 new medium-sized enterprises. Similarly, by purchasing Denizbank, Dexia could reach nearly 1.400.000 retail customers in Turkey. Additionally, HSBC was intending to join its broad corporate client portfolio with the SME client portfolio of Demirbank. [29]

In contrast to the above pull factors, there is also another view suggesting that deregulation is "the" factor that pulls foreigners. Although not explicitly stated in the actual cases included in this study, deregulation in the host country's financial system has an important effect on the foreigners' choice to enter into Turkey. After the changes in the Banking Law in 1984, foreign firms became eligible to form partnerships with their Turkish counterparts as well as to realize capital increase by 100 percent. International agreements were made in order to encourage investment and prevent double taxation. Foreign capital was guaranteed to be nationalized. The external financial liberalization process in Turkey which started in 1984 was completed in 1989 after the government issued Decree No.32 and accepted IMF's Article VIII in 1990. This decree made it possible for nonresidents to trade Turkish securities in the domestic stock exchange or government securities by the help of intermediary institutions in Turkey. Nonresidents also could bring the proceeds to their own countries and residents could buy securities that were issued by foreigners via authorized financial institutions, and transfer the foreign exchange to buy these securities abroad. This process deepened the foreign exchange market and increased foreign bank branches in Turkey boosting the competition in the sector. The reflection of this process on figures was an increase in the foreign holdings of shares from less than five percent in 1990 to more than 50 percent in 1997. [30]

The first push factor we study is the low profitability in the parent country as indicated in Kraft (2002) [31]. The cases covered in this study revealed that increasing profits is the common motivation in internationalization. Evidence comes from the Garanti-GE deal for which Fitch Rating Agency suggested that the upgraded ratings for Garanti Bank were a result of increased profits accompanying this partnership. Fortis, an already profitable company which purchased 89.3 percent of Dışbank shares, increased its profits by 93 percent after the deal. NBG's motivation in purchasing Finansbank shares is no different from these two. Through this transaction, in fact, NBG earns Finansbank's net profits which increased by 68 percent in one year.

Diversification is another factor, also mentioned in Paula (2003)[32], as to why foreigners decide to expand abroad. It is an integral segment of the expansion strategy of Dexia with more than 40 percent market share in France and more than 80 percent market share in Belgium in the public finance area which tries to expand into Europe and the US through partnerships and organic growth. Similarly, GE has operations in more than 100 countries and intends to expand into countries such as Russia, Romania, Netherlands, Turkish Republics and Middle East together with Garanti Bank. One reason to diversify into Turkey is its proximity, both culturally and physically, to the Middle East in the sense that it is easier to reach the Middle East from İstanbul than from, for instance, London.[33]

Banks also expand abroad in order to increase international trade and investment. With its expertise in foreign trade, HSBC offers SMEs in Turkey attractive opportunities. The GE's purchase of 25.5 percent share of Garanti Bank was accompanied by 1.8 billion dollars of American investment, showing the close relationship between trade and investment. Additionally, Fortis plans to set Turkey as the technology base for all of its operations such as telephone banking. In agreement with this, changes are suggested to be made in the law concerning foreigners' property rights in Turkey to increase investments.[34] Greece enters into Turkey in order to make investments in sectors such as industry, tourism and navigation although their main interest lies in the financial sector. Indeed, between 1990 and 2002, Greek investment in Southeastern European countries amounted to five billion Euros one tenth of which were spared for the banking sector.

Foreign banks whose parent countries have relatively small banking sector search for financial markets where they could benefit from greater opportunities. At this point, as the biggest developing economy in the Southeastern Europe, Turkey becomes attractive to banks such as NBG and Fortis.[35] For instance, Greek banking sector with 227,670 billion Euros of asset size as of the end of 2005 is small relative to the Turkish banking sector whose asset size for the same period is 295,844 billion dollars. In fact, Finansbank with its 5.2 percent share of loans, 208 branches and 1.200.000 active customers is said to be a perfect match for NBG.

It may be the case that banks internationalize following their customers.[36] To give an example, among the seven foreign entry cases examined in this study, banks in Greece are found out to follow Greek industrial and commercial enterprises through Southeast European countries as does HSBC.

The above analysis shows the relevance of the pull and push factors mentioned in the literature to the case of Turkey. Apart from these general factors, there are also Turkey-specific reasons yet to be discussed before reaching a conclusion. Table-6 summarizes our findings related with the pull factors relevant for each foreign entry case.

Insert Table-6

Most of the banks included in this study reported that Turkey is an attractive market with an increasing population and per capita income.[37] Its population of approximately 70 million is expected to reach 82 million in a decade and per capita GDP is expected to grow by more than 4 percent per annum. Therefore, the banking services and the necessary public infrastructure are supposed to increase in near future. This environment is what pulled Dexia, among others, to Turkey, leading to an agreement as to the purchase of 75 percent shares of Denizbank.

Foreign banks' consideration of Turkey as a country to expand into is also affected by the structural reforms carried out in the macroeconomic environment.[38] After the Nov. 2000 and Feb. 2001 crises resulting in the contraction of the Turkish economy, Banking Sector Restructuring Program was put in place. As a result, financial risks in the banking sector were alleviated, capital structure was strengthened, bank profitability increased and growth prospects in the sector improved. These improvements in the banking industry became the underlying reason of foreign entry in many cases.

Turkey's high foreign trade and growth potential is the mostly cited Turkey-specific pull factor leading foreigners in their choice of Turkey.[39] After recovering from the 2001 financial crisis, Turkey experienced a 7.6 percent GNP growth in 2005 and the amount of loans given increased. This financial recovery can also be observed from the different mark-ups in Dışbank and Finansbank sales (since growth outlook is said to be the primary factor used in valuations by analysts). For the 2005-2009 period, while the real GDP growth is forecasted to be 2.1 percent for the Euro zone and 4.3 percent for the Central and Eastern Europe, more than five percent growth for the Turkish case increases foreigners' appetite for Turkey, as was the case in Finansbank-NBG and Denizbank-Dexia agreements.[40] As another case, Fortis, which is an expert in commercial and private banking and in insurance, tries to take place in the promising markets outside of Benelux such as Europe and Asia as part of its overall strategy of ten percent annual growth. GE reports that Garanti Bank provides a strong base for growth with its high quality workforce, wide distribution network and technological background. Moreover, Koç Financial Services aims to grow in the Turkish credit card and consumer credits market, the purchase of Yapı Kredi shares creating a bank big enough to be able to take part in bank sales in the EU.

Although the EU accession negotiations do not mean that Turkey is strong in absolute sense against possible economic and political risks, the journey towards the Union is what puts Turkey in an attractive position from the viewpoint of foreign investors.[41] This can be observed in NBG's suggestion that its choice of Turkey is related in part to its expansion in Europe. As long as the requirements from the EU side as to the trade restrictions are satisfied, the promising investment environment in Turkey will increase foreigners' appetite for Turkey. The relative attractiveness of the Turkish financial market can be observed from data in Table-7. The share of net interest income in total assets is bigger in Turkey than in EU-25 and the selected EU countries, with 4.61 versus 1.31, pronouncing one more time the high profitability of the Turkish banking sector. In terms of Return on Assets, data show that Turkey has high growth potentials compared to others, having a figure three times as much as that in EU-25 or in the selected countries. Moreover, personnel expenditures to total assets and nonperforming loans to total loans ratios attract attention due to their high levels compared to those of EU-25 and the selected EU members.

Insert Table-7

In June, 2003, Law No 4875 on Foreign Direct Investment was issued in order for the Turkish foreign investment to comply with international standards. Before this law was passed, founding a new company, new branches, liaison offices or participations required the permission of the Foreign Capital General Directorate. Under this law, however, all but the liaison offices are required to give information and only for statistical purposes. Additionally, foreigners can now make foreign direct investments with no extra burden such as the previous requirement of 50.000 EUR. They no more need to have permission before the establishment stage, and are able to form all types of legal entities that domestic firms are allowed to form and with no limitation. Therefore, differences in the treatment of Turkish and foreign investors are vanishing, and as a result of the simplified process, it has become easier to establish a firm in Turkey encouraging foreign investment. [42]

Improving macroeconomic situation of Turkey is also frequently mentioned by foreign banks among the pull factors. [43] Inflation has seen single digit numbers after long years of high and chronic inflation. Interest rates have been low, which, together with increasing income and consumer confidence, increase loans to GDP ratio, and enable banks to perform their mediatory role more effectively. In fact, from May, 2007 on, no tax will be imposed on financial intermediation supporting the recent development.

Foreigners also come to Turkey choosing banks with sound corporate governance. [44] One example is Dexia purchasing 75 percent of Denizbank which successfully minimized the negative impacts of the crises period through its strong management, and continued its operations without deviating from its steady growth strategies. Another case is the GE- Garanti agreement. Garanti Bank was chosen primarily due to its improved corporate governance in which area GE was placed first in a survey by Financial Times. [45] One underlying reason in the UniCredito-Koç Group and Yapı Kredi deal was to have a clear managerial structure, a better commercial image (there would no more be two banks for the same customer base) and a simpler balance sheet structure. [46]

The fact that the New Basel Accord will be effective in Turkey from 2008 on will create an economic environment with better supervision and market discipline. [47] High capital adequacy ratios in the banking sector will decrease to 16.9 percent with the new arrangement. The need for consolidation in the sector will be more intensely felt, and thus internationalization of the financial sector will gain popularity. [48] A survey conducted by Turkish Banking Regulation and Supervision Agency on the readiness of the sector for Basel II revealed that with respect to the percentage of assets in the total banking sector, 50.5 percent is at the beginning level, 45.70 percent is at the intermediate level, 2.8 percent is at advanced level and less than one percent have not yet started the process. When it becomes effective, Basel II will add to banks' transparency and quality of risk management which make Turkey an attractive market to expand into.

Signals for growth in the mortgage industry is an additional factor increasing the popularity of Turkey from the point of view of foreign banks. In this respect, it is beneficial to mention about one other underlying reason for foreign entry. Behind the scene, there lies the fact that high population in Turkey, migration from rural areas to big cities, and high rental fees have created housing problems in Turkey with a burden of 300.000 new demand for houses per year.[49] The severity of the case is better understood by the fact that on its own the city İstanbul welcomes as many migrants in one year as Paris does in 30 years.[50] Additionally, only three percent of housing has been financed by banks in Turkey during 2002- 2004 period. While the housing financing market constituted 40 percent of GNP in Europe and 5-15 percent in developing countries for sure, Turkey lagged behind considerably. Nevertheless, low inflation coupled with falling interest rates recently facilitated the process of change in legislation granting banks the right to offer mortgages this year.[51] With the new legislation, financing institutions have been granted tax benefits, foreclosure procedures for mortgage were shortened and floating interest rates became considerable. As a result of all these, many foreign banks such as NBG and Dexia, which are experts in mortgage and consumer banking, entered into Turkey to take advantage of this high growth potential in mortgage as well as in consumer credit markets. Moreover, HSBC's motivation was no different from these two as long as the development in the mortgage market is concerned.

4. Conclusion

Out of a need to explore the reasons for the recent spread of foreign banking in Turkey, this research attempts to provide the reader with insight on the issue using information from seven bank entry cases. This study is not concerned about whether foreign entry is good or bad or the subsequent effects of foreign entry, but about the "why" side of the issue trying to compensate for the fact that there is no study on the issue concerning the Turkish case.

While examining the reasons of foreign entry, in the first section, we have listed the pull and push factors given in the literature attempting to find similarities to the foreign entry case for Turkey. Because of our need to delve into the issue for the Turkish case, in the next section, we looked at the Turkey-specific pull factors going over the seven foreign entry cases selected, the foreign parties being National Bank of Greece (NBG) and EFG Eurobank from Greece, Fortis of Netherlands, Dexia from Belgium, General Electric (GE) from the United States, HSBC of England, and UniCredito from Italy.

In our research, most of our findings confirm the reasons spelled in the literature. One frequently pronounced reason of entry is the improving macroeconomic environment in Turkey reflecting itself in low inflation numbers after long years of high and chronic inflation, and declining interest rates. Additionally, Turkey's importance in the geo-political arena together with its increasing population and per capita income make our domestic market attractive.

One other finding of this study is that although foreigners are mostly welcomed on the expectation of a higher level of technology, the Turkish case shows that it may be foreigners who expect technology improvement following the deal. The same situation is also relevant when the relatively richer product and service variety in Turkey is concerned in that foreigners aim to take advantage of the diversity of financial products and services in Turkey.

Apart from this factor, high growth potential in our domestic banking industry is a reason mentioned by all the entrants among their motivators in choosing Turkey. In this growing macroeconomic environment, foreign banks expand into Turkey to buy not only banks per se but also market share, which is more difficult to acquire.

The regulations concerning foreign entry to Turkey dates back to 1984 when there were amendments in the Banking Law giving way to a high degree of internationalization of the Turkish financial sector. Financial liberalization in the sector increased the depth of the Turkish financial market as a result of more severe competition, and this in turn led to even higher foreign share in the domestic sector.

In addition to many other countries, Turkish financial market will open a new page after Basel II Requirements become effective in 2008. Supervision in the banking sector will be improved and this will create an environment with high level of confidence in the system pulling foreigners to Turkey.

High growth potential in the mortgage sector is another frequently mentioned reason attracting the attention of foreigners. For long years, banks have not been engaged in the task of housing financing. However, problems of housing started to be alleviated by banks offering an increasing amount of mortgages thanks to the improving macroeconomic situation in Turkey.

While an increasing foreign share in the Turkish financial market may be attractive as well as beneficial, the issue still deserves to have a closer look. It seems to be the case that Turkey's bank owners give up on a sector that is likely to be a very lucrative market in the future due to high discount rates on domestic banks, i.e., long term gains seem to be sacrificed in search for short term profits.

5. Tables

Table-1: Strengthening Turkish Banking Sector:

	Asset Quality	Profitability	Capital Adequacy	Financial Strength
1999	100	100	100	100
2000	93.4	93.6	98.9	94.3
2001	73.3	87.8	113.9	97.4
2001	85.8	104.0	126.7	102.5
2003	101.0	105.7	144.0	109.2
2004	109.6	105.4	145.0	111.3
2005 May	112.6	107.0	143.0	110.5

Source: Central Bank of Turkey
Index, 1999=100

Table-2: Asset Share of Banks with Foreign Share in the European Union Countries:

Country	2001	2002	2003	2004	2005
Germany	4,7	6	5,9	6,2	10,5
Austria	19,8	21,5	19,5	19,2	19,8
Denmark	31,8	30,6	315,9	30,7	30,7
Finland	77	78	61	63	59
Spain	11	7,8	8,3	8,8	9,7
Litvania	85	96,1	95,6	90,8	91,7
Luxemburg	92,3	92,1	93,5	93,9	94,7
Hungary	-	90,3	87,9	66,4	87,1
Slovak Republic	89,9	95,6	96,3	96,7	97,3
Greece	22,2	24,1	25,3	27,3	30,3
Turkey(*)	3	3,1	2,8	11,8	15,8

Source: IMF, World Bank, Lund and Rasmussen (2006), relates countries' authorities
(*) Turkey 2005 data reflects March 2006 data.

Table-3: Selected Ratios for EU-25:

EU-25	Domestic Banks	Banks with foreign capital
Nonperforming Loans (Gross) as a percentage of Loans	3	1,83
General Capital Adequacy ratio	12	15,57
Tier 1 ratio	8	12,4
Expenses /Costs ratio	59,42	59,52
Profitability ratio	0,5	0,56

Note: Banks with foreign capital: Partnerships or subsidiaries controlled by banks with foreign capital as defined by the reporting member country.
Source: EU Banking Sector Stability, Oct, 2005, ECB.

Table-4: Factors Affecting the Internationalization Strategies of EU Banks:

Descriptive Variables (%)	***Direction of the relation***	***Statistical Significance Level(%)***
Shares /Deposits and other short term funds	-	10
Equity /Assets	-	1
Net Interest Margin	-	5
Net Interest Income/ Average Assets	-	5
Net Loans/ Total Assets	-	10
Total Assets	+	1
Net Income	+	10
Operating Income	+	5

Note: Variable described: Foreign asset share in the total assets of EU banks.
Source: Results of regression analysis conducted by EU Central Bank, EU Banking Structures, Oct, 2005, ECB.

Table-5: Pull and Push Factors:

	Banks						
	NBG-Finans bank	*EFG Euro bank-Tekfen bank*	*Fortis-Dış bank*	*Dexia-Deniz bank*	*GE-Garanti bank*	*HSBC-Demir bank*	*Uni Credito-Koç Group-Yapı Kredi*
Pull Factors:							
High amounts of debt	*	*	*	*	*	*	*
Increasing the international trade	*	*	*	*	*	*	*
Improving technology	*	*			*	*	
Increasing the product and service variety	*		*	*		*	
Growth opportunities	*	*	*	*	*	*	*
Low level of competition in the host country			*				
New customer base	*	*	*	*		*	*
[a]Deregulation							
Push Factors:							
Low profits	*	*	*	*	*		*
Diversification	*	*	*				*
Foreign trade	*	*	*	*		*	
Foreign investment	*	*					
Size of banking sector in the parent country	*	*	*	*			
Going after their customers	*	*				*	
[a]Regulatory restrictions at home							

Source: Authors' tabulation from various newspaper issues and internet sources.
[a]: No evidence with respect to this factor.

Table-6: Turkey-specific Pull Factors:

	Banks						
	NBG-Finans bank	*EFG Euro bank-Tekfen bank*	*Fortis-Dış bank*	*Dexia-Deniz bank*	*GE-Garanti bank*	*HSBC-Demir bank*	*Uni Credito-Koç Group-Yapı Kredi*
Increasing population and per capita income	*	*	*	*			*
Reforms in the investment area	*		*			*	*
High foreign trade and growth potentials	*	*	*	*	*	*	*
Geopolitical importance	*	*	*	*			
EU accession process	*	*	*	*	*		*
[a]Easy to be taken over							
[a]Small size of Turkish banks							
[a]Equal treatment of Turkish and foreign banks							
[a]No limitation to the foreign ownership of banks							
[a]Easier entrance to the Turkish market							
Lower interest rates	*	*	*				*
Declining inflation rates	*	*	*			*	*
Improving corporate governance system	*			*	*		*
Improving auditing and regulation	*		*	*			
Flexible exchange rate system	*						
Basel II Agreement				*			
Consumer credits and mortgage	*	*	*	*	*	*	*

Source: Authors' tabulation from various newspaper issues and internet sources.
[a]: No evidence found with respect to this factor.

Table-7: Comparison of Turkey and EU with respect to selected financial ratios:

%	***EU-25***	***Germany¹***	***Holland²***	***Turkey(*)***
Net Interest Income/ Total Assets	1,31	1,18	1,30	4,61
Personnel Expenditure/ Total Assets	0,85	0,57	0,90	1,33
Debt Securities/ Total Assets	19,65	19,90	22,60	36,03
Total Loans/Total Assets	65,72	72,80	54,90	37,80
Nonperforming Loans(gross) / Total Loans	2,73			5,00
Non-cash Loans/ Total Assets	15,28		16,60	16,30
Net Non-interest Income/ Total Income	43,42			19,41
Net Interest Income/ Total Income	56,58	73,40	58,40	80,59
Total Expenses/ Total Income	59,42		71,50	82,56
Managerial Expenses/ Total Expenses	31,40		34,50	36,60
Return on Assets	0,50	0,67	0,50	1,68
Return on Equity	12,21	4,20	9,80	11,81

Note: EU-25 data are as of 2004 and taken from ECB Banking Sector Stability
(*) Turkey data are as of the end of 2005.
[1] Association of German Banks, 2004 data
[2] De Nederlandishe Bank 2004 & 2005 data

[1] See Financial Stability Report (June 2006)-Turkish Central Bank, pp.37-56.

[2] This number increases to 33.6 percent when shares traded in the stock exchange are taken into account. This and the following figures as to foreign share in consumer credits and debts come from various issues released by the BRSA of Turkey.

[3] See Vesile Çakar, "Yabancı Sermayeli Banka Girişleri ve Ulusal Bankacılık Sektörleri Üzerindeki Etkileri," TCMB Bankacılık ve Finansal Kuruluşlar Genel Müdürlüğü, TCMB Uzmanlık Yeterlilik Tezi (2003), p.21.
Ziya Öniş and Ahmet F. Aysan, "Neoliberal Globalization, the Nation-State and Financial Crises in the Semi-Periphery: A Comparative Analysis," *Third World Quarterly* (February 2000), p. 15.

[4] See Heather Montgomery, "The Role of Foreign Banks in Post-Crisis Asia: The Importance of Method of Entry," *ADB Institute*, Research Paper Series No: 51, (2003), p.3.; Dietrich Domanski, "Foreign banks in emerging market economies: changing players, changing issues," *BIS Quarterly Review* (2005), p.71.

[5] See Hongyu Liu, **"**Foreign Participation in Banking Reform: The Poland Experience," *Perspectives*, Vol.2, No.4, Overseas Young Chinese Forum 2001-2002 (2001), p.3.

[6] See Luiz Fernando Rodrigues De Paula and Antonio J. Alves, Jr. "The determinants and effects of foreign bank entry in Argentina and Brazil: a comparative analysis," (2003), p.10.

[7] See Yongil Jeon, Stephen M. Miller and Paul A. Natke, "Do foreign bank operations provide a stabilizing influence in Korea?," *The Quarterly Review of Economics and Finance*, Vol. 46 (2006), p.83.

[8] See Claudia M. Buch and Stefan M. Golder, "Domestic and Foreign Banks in Germany: Do They Differ?," *Kiel Institute of World Economics*, Kiel Working Paper No. 986 (2000), p.37.

[9] Tier 1 capital is the core measure of a bank's financial strength from the viewpoint of a regulator. Being a measure of the capital adequacy of a bank, it includes financial capital that is considered the most reliable and liquid, primarily Shareholders' equity.Tier-1 ratio equals tier-1 capital divided by risk-adjusted assets.

[10] See Jonathan Coppel and Michael Davies, "Foreign Participation in East Asia's Banking Sector," Contribution to the CGFS Working Group on FDI in the Financial Sector of Emerging Market Economies, International Development, Reserve Bank of Australia (2003), p.22. Christian Weller, "The Supply of Credit by Multinational Banks in Developing and Transition Economies: Determinants and Effects," *United Nations*, DESA Discussion paper No. 16 (2001), p.12. Allen N. Berger, Robert DeYoung, Hesna Genay and Gregory F. Udell, "Globalisation of Financial Institutions: Evidence from Cross-border Banking Performance," Brookings-Wharton Papers on Financial Service, Vol.3 (2000), p.23 – 158, p.7.

[11] Vesile Çakar, "Yabancı Sermayeli Banka Girişleri ve Ulusal Bankacılık Sektörleri Üzerindeki Etkileri," TCMB Bankacılık ve Finansal Kuruluşlar Genel Müdürlüğü, TCMB Uzmanlık Yeterlilik Tezi (2003), p.18.

[12] See Luiz Fernando Rodrigues Paula, "The Determinants of the Recent Entry of Foreign Banks in Brazil," Proceedings of the 5th Brazilian Congress of Economic History and the 6th International Conference on Business History, No.023 (2003), p.10.

[13] B. Gerard Dages, Linda Goldberg and Daniel Kinney, "Foreign and Domestic Bank Participation in Emerging Markets: Lessons from Mexico and Argentina," *FRBNY Economic Policy Review*, (Sep. 2000), p.18.

[14] Evan Kraft, "Foreign Banks in Croatia: Another Look," *Croatian National Bank*, *Zagreb*: Croatian National Bank Working Paper W-10 (2002), p.7.

[15] Luiz Fernando Rodrigues De Paula and Antonio J. Alves, Jr. "The determinants and effects of foreign bank entry in Argentina and Brazil: a comparative analysis," (2003), p.8.

[16] See Claudia M. Buch, "Why Do Banks Go Abroad? Evidence from German Data," *Financial Markets, Institutions & Instruments*, Vol. 9, No.1 (2000), p.37. Christopher J. Green, Victor Murinde and Ivalyo Nikolov, "The Efficiency of Foreign and Domestic Banks in Central and Eastern Europe: Evidence on Economies of Scale and Scope," *Journal of Emerging Market Finance*, Vol.3, No.2 (2002), p.178. Robert Lensink and Niels Hermes, "The Impact of Foreign Bank Entry on Domestic Banks: Does Economic Development Matter?," *Journal of Banking and Finance*, Vol.28, No.3(2002), pp.553-568.

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[21] Ibid., p.14.

[22] Vesile Çakar "Yabancı Sermayeli Banka Girişleri ve Ulusal Bankacılık Sektörleri Üzerindeki Etkileri," TCMB Bankacılık ve Finansal Kuruluşlar Genel Müdürlüğü, TCMB Uzmanlık Yeterlilik Tezi (2003), p.21.

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