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Foreign banks in Turkey and Other EU Accession Countries – Does Minority vs. Majority Ownership Make the Difference?

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Abstract

We compare banking sector development in the EU Accession Countries (AC) Bulgaria, Croatia, Romania and Turkey with a special emphasis on the role of foreign banks. We discuss selected features of the Accession Countries' banking sector reform and patterns of foreign entry, combining the efficient structure hypothesis with findings from the joint venture literature. As in the early stages of economic restructuring in other AC, Turkey currently relies on minority foreign bank involvement and industry-bank conglomerates. We argue that minority foreign bank involvement did not prove conducive to economic growth in the New EU Member States and other EU Accession Countries.

Key words: foreign banks, minority ownership, Turkey, EU Accession Countries, growth

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Bettina Hagmayr / Peter Haiss[2]

1. Introduction

The banking sectors in Turkey and the other EU Accession Countries[3] (AC) are undergoing major structural reforms with the notable feature of growing foreign market involvement. Many of the measures implemented in the AC resemble earlier moves in the now New EU Members States (NMS). Were the integrative moves and reforms by the Accession Countries successful? What lessons can be derived for Turkey with its different structural-economic background? We draw on the experience in NMS and AC and combine literature on banking structures with literature on joint ventures and corporate governance. While foreign involvement in banking proved crucial in the NMS for financial sector stabilisation and economic development, does this necessarily imply majority foreign ownership also in Turkey? This issue is of interest not only to Turkey and other AC, but to emerging markets and other countries in general where related financial sector restructuring is under way, for example China.

In May 2004, the European Union (EU) was enlarged by ten New Member States (NMS). A majority of these are transition economies in Central and Eastern Europe (CEE), which had to implement reforms and restructure their economy in order to meet the accession criteria. The transition to a market oriented system was accomplished through privatisation. While in most of the NMS' initial reforms foreign ownership was limited to de-novo banking licences and minority stakes in privatised institutions, entry restrictions were slashed following banking crises. Privatisation in the banking sector thus became dominated by foreign bank's entry. The peak of foreign investments in the NMS was reached in 2001, which reflects that reconstruction of the NMS' banking system is finalised. Foreign investors now increasingly turn to the Accession Countries in South-East Europe (SEE) and beyond into other transition countries, where reform of the banking sector lacks behind. Foreign investors provide capital and also contribute to efficiency of the financial sector and the economy at large.

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[3] Bulgaria, Croatia, Romania; Accession Candidate FYR Macedonia will be dealt with only briefly in the paper depending on data availability.

In Bulgaria, Croatia and Romania, the banking sector is dominated by foreign banks, which hold majority interests in newly privatised banks. Turkey was declared EU Accession Country (AC) in October 2005, causing an equal rise in interest of foreign investors in Turkish banks. Turkey suffered from a major financial and economic crisis in 2000/01, but has been successful in implementing reforms and gaining stability. This paper provides an outline about foreign banks entry in Turkey and the other EU AC. The question of different approaches to foreign bank entry is addressed. Additionally this paper provides an overview about the ownership structures of major banks in the countries investigated.

While the traditional approach in industrial economics to competition is characterised by the structure-conduct-performance-paradigm (SCP),[4] we follow the efficient structure hypothesis (ESH)[5] in arguing that a country's banking structure is driven by the efficiency of the market participants. According to the SCP, the key to understanding and predicting the performance of an industry is found in the industrial structure.[6] Structure is defined in the relative role that financial sectors and players have in the economy (e.g. domestic credit relative to GDP), the size, ownership and concentration of banks and the ease of market entry, among others. Conduct, which covers aspects of firm behaviour and objectives, may be determined e.g. by the ownership structure of public vs. private owners. Performance can be interpreted in a microeconomic way (e.g. profitability, share of non-performing loans) or in the contribution of the banking sector to economic growth. We use the SCP in a rather descriptive way to depict relevant structural features of the Accession Countries banking sectors and delineate possible scenarios for future development of the Turkish banking sector.

While the traditional SCP approach takes banks as passive agents, we follow the efficiency structure hypothesis (ESH) and argue that performance also determines structure; deregulation has made financial markets contestable.[7] As the lacklustre performance of the banking sector could not contribute to GDP growth in AC as long as foreign ownership was kept at bay, the (ownership) structure had to be altered by removing barriers to majority foreign entry. In case of the AC, foreign banks with superior management and production technology had lower costs and therefore contributed to higher performance of the financial sector and the AC´s

[4] See e.g. Waterson 1984
[5] See Hahn (2005) for a review
[6] Davis and Steil 2001, 117
[7] Davis and Steil 2001, 117

economies at large.[8] We draw on the joint venture and corporate governance literature[9] in arguing that minority foreign bank ownership and their limited management involvement provides limited incentives for foreign investors to take an active interest and thus contribute to overall bank sector development.

The rest of the paper is organised as follows. The following section compares financial sector structures in Turkey with the other Accession Countries. Section three draws lessons from bank restructuring in the EU´s New Member States. Section four discusses foreign bank entry in the EU´s Accession and other South-Eastern European Countries. Section five discusses the Turkish banking specifics. A discussion and conclusion draw up the findings.

2. Financial Intermediation and Bank Structures in the Accession Countries

The influence of the financial sector on the economy can be measured via total domestic financial intermediation, defined as the sum of domestic credit, market capitalisation of domestic shares and outstanding domestic bonds. Compared to EU-25 the level of total domestic financial intermediation is still low in most EU Accession Countries, with Turkey and Croatia coming closer to the EU-25 average (table 1). In 2003 financial intermediation in EU-25 accounted for 259%, comprising of 108% domestic credit, 65% market capitalisation of domestic shares and 86% domestic bonds outstanding. The ratio of bank assets to GDP was 205% in EU-25 in 2003.[10]

Table 1: Financial Intermediation in EU Accession Countries (2004)

in % of GDP	**Bulgaria**	**Croatia**	**FYR Macedonia**	**Romania**	**Turkey**
Domestic credit	36%	52%	18%	16%	53%
Market capitalisation of domestic shares	4%	30%	7%	15%	30%
Domestic bonds outstanding	29%	19%	n.a.	10%	52%
Total domestic financial intermediation	**69%**	**110%**	**~ 25%**	**41%**	**135%**
Bank assets	65%	109%	57%	39%	69%

Source: AMECO Database 2006, Barisitz 2005, BAT 2004, BIS 2005, BNB 2004, Bruckbauer 2005, BSE 2006, EBRD 2005, FIBV 2004, IFS 2006, RNB 2004, SSE 2006

Demirgüc-Kunt and Levine (1999) find that the Turkish financial sector had a particularly small and inactive banking system with a ratio of domestic bank assets to GDP at 19% and

[8] We extend the Berger (1995) argument of higher X-efficiency on the firm level resulting from superior management or production technology to performance implications of the banking sector to the economy at large.
[9] E.g. Fink, Haiss, Orlowski and Salvatore 1998; Kogut 1988a; Podpiera 2006
[10] Fink, Haiss and Ugljesic 2005, 10

market capitalisation to GDP at 14% at the end of the 1990s.[11] However, the improved figures for 2004 (bank assets to GDP 69% and market capitalisation 30%) suggest, that in the recent years major developments took place. Financial intermediation is closely related to general economic growth.[12] Transition economies Bulgaria (1996/1997), Croatia (1998/99) and Romania (1997/98) suffered from banking crisis during the 1990s; they registered a steady economy ever since. Turkey suffered from an economic, financial and banking crisis in 2000/01 and FYR Macedonia suffered from a security crisis in 2001. As indicated by table 2 in both countries GDP contracted significantly. Compared to EU-25 all countries of interest grew stronger in recent years. As for GDP per capita EU AC are well below EU-25 (23,290 EUR in 2005). In 2005 Croatia had the highest GDP per capita (6,685 EUR) among EU AC. Romania (3,611 EUR) and Turkey (3,971 EUR) had almost the same level in 2005. Bulgaria's GDP per capita in 2005 was 2,738 EUR, while FYR Macedonia's GDP per capita is still below 2,000 EUR.

Table 2: real GDP Growth, in %

	1999	2000	2001	2002	2003	2004	2005
EU-25	3.0	3.9	1.9	1.2	1.2	2.4	1.6
Bulgaria	2.3	5.4	4.0	4.8	4.5	5.6	5.5
Croatia	-0.9	2.9	4,4	5.2	4.3	3.8	3.5
FYR Macedonia	4.3	4.5	-4.5	0.9	2.8	2.9	3.5
Romania	-1.2	1.8	5.3	4.9	5.2	8.3	5.5
Turkey	-4.7	7.4	-7.5	7.9	5.8	8.9	7.4

Source: EBRD 2005, Eurostat

Credit growth accelerated considerably in the AC during recent years. For example, growth in credit to the private sector amounted to more than 45% per year in Turkey and Bulgaria in 2003 and 2004.[13] Both the level of intermediation and the loan quality improved notably in recent years in the AC. Romania's non-performing loans decreased in 2000 due to changes in loan classification and the transfer of non-performing loans from Bancorex and Banca Agricola to the Banking Assets Recovering Agency.[14]

[11] Demirgüc-Kunt and Levine 1999, 7
[12] Stubos and Tsikripis 2004, 6
[13] IMF, 2005, 62
[14] EBRD 2005, 168

Table 3: Prudential banking sector indicators

		Bulgaria	Croatia	FYR Macedonia	Romania	Turkey
Return on assets (ROA)	2000	3.1	1.3	0.8	1.8	n.a.
	2001	2.9	0.7	-0.7	2.5	n.a.
	2002	2.1	1.3	0.4	2.7	1.1
	2003	2.4	1.4	0.5	2.7	2.3
	2004	2.1	1.4	1.1	2.5	2.5
Return on equity (ROE)	2000	20.3	10.4	3.8	12.3	-10.5
	2001	20.2	6.5	-3.2	15.8	-69.4
	2002	14.9	13.7	2.1	18.8	9.3
	2003	22.7	15.6	2.3	20.0	16.0
	2004	20.0	16.6	6.2	19.3	17.4
Capital adequacy ratio	2000	35.6	21.3	36.8	23.8	17.3
	2001	31.1	18.5	35.3	28.8	15.3
	2002	25.2	17.2	28.1	25.0	25.1
	2003	22.4	15.7	25.8	20.0	30.9
	2004	16.6	14.1	23.0	18.8	28.8
Non-performing loans (in % of total loans)	2000	10.9	19.8	46.5	3.8	9.1
	2001	7.9	15.0	44.4	3.4	29.3
	2002	10.4	11.0	35.7	2.3	17.6
	2003	4.4	9.1	34.9	1.6	11.5
	2004	3.7	8.5	27.5	1.7	6.0
Liquid assets/total assets	2000	26.0	n.a.	47.5	n.a.	32.1
	2001	25.5	n.a.	54.6	n.a.	31.0
	2002	29.3	n.a.	44.8	78.6	34.3
	2003	25.5	n.a.	n.a.	62.7	38.8
	2004	31.6	n.a.	n.a.	63.6	37.4

Source: BAT, Duenwald 2005: 25, EBRD 2005, IMF 2003, IMF 2005: 200ff, Perrin 2005: 46

In the crisis year non-performing loans in Turkey amounted 29.3%, 2004 was the first year with a ratio under 10%. Although the total loan portfolio was relatively small and thus growing non-performing loans were not the major source for the crisis in 2000/01, non-performing loans accounted for almost half of the restructuring costs.[15] Concerning return on assets Bulgaria, Romania and Turkey (in 2003) show ratios above 2%, whereas Croatia's return on assets was less than 2%. Return on equity was above 20% in Bulgaria in 2003 and 2004. In Croatia, Romania and Turkey the ratio ranges around 15% (see table 3).

3. Lessons from foreign bank entry in the EU´s New Member States

The creation of a full-fledged financial system is an integral and important part of a typical accession strategy. The financial sector has a special role, as it mobilises resources and allocates them to those investments that are capable of generating the highest returns on capital. The better the financial sector can perform this role, the better the economy will

[15] Steinherr, Tukel and Ucer 2004, 18

perform in the long term. A sound financial sector improves the screening of fund-seekers and the monitoring of the recipients of funds, which improves allocation of resources. It encourages the mobilisation of savings by providing attractive instruments and savings vehicles. This may also increase the savings rate. In the medium term, economies of scale in financial institutions lower costs of project evaluation and origination, and facilitate the monitoring of projects through corporate governance. Financial intermediaries provide opportunities for risk management and liquidity. They promote development of markets and instruments with attractive characteristics that enable risk sharing.[16]

The quickest way to bring the necessary management changes is to give the bank independence from the government through foreign direct investment (FDI) in the banking sector. There are several strategies to privatise banks: outright trade sales, sale by voucher, initial public offerings. Privatisation of state owned banks together with opening of banking institutions to foreign investors improves the performance of banking sectors in transition countries. Bonin, Hasan and Wachtel (2005) indicate that foreign owned banks are most efficient and government owned banks are least efficient. Foreign banks bring with them stability and rapid improvements because of their know-how in marketing, risk management and information technology.[17]

Financial sector transformation, however, did not go that smoothly in the NMS and AC. After 1990, the new state owned commercial banks started life with an inherited overhang of troubled assets (the "stock problem"). During transition, a wave of new bad debt had to be swallowed by the banks, and later on by the respective taxpayers via repeated recapitalisations (the "flow problem").[18] Average annualised net fiscal cost of bank restructuring (direct fiscal costs minus sales proceeds of state banks) was above 1.5% of average 1995-2002 GDP in the Czech Republic and Turkey, in the 1-1.5 per cent-range in Croatia and Romania, in the 0.5-1 per cent-range in Bulgaria, Hungary, Lithuania and Slovakia and below 0.5% in Latvia and Slovenia.[19] The process of cleansing the accounts of the politically sensitive state owned enterprises and of the banking system brings hidden liabilities of the public sector to the surface. In the Czech case, considering the Consolidation Agency activity drives general government deficit up from 3.9% of GDP to 6.7% of GDP in 2002, with total holdings of bad assets amounting to about 15% of GDP.[20]

[16] Wachtel 2001; Levine 1998
[17] OECD 1993
[18] Breuss, Fink and Haiss 2004
[19] Sherif 2003
[20] European Commission 2003, 15f

More stringent lending policies by foreign owned banks helped to reduce bad debt levels. On average, roughly 70% of the banking market in the New Member States is under control of foreign banks – way above the 16% foreign bank assets in the Euro zone. In Estonia, Lithuania, Malta, Slovakia and Croatia local banks are essentially owned by foreign banks. In the Czech Republic, Hungary, Poland and Croatia the share of foreign owners is around 80%,[21] with Slovenia as notable exception. These foreign banks had to substitute for domestic financial supervision during transition.[22] Bonin, Hasan and Wachtel (2005) and Fries and Taci (2005) find that foreign owned banks are more cost-efficient than domestic banks in emerging markets. Besides providing stability and bringing „fresh money“, credit risk management techniques and improved corporate governance to these markets,[23] the strong involvement of foreign banks in the NMS, mainly from the 'old' EU-15, also implies a growing integration of these financial markets into the EU-15's financial markets. Theory and empirical findings[24] suggest that integration of financial markets contributes to economic growth, which should equally apply to Turkey and the other Accession Countries.

The dominant presence of foreign ownership in Central and Eastern Europe (CEE) stems from privatisation of former state owned banks. The prevalent mode of foreign entry in transition economies is the establishment of subsidiaries through the acquisition of local banks, rather than the creation of foreign branch offices. By the end of 2003, more than 85% of foreign bank operations were run as subsidiaries, which accounted for about 95% of total foreign bank assets. Some foreign banks initially entered the market via greenfield operations. However, usually the banks acquired a small equity share in the CEE banks and increased their shareholding step by step.[25]

Table 4 shows a ranking of the largest acquirers in NMS according to deal values from 1990 to June 2004. Among the top five only one bank is from outside Europe – US Citigroup. The most popular M&A targets have been the Czech Republic, Hungary and Poland. Banks from the 'old' EU-15 are dominant in the region might be due to economy of scale considerations and a lack of opportunities to expand in home markets. The acquired banks frequently operate under the parent's brand name, which is often linked to transfer of reputation.[26]

[21] Backé and Thimann 2004; Buch, Kleinert and Zajc 2003
[22] Wagner and Iakova 2001
[23] Buch, Kleiner and Zajac 2003
[24] e.g. Baele et al 2004; Giannetti et al 2002
[25] ECB 2005, 17f; Domanski 2005, 34f
[26] Domanski 2005, 33ff

Table 4: Largest acquirers in NMS according to deal values (1990 – June 2004)

Acquirer	Target nations	Deal values (€ million)
Erste Bank (AT)	CZ, SK, HU	2,141
KBC (BE)	CZ, PL, HU, SI	1,983
Société Générale (FR)	CZ, SI	1,329
Citigroup (US)	PL	1,038
Bayerische Hypovereinsbank (GER)	CZ, PL	932
SEB (SE)	LT, EE, LV, PL	569
IntesaBCI (IT)	SK	440
Bank Przemyslowo-Handlowy (PL	PL	400

Source: ECB 2005: 19

The majority of cross-border M&A in the banking sector was between 1999 and 2002 with the peak reached in 2001. Since 2002 only a few primary M&A took place in the NMS, reflecting the fact that most banks are now privatised and have a stable shareholdership.[27]

4. Foreign bank entry in South-East Europe (SEE)

A region banks are increasingly looking at is South-East Europe (SEE), including the Accession Countries. The banking sector in the SEE-7[28] with total assets of EUR 100 bn is about one-quarter the size of NMS. GDP in SEE-7 (2005: EUR 165 bn) is about one-third of GDP of NMS. Foreign banks hold 72% of the SEE-7 market, a share overall similar to that in the NMS. Bank consolidation has not progressed as far as in the NMS. This is indicated by the higher number of banks in the region (224) compared to NMS (205), while having a smaller number of inhabitants and a lower volume of banking transactions.[29] As can be seen in table 5 foreign banks investing in SEE-7 are also mainly from Europe. The top three in terms of market share are neighbouring countries Austria, Italy and Greece. That suggests a similar strategy compared with foreign bank entry in NMS, namely to establish an ever-wider regional network.[30]

[27] ECB 2005, 17ff
[28] SEE 7 countries: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, FYR Macedonia, Romania and Serbia
[29] Bruckbauer 2005, 6ff
[30] Bastian 2003, 97

Table 5: International banking groups in SEE-7 by country of origin

Country of origin	**Total assets (pro rata basis) in EUR bn**	**Market share in %**
Austria[31]	24.0	29.1
Italy	13.4	16.2
Greece	5.2	6.3
France	2.3	2.8
Hungary	2.8	3.4
Netherlands	2.8	3.4
USA	2.6	3.2
Germany	1.8	2.1
Turkey	0.4	0.5
Slovenia	0.1	0.2

Source: Bruckbauer 2005: 11

A crucial element of the effective transition of SEE-7 countries' banking systems is the privatisation of state owned banks. Delays in the privatisation process are due to government policy reluctance.[32] As in NMS in SEE-7, privatisation in the banking sector is characterised by the entry of foreign banks. High growth in NMS and AC represent a platform for further economic expansion and banks are keen for more opportunities. A large network and a market share about 8% to 10% is essential to achieve strong growth and have the critical mass to do retail.[33]

5. Banking in Turkey and the other Accession Countries

Bulgaria, Croatia and Romania

As most of the transition countries, Bulgaria suffered from an economic and financial crises in 1996/97.[34] The crisis was a consequence of lending to essentially bankrupt state owned enterprises in the early 1990s, as well as a regional and sectoral focus, which reduced the banking industry's capacity to absorb shocks. Prior to the crisis, the National Bank of Bulgaria was very restrictive concerning licensing foreign banks. First branches of foreign banks were allowed only in 1994/95 and thus the banking market was opened very slowly to foreign competition initially.[35]

[31] BA-CA and HVB holdings are reported under Austria
[32] Stubos and Tsikripis 2004, 6
[33] Timewell 2005, 160
[34] Gronkiewicz-Waltz 2006, 46
[35] Gardo 2005a, 27f

To overcome problems of corporate governance, inject managerial and technical know-how and prudent bank management, majority bank ownership was also chosen as solution in the AC once initial hesitance was overcome (see tables 6 and 7), with market concentration remaining high (table 8). The market share of state owned banks in Bulgaria was above 50% until 1999; already in 2000, it fell under 20%. Market share of foreign owned banks grew steadily, reached a level of 70% in 2001, and is above 80% since 2003. Croatia's state owned banks had a market share of almost 80% in 1996. Already the following year the share fell under 50%. Noteworthy is the development from 1999 to 2000. The share of foreign owned banks in Croatia grew from around 40% to 84%, while the share of state owned banks fell under 6%. In Romania market share of foreign owned banks was slightly above 60% in 2004 and generally grew slower than in Bulgaria and Croatia.[36]

Table 6: Market share of foreign owned banks (total assets, in %)

	1996	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**
Bulgaria	9.5	18.0	32.3	44,7	67.0	70.0	72.0	82.3	82.5
Croatia	1.0	4.0	6.7	39,9	84.1	89.3	90.2	91.0	91.3
FYR Macedonia	n.a.	n.a.	n.a.	11.5	53.4	51.1	44.0	47.0	47.3
Romania	11.2	17.2	20.0	47.8	50.9	55.2	56.4	58.2	62.0
Turkey	2.4	4.3	4.3	5.3	5.2	3.1	3.1	2.8	3.4

Source: EBRD 2005, Gardo 2005, Günay Ökan and Günay 2006, BAT 2005

Table 7: Market share of state owned banks (total assets, in %)

	1996	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**
Bulgaria	82.2	67.1	56.4	50.5	19.8	19.9	16.6	2.5	2.3
Croatia	78.4	41.9	43.1	45.6	5.7	5.0	4.0	3.4	3.1
FYR Macedonia	n.a.	n.a.	n.a.	1.3	1.1	1.3	2.0	1.8	1.9
Romania	80.9	80.0	75.3	50.3	46.1	41.8	40.4	37.5	6.8
Turkey*	38.6	34.0	35.0	34.6	34.2	32.7	31.9	33.3	34.9

Source: EBRD 2005, Gardo 2005, Günay Ökan and Günay 2006, BAT 2005
* excluding I&D and SDIF („bad asset/consolidation") banks

Table: 8: Concentration ratio (C4-loans, in %)

	1996	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**
Bulgaria	67.8	56.5	47.7	43.6	41.5	38.7	41.7	43.1	47.9
Croatia	60.1	53.1	53.3	58.1	62.0	60.0	58.6	66.1	65.0
FYR Macedonia (C2)	n.a.	n.a.	n.a.	55.0	55.8	55.5	54.1	55.5	52.9
Romania (C5)	n.a.	70.6	67.3	66.7	65.4	66.1	62.8	61.5	59.8
Turkey	43.0	40.0	40.0	42.0	43.0	53.0	54.0	54.0	n.a.

Source: EBRD 2005, Gardo 2005, Günay Ökan and Günay 2006, BAT 2005

[36] Gardo 2005a, 31ff

In addition to a reform-reluctant political regime conflicts in the aftermath of Yugoslavia's disintegration hindered Croatia's banking sector from development and restructuring. Yugoslavia introduced a two-tier banking system already in the 1960s within the context of its special economic concept of market socialism. Unlike other transition countries, Croatia already possessed a basic institutional and legal framework and market-like banking practices. However, due to the political environment during the military conflicts in the Balkans, Croatia was not able to leverage these advantages. First steps to restructure the banking sector, merely of a financial nature though, were taken within the framework of a linear rehabilitation programme as a reaction to the National Bank of Yugoslavia freezing private foreign currency deposits. These measures neglected the need to implement effective corporate governance structures. Soft budget constraints, moral hazard and bad debt legacy, were some of the following problems. The Croatian National Bank launched a second round of restructuring measures. Continued difficulties in banking sector reforms, economic slowdown and a loss of confidence in emerging markets following the Asian and Russian crisis accumulated in a major banking crisis in 1998/99. As indicated in the tables above only then the state withdrew from the banking sector.[37]

In Romania, reform of the banking sector started late compared to other transition countries in the region. The process of transition to a market-oriented banking system included an undercapitalised sector, bad debt problems and lack of market discipline. The following banking crisis was accompanied by the collapse of numerous banks. Market share of state owned banks was under 40% only in 2003 for the first time.[38]

Composition of the Turkish banking sector

The Turkish banking sector currently consists of 47 banks with 131,012 employees in 6,164 branches. Turkish banks can be divided into five groups (see table 9). Private owned banks represent with about 60% of total assets the biggest group. The three state owned banks (Ziraatbank, Vakifbank, and Halkbank) account for more than 30% of the banking sector's assets and therefore continue to play an important role. There is one bank (Bayindirbank) left in the Savings Deposit Insurance Fund (SDIF), which is responsible for restructuring problem banks after recent crisis through liquidation, merger, or sale. Since 1997, 20 banks have been

[37] Gardo 2005b, 34f
[38] Gardo 2005c, 47f

taken over by the SDIF. The second remaining bank in the SDIF (Pamukbank) was merged with Halkbank in 2004.[39]

Table 9: Turkish banking sector – bank groups

	2001	2002	2003	2004	2005
Deposit Banks					
State owned Banks	3	3	3	3	3
Privately owned Banks	22	20	18	18	17
Banks under the Deposit Insurance Fund	6	2	2	1	1
Foreign Banks	15	15	13	13	13
Non-depository Banks					
Development and Investment Banks	15	14	14	13	13
Total	**61**	**54**	**50**	**48**	**47**

Source: BAT 2005

Table 10: The ten largest Turkish Banks, as of September 10 2005

	Banks	Total Assets (EUR Million)	Total Loans (EUR Million)	Total Deposits (EUR Million)	Total Share-holders' Equity (EUR Million)	No. of Branch Offices	No. of Employees
1	Türkiye Cumhuriyeti Ziraat Bankası A.Ş.	37,076	7,697	29,065	3,202	1,146	20,499
2	Türkiye İş Bankası A.Ş.	34,399	11,550	20,275	5,377	869	16,910
3	Akbank T.A.Ş.	30,108	12,049	19,042	3,703	654	11,119
4	Türkiye Garanti Bankası A.Ş.	20,010	9,126	12,432	2,269	418	10,352
5	Türkiye Vakıflar Bankası T.A.O.	17,692	6,192	12,645	1,565	302	7,151
6	Türkiye Halk Bankası A.Ş.	16,133	2,996	12,175	1,864	592	10,671
7	Yapı ve Kredi Bankası A.Ş.	14,280	6,148	9,618	1,280	405	10,303
8	Koçbank A.Ş.	8,702	3,480	4,929	559	172	3,653
9	Finans Bank A.Ş.	6,714	4,257	3,536	807	194	6,181
10	Denizbank A.Ş.	5,329	2,558	2,848	617	219	4,842
	Total (10 banks)	190,443	66,051	126,565	21,242	4,971	101,681
		84.46%	78.21%	88.51%	72.36%	80.65%	77.61%
	Total (all banks)	**225,487**	**84,450**	**143,001**	**29,355**	**6,164**	**131,012**
	in % of GDP	78.08%	29.24%	49.52%	10.16%		

Source: BAT 2005

Concentration in the Turkish banking sector is high. The ten largest banks in terms of assets comprise 84,5% of the whole banking sector – the five largest banks account for about 62% (table 10). The top ten banks hold nearly a 90% share of total deposits. Over 80% of branches are provided by the ten largest banks, which employ 77% of employees in the sector. The largest bank (Ziraatbank) is state owned; the other two state owned banks are on fifth and

[39] Kuser 2005, 76

sixth place. Ziraatbank's major focus is the agricultural sector. Halkbank's main business is microfinance and lending to small and medium sized enterprises. The remaining seven banks are privately owned commercial banks. Total assets of the Turkish banking sector amounted 78% of GDP in 2005 (2004: 69%).

After the last crisis years, 2000/01 a total of 20 banks was closed, through either liquidations or mergers.[40] Since then total assets grew steadily. The share of total loans grew to 37.5% and the share of shareholders' equity to 14.2%. For key figures, see table 11.

Table 11: Development of key figures

	Total Assets EUR Million	Total Loans in % of Total Assets	Shareholders' Equity in % of Total Assets
2002	123,724	26.5%	12.1%
2003	142,107	28.0%	13.0%
2004	168,075	33.7%	15.0%
2005	225,487	37.5%	14.2%

Source: BAT 2004, 2003

Bank ownership and recent developments

Table 12: Top 10 banks in Turkey – main shareholders and market share

	Banks	Main Shareholders	Market Share
1	Türkiye Cumhuriyeti Ziraat Bankası A.Ş.	State owned	16.44%
2	Türkiye İş Bankası A.Ş.	Isbank Members' Supplementary Pension Fund (41.54%) CHP political party (28.1%)	15.26%
3	Akbank T.A.Ş.	Sabanci Holding (34.23%) Sabanci Family (23.29%) Aksigorta (6.62%) Exsa (2.21%)	13.35%
4	Türkiye Garanti Bankası A.Ş.	General Electric Consumer Finance (25.5%) Dogus Group (27.54%)	8.87%
5	Türkiye Vakıflar Bankası T.A.O.	Foundations managed by the General Directorate of Foundations (58.45%) Vakifbank Pension Fund (16.1%)	7.85%
6	Türkiye Halk Bankası A.Ş.	State owned	7.15%
7	Yapı ve Kredi Bankası A.Ş.	Kocbank A.S. (57.4%)	6.33%
8	Koçbank A.Ş.	Koc Financial Services (100%), i.e. 50% UniCredit	3.86%
9	Finans Bank A.Ş.	Former ownership: Fiba Holding A.S. (33.2%), Fina Holding (15.01%)Girisim Factoring (4.2) Fiba Factoring (3.27%); but recently acquired by National Bank of Greece	2.98%
10	Denizbank A.Ş.	Zorlu Holding A.S. (74.9965%)	2.36%

Source: BAT 2005, ISE 2004, bank homepages see references

The CHP political party (28.1%) and its pension fund (41.54%) own the largest privately owned bank Isbank. Akbank, the second largest privately owned bank, is hold by Sabanci

[40] Damar 2004, 16

Group by 66.35%. Sabanci Holding holds a 62% majority of Aksigorta's shares (insurance company) and Exsa Corporation is a Sabanci Group export company. In December 2005, General Electric Consumer Finance (GECF) acquired a 25.5% stake in Garanti Bank, Turkey's fourth largest private commercial bank. GECF acquired half of Garanti Bank's ordinary shares held by Dogus Group. The two parties signed an agreement to form an equal partnership in Garanti shareholding.

In September 2005 57.4% of Yapi Kredi Bankasi shares held by Cukurova Group (44.5%) and SDIF (12.9%) were transferred to Kocbank, which is owned by Koc Financial Services. Koc Financial Services is a Joint Venture between Koc Holding and UniCredit. Yapi Kredi and Kocbank together rank place four in terms of assets with 33.6 bln YTL, which is the net of repayment for Yapi Kredi sale and initial write off Cukurova loan and other adjustments to assets.

The FIBA Group, to which Fiba Holding, Girisim Factoring and Fiba Factoring belong, were majority owners of Finansbank's.[41] Outbidding Citicorp, National Bank of Greece recently acquired a 46% interest in the Ordinary Shares of Finansbank and 100% of the Founder Shares for a total of EUR 2.3bn or 3.6 times 2005 pro forma consolidated book value.[42]

Belgium's Fortis Bank acquired full ownership of 93.3% of shares of Dis Ticaret Bankasi (Disbank), the 13th largest bank in terms of assets (1.82% of total assets) from the majority shareholders - Dogan Holding, Dogan Family and the two pension funds of Disbank in - October 2005. The reason for the sell was due to new legislation, which excludes media owners from having stakes in the banking sector. Former Disbank majority shareholder Dogus Holding has newspaper, internet and TV interests.[43]

In February 2005, BNP Paribas became indirect shareholder of Türk Ekonomi Bankasi (TEB) after 50% of TEB's parent TEB Financial Investment Company had been transferred to BNP Paribas, which now holds 42.125% of TEB. TEB is the 14th largest bank (1.24% of total assets). There had been also negotiations of Dutch Rabobank to acquire a 36.5% stake in Sekerbank from the Turkish pension fund SPF, the largest shareholder of Sekerbank, but no deal came off.

Unlike the situation in the EU´s New Member States and other Accession Countries, Turkish owners frequently have been hesitant to relinquish full ownership. Before the financial liberalisation in the 1980s, the quality of the banking services was low. Due to the uncompetitive structure of the banking sector there was little incentive for improvements.

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[41] Finansbank also purchased 50.07% shares in the Banca de Credit Industrial si Commercial S.A. based in Romania in 2000.

[42] Mollenkamp and Riley 2006; NBG 2006

[43] Wells 2005, 119

Entry of foreign banks brought new services, advanced technology, and market oriented management skills into the Turkish banking sector.[44] Partnerships are likely to leverage local knowledge with technical and financial resources of the foreign bank. Turkish banks have today a relatively highly developed retail infrastructure, modern technology and broad branch networks, which makes it difficult for foreign investors to establish business without acquiring an existing Turkish bank.[45]

The market share of foreign banks in Turkey is low (table 13). The largest foreign bank operating in Turkey – HSBC – has a market share of 2%. All remaining foreign banks have a market share under 2%. Only two foreign banks have a branch network with more than 150 offices and more than 3000 employees. In 2005, seven out of 13 foreign banks only had one branch office. As already mentioned privately owned banks are the largest group with 60% of total assets. Foreign banks show a small increase in shares of total assets, loans and deposits since 2001 (table 14). But with 5.6% share in total assets foreign banks have as a group a very small market share.

Table 13: Five largest foreign banks (in terms of assets), as of September 30 2005

	Total assets (in EUR mn)	**Market share (in %)**	**Number of Branch Offices**	**Number of Employees**
HSBC Bank A.Ş	4,569	2.03	159 (2.58%)	3,918 (3.0%)
Fortis Bank A.Ş	4,114	1.82	175 (2.84%)	3,967 (3.03%)
Citibank A.Ş	1,478	0.66	24 (0.39%)	1,532 (1.17%)
Deutsche Bank A.Ş	473	0.21	1 (0.02%)	43 (0.03%)
ABN AMRO Bank N. V.	398	0.18	1 (0.02%)	125 (0.1%)

Source: BAT 2005

[44] Pehlivan 1996, 6
[45] Wells 2005, 119

Table 14: Sectoral breakdown of total assets, total loans, and total deposits

Deposit Banks	2001	2002	2003	2004	2005[46]
State owned Banks					
share in total assets	32.7%	31.9%	33.3%	34.9%	31.4%
share in total loans	22.1%	16.6%	18.2%	20.9%	20.0%
share in total deposits	33.6%	34.3%	37.5%	41.8%	37.7%
Privately owned Banks					
share in total assets	54.6%	56.2%	57.0%	57.4%	59.0%
share in total loans	57.7%	65.3%	67.1%	67.4%	67.1%
share in total deposits	56.7%	58.5%	57.3%	55.0%	57.0%
Banks under the Deposit Insurance Fund					
share in total assets	5.0%	4.4%	2.9%	0.6%	0.5%
share in total loans	5.3%	3.4%	1.3%	0.0%	0.0%
share in total deposits	7.5%	4.8%	3.0%	0.1%	0.0%
Foreign Banks					
share in total assets	3.1%	3.1%	2.8%	3.4%	5.6%
share in total loans	3.1%	4.0%	4.0%	4.6%	7.5%
share in total deposits	2.1%	2.4%	2.2%	3.1%	5.3%
Non-depository Banks					
Development and Investment Banks					
share in total assets	4.6%	4.4%	4.1%	3.7%	3.4%
share in total loans	11.8%	10.8%	9.4%	7.0%	5.5%

Source: BAT 2005

In comparison to other Accession Countries, the share of foreign investors in the Turkish banking sector is still small, though growing recently. Tables 15 to 17 show the five largest banks of Bulgaria, Croatia and Romania ranked by total assets. Whereas foreign participation in domestic banking has proven an effective means of promoting both competition and development of the banking sector in the NMS and AC, Turkey so far has not withdrawn from state influence into the banking market. In Bulgaria, Croatia and Romania the majority of shares are held by foreign banks, whereas in Turkey foreign investors form joint ventures and minority partnerships with their Turkish partners.

Table 15: The five largest Bulgarian banks ranked by total assets, as of 31 December 2004

Bank	**Main shareholder**	**Total assets (in EUR mn)**	**Market share (in %)**
Bulbank	UniCredito Italiano SA (85.2%)	1,841	14.5
DSK Bank	OTP Bank (100%)	1,664	13.1
HVB Bank Biochim[47]	Bank Austria Creditanstalt (99.6%)	1,314	10.3
United Bulgarian Bank	National Bank of Greece (99.9%)	1,125	8.8
Raiffeisenbank Bulgaria	Raiffeisen International Bank-Holding AG (100%)	1,026	8.0

Source: Gardo 2005a: 27, Bulbank-homepage

[46] data for September 2005
[47] Including Hebros Bank; acquired in November 2004

In Bulgaria UniCredit and Bank Austria Creditanstalt, a member of UniCredit Group, are planning the integration of Bulbank and HVB Bank Biochim, which should take place in 2007. The merger process of HVB Bank Biochim and Hebros Bank will be completed in the second half of 2006. An oligopolistic market structure is likely to emerge, due to the fact, that UniCredit's Bulbank subsidiary and HVB's business together have a market share of 24% and OTP's DSK unit, which has a 13% market share and more than a third of the buoyant mortgage market.[48]

Table 16: The five largest Croatian banks ranked by total assets, as of 31 December 2004

Bank	**Main shareholder**	**Total assets (in EUR mn)**	**Market share (in %)**
Zagrebacka banka	UniCredit Italiano SA (81.9%), Allianz AG (13.7%)	7,510	25.0
Privredna banka Zagreb	IntesaBCI Holding (76.3%)	5,458	18.2
Erste & Steiermärkische Bank	Erste Bank (59.8%) Steiermärkische Bank und Sparkassen AG (35%)	3,366	11.2
Raiffeisenbank Austria	Raiffeisen International Beteiligungs AG (75%) Raiffeisenbank Zagreb Beteiligungsgesellschaft mbh (25%)	3,181	10.6
HVB Splitska banka	Bank Austria Creditanstalt (99.7%); sale in discussion	2,797	9.3

Source: Gardo 2005b: 34

In Croatia, the largest banks Zagrebacka Banka and Privredna Banka Zagreb were privatised in 1999 and soon changed owners again. Already in 2002, a consortium of UniCredit and Allianz AG purchased the bank.[49] Privredna Banka Zagreb's new majority shareholder is IntesaBCI Holding. These two banks have together a market share of 43%.

Turning to Romania the most recent event in the banking sector was the signing of the privatisation contract of Banca Comerciala Romana in December 2005. Austria's Erste Bank will gain the control over 61.88% of the bank's shares. With successful conclusion of the share exchange of UniCredit to the shareholders of HVB Group the new UniCredit Group has started in 2005. In Romania UniCredit Romania, HVB Bank Romania and Banca Tiriac belong to UniCredit Group. The combined assets of the three banks are around EUR 3,000 mn.[50]

[48] Spiro 2003, 60
[49] Barisitz 2005, 69f
[50] HVB Bank Romania: http://www.hvb.ro/en/index.php

Table 17: The five largest Romanian banks ranked by total assets, as of 31 December 2004

Bank	Main shareholder	Total assets (in EUR mn)	Market share (in %)
Banca Comerciala Romana	Erste Bank (61.88%)	6,017	26.1
Banca Romana Pentru Dezvoltare	Société Générale (58.3%), EBRD (5.0%)	2,997	13.0
Raiffeisen Bank	Raiffeisen Group (99.5%)	2,121	9.2
Casa de Economii si Consemnatiuni	Ministry of Finance (100%)	1,360	5.9
ING Bank Romania	ING Group (100%)	1,296	5.6

Source: Gardo 2005c: 47, Banca Comerciala Romana-homepage

6. Discussion

Financial sector reform has been one of the main challenges in structural adaptation to the European Union. In the EU´s New Member States (NMS), initially foreigners were allowed in only for greenfield operations (via new licences) and via minority stakes in course of privatisation (brownfield /M&A). A notable exception is Hungary, where foreign banks could acquire majority stakes early in transition. The Hungarian authorities largely upheld reform momentum and opted early on for an efficient strategy of structural transformation of banking and the economy.[51] They had sold the majority of the banking sector's shares to foreign strategic investors by 1997.[52]

In most other NMS, majority foreign ownership was allowed after major banking and economic crises. There is recent empirical evidence that foreign ownership of the banking sector did indeed improve economic growth and restructuring in the NMS.[53] This evidence is based on large-scale majority ownership. Given that the benefits usually attributed to foreign owners (improving efficiency in intermediation, introducing hard budget constraints, improving risk management and corporate governance, providing fresh money) can only be implemented upon majority ownership, it remains questionable whether the Turkish approach of rather limited foreign ownership will show the same positive effects or if weak corporate governance will persist.

In Turkey, most of the private banks in the sector are owned by family owned holdings with industrial companies from a variety of economic sectors, and of related pension funds.[54] These banks were used as a source of creating funds for their industrial companies or group companies, much as were the case in the New EU Meber States and other EU Accession

[51] Barisitz 2005, 59
[52] Bonin, Hasan and Wachtel 2004, 28
[53] Eller, Haiss and Steiner 2005
[54] Günay Özkan and Günay 2006, 120

Countries prior to full-fledged privatisation to mainly foreign owners. As long as the ties between industrial groups and their banks in the NMS and other AC were strong and soft budget constraints prevailed, banking problems were prolonged and corporate governance of and by the banking sector was weak. According to the corporate governance and joint venture literature,[55] low ownership shares of foreign investors and their limited management involvement weaken the incentives and opportunities for foreign investors to implement necessary structural reforms conducive to improve performance both for the single bank and in aggregate terms for the banking sector and beyond for the economy at large. [56]

7. Conclusion

Most banks in the EU´s New Member States (NMS) and Accession Countries (AC) have been privatised with foreign strategic investors. EU accession perspective has contributed to a rush-in of investors expecting high growth rates and growing consumer markets. Banking systems had become unstable due to the lack of hard budget constrains and ordinary risk intermediation. The malfunctioning of the banking system, among others, resulted in financial and economic crisis in these countries. As initial trials to improve the banking situation via minority foreign involvement only were not successful, majority foreign ownership became the accepted solution.

Turkey has also suffered form major economic and financial crisis, most recently in 200/01. Since then, substantial reforms were implemented the Turkish economy grew steadil. In 2005 and 2006, a number of foreign investments, mostly from European banks, in the Turkish banking sector took place. Turkey is pursuing a different approach concerning foreign investors compared to other Accession Countries. Turkish bank owners ather prefer to form strategic partnerships and joint ventures with their foreign partners and retain a controlling share. The formal beginning of negotiations to join the EU might be a starting point for more foreign investments. The joint venture and corporate governance literature streams basically argue that hindered by limited market access (i.e. restricted to joint ventures and minority foreign ownership); foreign owners can exert only mildly positive effects on economic development and growth. Ilhami Koc, general manager of Is Investment: “Most people have long anticipated that the first wave of foreign investment into Turkey would be dominated by

[55] See e.g. Revoltella, 1998 and Kogut, 1988a, 1988b
[56] See Podpiera 2006

banks [...] What this tells us most broadly is that while the political integration into European Union is an open question, the economic integration is happening before our eyes."[57]

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[57] Judson 2006, 145

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