MARMARA UNIVERSITY

A STUDY OF THE FINANCIAL SERVICES SECTOR IN THE EEC WITH EMPHASIS ON THE REGULATORY CHANGES, AND THE EXAMINATION OF A NON-MEMBER COUNTRY'S POSITION IN THIS CONTEXT.

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BY YEŞİM L. SÜMERKAN

SUPERVISED BY Doç.Dr. EROL KATIRCIOĞLU

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İSTANBUL

ABSTRACT

Since the late 1960's, financial systems as well as world banking have been going through a period of considerable change. Traditional methods in these sectors are being replaced by new techniques. With the increasing globalization trends in the world of banking, traditional national sovereignty in financial systems is becoming a concept of the past. This is mainly due to the growing integration of world capital and financial markets, which also requires banks to adopt a global outlook in their strategies as they expand abroad to exploit foreign markets.

Within such a financial environment, banking systems too are evolving at a rapid pace. These changes, even though not uniform, often tend to have common elements. The industrial structure of banking and bank strategies are now in a process of realignment and adaptation, that is to say, they are going through major restructuring. Within this process there are intensifying pressures for banks to be pro-active rather than being reactive to change. This forces the banks to anticipate new developments and plan accordingly.

Given the background concerning the world of banking, this study examines the changes in the European Economic

Community which is becoming an increasingly important player in the world financial markets and the experience of a non-member country's banks (The sample country chosen for a non-member state being Turkey.) in this environment of change. The main focus of the study is access of non member country banks into the European financial markets.

In this study we have concentrated only on the banking side of the financial services sector, therefore, throughout the study the term is used as a synonyms of banking services.

A literature review was carried out to identify the characteristics of the changes in the banking system of the European Community within a regulatory framework and special emphasis on the Second Banking Directive. The first reason for this concentration on the Second Banking Directive is its global nature and its impact on the market for financial services at an international level.

The second reason is that, this directive lays down the crucial principles adopted by the European Communities which help in determining whether the Common Market for financial services could be considered as a liberal market or a "Fortress Europe"(from the point of view of access to the market and equal opportunites for participants).

In the second part of the study a survey of the Turkish banking sector is undertaken in order to ascertain their

current experience in the ever changing European Community Financial Services sector with regard to their experience in entering the EC financial markets, their readiness to the changes and the strategies they have used to adopt to it. The findings of the survey are considered in relation to the literature review and later recommendations aimed at improving the current practices are made.

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I would like to thank my family and my friends who have been very supportive and patient all through my work, and the bank managers who have given their time and knowledge to make this research possible. I hope that my work has been worthy of their support and that this research may be useful to some Turkish banks which are planning on entering the Single Market to provide financial services.

TABLE OF CONTENTS

PART I

...........................List of Abbreviations

Pg.

CHAPTER I INTRODUCTION..........................1

1.1 TOWARDS A EUROPEAN BANKING SYSTEM.....3

1.2. THE ROLE OF BANKS IN THE ECONOMY......4

1.3. BRIEF HISTORY OF BANKING IN EUROPE....5

1.4. INTRODUCTION TO EEC..................10

1.5. ANTICIPATED BENEFITS OF INTEGRATION..11

CHAPTER II PRINCIPLES RELEVANT TO BANKING IN THE EEC..................15

2.1. FREEDOM TO PROVIDE SERVICES..........18

2.2 FREEDOM OF ESTABLISHMENT.............19

2.3 FREE MOVEMENT OF CAPITAL.............21

CHAPTER I11 THE LEGISLATION RELEVANT TO BANKING IN THE EEC....25

3.1. DIRECTIVES...........................26

3.2. THE SECOND BANKING DIRECTIVE........28

3.2.1. THE FIRST BANKING DIRECTIVE........30

3.2.2. THE SECOND BANKING DIRECTIVE.......32

3.3. DISCUSSION OF CONCERNS OF NON-MEMBERS.........35

PART II

CHAPTER IV INTRODUCTION TO BANKING IN TURKEY............42
4.1. BANKING IN TURKEY....................43
4.1.1 BACKGROUND........................44
4.1.2 STRUCTURE.........................55
4.2. BANKING REGULATION IN TURKEY........62

CHAPTER V RESEARCH METHODOLOGY..............64
5.1 FORMULATION OF THE QUESTIONNAIRE....67

CHAPTER VI INTERPRETATION OF THE RESULTS....70
6.1. SURVEY RESULTS OF PART ONE..........70
6.2. SURVEY RESULTS OF PART TWO..........82
6.3 CONCLUSION..........................86

CHAPTER VII CONCLUSION......................88

..........................LIST OF REFERENCES
..................................APPENDICES

LIST OF ABREVIATIONS

EEC = EUROPEAN ECONOMIC COMMUNITY.

GATT = GENERAL AGREEMENT ON TARIFFS AND TRADE

LIBOR = LONDON INTERBANK OFFICIAL RATE.

SEA = SINGLE EUROPEAN ACT.

SYKB = SANAY˜ YATIRIM KALKINMA BANKASI (INDUSTRIAL INVESTMENT AND DEVELOPMENT BANK).

RT = ROME TREATY.

CHAPTER I INTRODUCTION

The world of financial services is a very dynamic one and particularly in the past two decades it has been going through a phase of rigorous change and restructuring. In this environment of transformation roles too have been evolving with time, players are changing, and powers are shifting. Japan and the United States of America (US); the major players of the world of banking along with other European countries, are paying special attention to a formation which is about to reach its completion that is the completion of the Single Market(*) by the end of 1992(**). The reason behind this particular interest is the potential power of this new formation.

This formation, or rather, the so called Single Market of the European Communities (EC), brings many eminent figures of the financial services such as the ones in London, Frankfurt, Paris and thus forms a combined market full of opportunities. In a sense it is like a club which has its own rules. It is particularly this resemblance to a club that makes the ones outside

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* Through out the study the terms Single market, Common Market or the Internal market are used as synonyms.
** This research began in September 1991 and by the time it was finalsed the Single Market had reached its completiton(so far only the negative effects can be observed i.e. rising unemployment, slowing down of growth) however in the field of finance the real deadline is 1995.

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wonder about the privileges of "membership". The non-members mainly fear that these opportunities offered by the Single Market may be reserved for members only. They describe the Single Market as a "Fortress Europe", which is very attractive because it is full of potential, however, in order to be able to exploit these opportunities one is faced with a pass word "membership".

The Commission of the EC, however, argues just the contrary. It claims that with the completion of the Single Market, all of the barriers preventing the free movement of goods, services, persons and capital will be eliminated in order to ensure free competition. According to the Commission after its completion, the Single Market is going to be like an arena in which the name of the game will be "the survival of the fittest". Another promise made by the Commission is that the completion of the Single Market shall not lead the EC to actions that would conflict with its international obligations arising under the General Agreement on Tariffs and Trade (GATT). The Commission further argues that the opportunities are there to be exploited by non-members as well as members, provided that non-members do not impose any restrictions on EC members on the part of access to, or freedom to provide services or establishment in their own market. This concept of "reciprocity" is the core of the Commission's attitude

towards non-members, which it claims it to be nothing but fair treatment.

Given these two opposing points of view, one can only judge the EC Commission's attitude that is whether it is pursuing a discriminatory policy towards non-members or not, by looking at its implementation in practice. With this goal in mind, we have carried out an analysis of the evolution in the Western European Banking. This analysis is also coupled with insights to the regulatory framework of the EC in which special emphasis is placed on the Second Banking Directive because of its crucial role in this sector of the Single Market. Then we constructed a survey in order to see the experience of a non-member country, i.e. Turkey, in the EC market. Finally, we have interpreted the findings of the survey in the light of the literature review so as to be able to justify one of the above mentioned points of view.

1.1 TOWARDS A EUROPEAN BANKING SYSTEM

This chapter is aimed at providing a general background to the changes in the Western European Banking by basically spotting the trends that triggered the chain reaction leading to the new system.

The economic incentives and pressures have served as the driving forces in the process of financial

innovation, or rather, the structural process of chang have characterized today's financial system. In other words, the factors which necessitated the change tende to be of an economic nature. Therefore, the role of th banking sector in the economy is considered as an important starting point.

1.2. THE ROLE OF BANKS IN THE ECONOMY

Firstly, the whole society benefits from the operations of a bank as a result of this sectors role in facilitating trade as well as investment in the country. In very basic terms, banks serve as intermediaries which channel the funds from savers to borrowers. Secondly, this process of channeling is closely linked with the stability of the economy, because if it is not carried out efficiently, the productivity of the rest of the economy will be hindered as well. For example, a faulty risk analysis leading to losses may weaken the confidence in the financial system or may end up having unfavorable economic consequences. In his study Kane (1981) mentions the "Domino Theory" of bank failure, and describes bank failures as "contagious", and further argues that because of this role they must be controlled in order to "prevent the system from collapsing" (1).

Another factor which makes the banking sector very important, is the role of banks in implementing monetary policies of governments through the control of the money supply.

The above mentioned roles of banks are some of the most important ones which have necessitated the need for this sector to be very closely monitored. In order to be able to channel the behavior of these institutions in the desired direction, banking authorities have used regulatory interference as a tool. In other words, it was the increasing economic importance that created the need to control. The response to this need was regulation in all of its forms, and it was the key factor that was used in the shaping of policies in banking. On the part of the banks however, the response was slightly different. Whenever there was a new form of regulation restricting the banks activities, the banks would look for ways of circumventing it and this process of aversion would generally result in an innovation in the sector. (i.e. a new debt instrument such as the CD's).

1.3. BRIEF HISTORY OF BANKING IN EUROPE

The evolution of banking and financial systems in European countries has been influenced by a wide range of different political, socioeconomic, and geographical

factors. However diverse these factors may have been, it still is possible to identify certain general patterns that have been experienced in many of the industrialized European countries since the seventeenth century. Throughout the seventeenth and eighteenth century, as argued by Gardener and Molyneux (1990), banks were unit-based and mainly small private institutions that only specialized in serving the needs of the local markets. (2)

As we move into the early nineteenth century the functions of banks still remain rather simple with a few attempts by a limited number of banks to engage in financing international trade (Revell 1987) (3). However, with the industrial revolution banks started to expand geographically and they also became larger in size in order to be able to supply the required funds. Obviously, the nineteenth century was a period of marked change in world banking. Finally, in the twentieth century the system settled into more stable and well ordered patterns. Within their own boundaries financial systems of countries became highly structured. As well as being highly structured, they were also highly country specific with each government exercising a noteworthy degree of independent control over their own system. However, after the second World War growing interdependence of economies came into the scene.

From the 1960's banking competition began to intensify, and this in return increased the pressure to innovate. The main characteristic of many of these innovations was that, they were all created as response to economic incentives, as attempts to circumvent or to avoid statutory or regulatory limitations (Eisenbeis 1980 and Kane 1977,1981)(4). In certain cases these restrictions were aimed at controlling the terms under which banks were permitted to provide services to the public or to direct the funds in the desired direction. But the common element in these restrictions was that, they were mainly aimed at preserving the stability of the economy and the financial system as a whole, and generally were in several different forms. Aspinwall and Eisenbeis(1985) classify them in the following form(5) :

1- Rate ceilings on time and savings deposits and demand deposits,

2- Capital requirements,

3- Reserve requirements,

4- tax laws,

5- Limits on geographical expansion and product diversification.

The first major event which triggered significant financial innovation, was the 1959-60 period of monetary restraint. The developments in the real

economy during this period, such as the high nominal interest rates as well as inflation qualified this era as a volatile and uncertain one. This uncertainty and volatility in return brought more complexity and risk to the system. During the 1970's and early 1980's European governments focused their macroeconomic attention on lowering the inflationary pressures as well as reducing market supply side constraints. This new policy meant that the governments were now relying on the allocative powers of the market itself. These market-based methods of economic, financial and monetary control have paved the way to a period of liberalization, both in the worldwide financial arena and in the traditional banking market. All of the above mentioned economical forces, along with a growing commitment by many governments towards monetary policies and market solutions, helped to produce an environment of marked deregulation.

The increased size and volatility of capital flows across borders coupled with financial liberalization, has boosted the integration of international financial markets (Pecchioli, 1983)(6). With this new trend, the barriers between traditionally separate financial institutions and markets began to come down in many countries. These structural deregulation trends accompanied by growing supervisory re-regulation was experienced in many of the European countries as well

as the international banking system as a whole. Supervisory re-regulation was deemed necessary, because in many cases traditional supervisory methods had been found lacking in the new environment.

The most obvious reflection of the liberalization in the traditional banking markets was the increased price competition. The types of business activities in which banks and non-bank financial institutions were permitted to engage were also changing. In an environment of such dynamic change regulators are naturally finding it increasingly difficult to identify the regulates, that is, the ones to be regulated. As the barriers which separate the markets in countries break down, so do those characteristics which used to differentiate between financial and non-financial institutions. The distinctions are becoming more and more blurred, eventually leading to a more uniform system in the world of banking and finance. However, this minimization of distinctions can best be achieved through harmonization of legal systems relevant to this sector in each country. This is the exact goal the EC has in mind, and therefore, it has made many attempts to harmonize the legal system in the banking sector of the Internal Market.

1.4. INTRODUCTION TO EEC:

The European Economic Community was founded by six countries in 1957, and the objectives of it were laid down in Article 2 of the Treaty of Rome(7), which established the Communities. These are "the promotion of a harmonious development of economic activities, a continuous and balanced expansion, an increase in stability, an accelerated raising of the standards of living and closer relations between the Member States". All of these objectives are of an economic nature, and Article 3 of the Treaty provides mechanisms intended to achieve these goals. One of these is the creation of a Single Market, and the other is the approximation of the economic policies of the Member States. Even though, the factors which constituted a Single Market were not so clear cut in the Treaty of Rome, they were well defined in the amended form of the Treaty, that is, the Single European Act (SEA). According to Article 8a of the SEA, "the internal Market shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of this Treaty"(8). The integration process was to be completed by the end of 1992. A deadline was set in the SEA for the completion of this Single Market so as to make the dream a reality.

1.5. ANTICIPATED BENEFITS OF INTEGRATION:

The 1992 program focuses on removing remaining barriers to intra Community trade which result from a variety of non tariff barriers, such as differences in national rules or laws regarding product standards. Such differences may effectively prohibit products made in one Community country from being exported to another. In order to deal with the remaining barriers to trade within the EC the Community has adopted a new concept called "mutual recognition". With this new notion Member States have agreed to respect the validity of each others laws, regulations and administrative practices that have not been harmonized at the Community level. In essence Member States have pledged not to use differences in national rules to restrict cross-border flows of goods and services.

The Single Market Plan will, according to many analysts, result in the realization of significant economic benefits for the EEC and its members.

First of all the completion of the Internal Market presents the businesses of non-members a barrier-free market in place of what had been 12 different entities.

Secondly, the lifting of all trade barriers hindering the proper functioning of a liberal market within the EEC is expected to result in a more efficient use of resources. The reason behind this

expectation is the theory that increased competition will shift the production of goods and services to the lowest-cost supplier. In other words, National producers will no longer enjoy the relative protection of a country's boundaries and will remain in business only if they can compete with the producers of other Member States.

There are not only opportunities but also incentives for firms to expand geographically so as to achieve economies of scale. These incentives and the accompanying structural and geographical shifts of capital and other resources will cause a major restructuring of corporate Europe too. The consequences of these trends within the Community have been increases in cross border operations along with mergers and acquisitions particularly in the past five years. The changing environment of the market in the EEC, is such that firms are forced to merge so as to be able to defend their strategic interests in the new market. All of these changes that had taken place before the deadline of end of 1992 can be interpreted as preparations for the new coming market.

Now firms must be both prepared to serve a larger customer base in order to get the most out of this integrated market and be prepared for tougher competition.

The European Commission, according to the Cecchini Report, projects that the elimination of physical, technical and fiscal barriers is to increase the EEC gross domestic product by 4.25 to 6.5 percent, reduce consumer prices by 6 percent, and create some 2 million new jobs within a few years(9).

In other words, an integrated market is almost definitely expected to result in an increase in economic activity which in return will create an increase in demand and consumption. This situation obviously implies greater opportunities for suppliers.

Other than stimulating shifts to the lowest-cost supplier the increased demand as well as increased competition is also expected to result in narrower profit margins, high product quality, high degree of innovation and an inevitable initial shakeout.

The striking element of this integrated market is that these opportunities are supposedly there to be exploited by all firms regardless of whether they are headquartered or operating inside the Community and whether they are EC or third country firms. Therefore, the size and the opportunities offered stimulated not only intra-European but non-European interest in the Community as well. However, it is rather difficult to predict the extent to which the increased demand will be satisfied by the imported rather than domestic goods. This situation brings to mind an important issue

of concern, which is whether the Community will become a protectionist market in spite of what is advocated by the Commission of the EC.

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CHAPTER TWO PRINCIPLES RELEVANT TO BANKING IN THE EEC

The Commission regards the services sector as critical because of its steady growth and future importance in the EC economy. This importance attached to the services sector is evident in the White Paper which states that "the establishment of a common market in services ... is one of the main preconditions for a return to economic prosperity" (1). The financial services take up a major part of this particular attention. It is a sensitive sector both from the economical point of view as well as the political one because it impinges upon the management of the economy coupled with the monetary and fiscal policy of the state.Mainly due to these functions, the Services sector in the Member States has been, on the whole, highly regulated by national governments. This is especially the case with financial services such as banking, insurance, brokerage, where the Member States exercise their control as well as limiting the right and conditions of establishment.

The regulations imposed on these institutions and the financial stability requirements vary from country to country. As a result of these differing regimes, the prices for financial services differ considerably among the Member States often by more

than 50 per cent(2). When this issue is tackled from the point of view of the consumers, or even the EC economy as a whole, the difference creates a loss just like a leakage. Having spotted this defect of the system hindering the "return to prosperity", the Commission decided to take action to harmonize the Financial Services sector.

In order to bring about the Community-wide market in Financial services, or more precisely to unify the financial system the Commission has issued various directives, regulations and recommendations. The aim was to create a "European Financial Area".

The framework for this harmonization is to be found in the EEC Treaty, and the mechanism for its implementation in the decision-making process of the Community as reformed in 1986 by the Single European Act. Prior to the White Paper and the SEA the Commission had a more detailed approach towards the harmonization of the financial services. However, time proved this method to be inadequate for the harmonization of such an important sector. As a result the Commission shifted its policy from harmonization to mutual recognition of national norms. This was done in order to both speed up the integration process in the field of financial services and make the completion a reality by the end of 1992. The new method proved to be very fruitful because instead of the detailed harmonization measures which often involve years of

negotiations in the Council, the Commission adopted the principle of home country control, mutual recognition of national standards and minimum harmonization of essential standards at the Community level.

Under this system, financial institutions chartered by any individual Member State will be deemed by other members to be adequately supervised on a consolidated basis by their home country in line with the requirements set forth in EC directives.

The second approach adopted by the Commission in speeding up the liberalization of financial services was to treat the sector from the point of view of free movement of "financial products". Therefore, all of the principles applicable to industrial products are now applicable to the financial products too. In this way the Commission hopes to accomplish the same progress in the financial products as it did in industrial goods.

There have been numerous efforts by the Commission to liberalize the financial services. However, the Community legislation, apart from breaking ground, still has to overcome a serious obstacle which is the claim to excellence of well-established national practices and traditions as well as the aversion to change.

We have mentioned the crucial views the Commission has adopted in dealing with the

harmonization of the financial services sector. However, this would not suffice in understanding the process of integration in this sector. The harmonization of the banking and financial services in the EC has to be seen in the context of the main principles of the Internal Market. The ones most relevant to the sector are the right of establishment, the freedom to provide services and the free movement of capital.

2.1. FREEDOM TO PROVIDE SERVICES:

Free movement in the Treaty is guaranteed not only to those who are employees of others, but also to the providers of services, that is, someone who is established in one Member State and providing services in another. This freedom has dual effect, because it also applies to the recipients of the service and gives them the freedom to move to another Member State to receive the services provided.

Article 59 of the Treaty is aimed at removing all barriers which may hamper this freedom. Article 60 of the same treaty also defines the services which fall under this legislation. According to these guidelines services are "...normally provided for remuneration...", and they include the activities of an industrial, commercial, professional, or craftsman like nature.

The freedom to provide services is a right guaranteed by the Treaty of Rome to the nationals of all Member States, and Article 7 of the Treaty requires that discrimination on grounds of nationality is not permitted in any Member State. However, there also is an escape clause which allows Member States to impose restrictions on non-nationals seeking to provide services within their territory, provided that this is only done to prevent the evasion of rules relating to professional conduct, professional rules, ethics or other forms of professional supervision. Another requirement is that there must not be any other less restrictive way of ensuring compliance with such professional requirements.

2.2. FREEDOM OF ESTABLISHMENT

The principle of freedom of establishment is set out in the Article 52 of the Treaty of Rome. It requires Member States to progressively abolish all restrictions hindering the "freedom of establishment of nationals of a Member State in the territory of another Member State... in the course of the transitional period". In 1974 the European Court of Justice has reaffirmed the direct applicability of the freedom of establishment principle from the end of the transitional period in the Reyners and van Binsbergen cases respectively(3).

The Article also stresses that such progressive abolition applies to restrictions on the setting up of agencies, branches or subsidiaries by nationals of any Member State in the territory of another Member State. Furthermore, Article 52 also defines the scope of freedom of establishment which includes "the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, in particular companies or firms..". These companies or firms referred to in Article 52 must be formed in accordance with the civil or commercial law of a Member State and have their registered office, central administration or principle place of business within the Community (Article 58 of RT.). Article 52 of the Treaty also requires the Member States to grant "national treatment" to parties from other Member States operating in their territory. Basically, financial institutions coming from other Member States will be operating under the same conditions laid down for a Member States own nationals by the law of the country as well as being subject to the regulations concerning capital. The principle of freedom of establishment can not really function effectively if the free movement of capital and non discrimination are not achieved, because these concepts are very intertwined.

2.3. FREE MOVEMENT OF CAPITAL

The liberalization of the financial markets can not be achieved in the absence of free movement of capital because this takes up a major part of the financial activities. As D.Lasok and J.W.Bridge (1987,p.409) put it the concept of a liberalized Common Market would be "largely illusory" without the removal of all barriers retarding the movement of capital(4). The relevant Articles of the Treaty governing the free movement of services often make references to the free movement of capital, which is another evidence of the two freedoms being intertwined. Therefore, the progress of the two freedoms is meant to be synchronized with one another. Similarly, according to the second paragraph of Article 61 of the Treaty "the liberalization of banking and insurance services connected with movements of capital shall be effected in step with the progressive liberalization of movement of capital".

Articles 67 through 73 and 104-109 of the Treaty regulate the free movement of capital. The core of these articles is that Member States are to abolish between themselves all restrictions on the movement of capital belonging to persons resident in Member States. The principle of non-discrimination is also valid regardless of the place of residence or on the place where such capital is invested.

An issue worthy of scrutiny is Article 72 of the Treaty regulating the free movement of capital. According to this article "Member States shall keep the Commission informed of any movements of capital to and from third countries which come to their knowledge...and in such a case the Commission may deliver its opinion to the Member States". First of all the article lacks the element of enforcement because of its wording(i.e. Member States "shall"). This article may suggest a form of discrimination on the part of control on capital flows from third countries because the capital flows within the Community are not subject to such control.

However, the fact that no distinction as to the origin of the capital is mentioned in the Article suggests that the same condition is valid for both banks of Member States as well as those of non-members. Therefore, it is difficult to argue that this is a protectionist approach.

The Member States are required to liberalize their domestic rules governing the capital and the credit system. The aim is to achieve the highest possible degree of liberalization. However, on the part of balance of payments and the standing of their currency Member States have the responsibility to ensure the stability. It also is recognized that differences between national exchange rules might still exist.

The rates of exchange as well as each members economic stability are matters of common concern because of their impact on the proper functioning of the Common Market. Consequently, there is room for interference by the Commission to this responsibility of the Member States.

In the case of such disturbances in the functioning of the Common Market the Treaty allows the Member States to take the necessary measures to overcome these difficulties after consulting the Commission. In taking such measures Member States do not enjoy complete freedom for they are subject to the control of the Council, which may amend these measures if it finds them to be excessive. In other words, the measures taken may not exceed the cause.

There has been considerable progress in the liberalization of the capital markets resulting from the adoption of the First and the Second Directive. The best examples of this progress can be seen in the elimination of exchange controls in respect of current transactions, transfer of personal funds, investments in real estate and transfers in relation to the movement of goods and the provisions of services. Member States must permit such payments and transfers in the currency of the Member State in which the creditor or beneficiary resides. Important implications for the liberalization of current payments resulted from the European Court's distinction between such payments and movements of

capital in the Luisi and Carbone case(5). According to the European Court of Justice the physical export of bank notes did not fall under movement of capital as defined in Article 67 but fell within the area of current payments for services covered by Article 106(1).

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CHAPTER 3 - THE LEGISLATION RELEVANT TO BANKING IN THE EEC

Despite the fact that the Treaty itself provides a legal basis for the creation of a European banking system and that many years have gone by since it went into force on January 1, 1958, the Community is far from having an integrated market. The Member States have failed to coordinate their economic and monetary policies to the extent necessary to provide a common ground of rules. This common ground would be such that banks could handle capital freely within their common territory without hindering competition. The Community has both the power and the obligation to adopt the necessary measures to achieve this harmonization of economic activities and bring about integration.

In order for a better understanding of the specific measures intended to further the formation of the Single Market for financial Services in the EC, it is necessary to be familiar with the process by which the Community passes its laws.

Since this study is not meant to be about the legal framework of the EC, going into great depth about legal technicalities is not considered necessary, and just a broad explanation of the procedures should suffice. This is basically a three step procedure: (December 89, EEC Commissions Report) (1)

1- As a first step, the Commission, which has executive and administrative functions, initiates and drafts a proposal which it later submits to the Council.

2- The European Parliament, which is composed of elected citizens of the Community, and the Economic and Social Committee, examine and make comments on the proposal.

3- Finally, it is the Council that adopts the proposal, which later becomes law.

There are various types of measures used in implementing the principles laid down in the Treaty of Rome. However, in the financial services sector of the Single Market, these measures are mainly in the form of Directives. Therefore, we will concentrate on measures having this form.

3.1. DIRECTIVES

The definition of this form of measure is laid out in Article 189 of the Treaty of Rome itself. Even though, it is not declared as a directly applicable * form of measure, it is considered binding only "as to the result to be achieved". As regards the "choice of form and methods" Member States national authorities are free. However

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(*) A measure which is considered to be binding upon Member States without any further adjustments in the national law, that is to say, such a measure of the Community also becomes the law of the country as soon as it is adopted.

unconstrained the national authorities may be in the choice of methods to achieve these goals laid out in the directive, there are limits to this freedom, because they are faced with a deadline for implementation. This deadline implies that these directives have no direct affect. In other words, a directive has an effect only after the expiration of the deadline, not the moment it is adopted. This application is rather common in other forms of measures as well. In practice, particularly in the past few decades since the creation of the EC, only little progress towards harmonization has been made because the directives that were adopted were very modest in their content of common rules for banks. Another reason for the delay in harmonization may be the widely diverging interests of numerous parties requiring a long period of time for reconciliation. Even the fact that the Commission felt the need to form the Single European Act shows the extent to which the harmonization ofthe financial services sector had been avoided by the Member States.Therefore, we believe that it will not be a mistake to say that the Member States have been very remiss in implementing the harmonization process up until the adoption of the SEA, which can be regarded as a sign of their sheer reluctance to give up their own national system.

Moreover, the directive which is normally used to harmonize national laws by commanding the Member States to take the necessary measures so as to achieve the intended objectives, is a relatively weak instrument of legal integration. There are several reasons behind this. The first being, its tendency to allow derogation's, and the second, its having been confined to the lowest common denominator. It is not surprising, therefore, that the harmonization of the banking sector has begun rather late in the life of the Community, and that it showed little progress until the Commission's White Paper in 1985. The Commission singled out the sector for urgent action and tried to motivate the creation of the "financial product", which ought to enjoy the same status as goods lawfully produced in a Member State. This lack of definition as to what a "financial product" was, seemed to be the handicap of the financial services sector, or rather, the services industry in general. It was believed that, once a clear definition of the "financial product" was formulated, the services would be entitled to free circulation within the entire Single Market.

3.2. THE SECOND BANKING DIRECTIVE

On December 15,1985 the EC adopted the Second Council Directive (89/646/EEC) [2] on the Coordination of Laws, Regulations and Administrative

Provisions relating to the Taking-up and Pursuit of the Business of Credit Institutions and Amending Directive 77/780/EEC(The Second Banking Directive) (3). The Second Banking Directive is the centerpiece of the new banking Law in the EC. This directive obligates the Member States of the EC to implement its provisions into their national law by January 1, 1993. As a result, the Second Banking Directive will be transformed into law and become directly binding on persons doing or intending to do business in the EC.

The Second Banking Directive is expected to cause major changes in the legal framework of the banking business in the EC. This affect will be more apparent in the way banks will be doing business in the EEC and the way in which non-EEC banks can enter the European Market. The fundamental aim of the Second Banking directive is to create a single EEC-wide banking market with no internal barriers to the movement of banking services and the establishment of branches within the Community.

The fundamental issue of bank supervision projected by the Second Banking Directive is the principle of Home Country control. According this directive, each credit institution will be generally supervised by the authorities in accordance with the law of the Member State where it has been licensed as a credit institution through a branch (but not through a subsidiary) located in another Member

State (the Host Member State). As a result, banks doing business in a Member State that have been licensed by a different Home Member State will be subject to differing legal rules and therefore will not have the same competitive opportunities. In order to eliminate such disadvantages, the creation of a single EEC-wide banking market requires the basic standards of supervision of the various Members to be broadly similar. The achievement of such harmonization of basic standards of supervision is the aim of various EEC directives and recommendations that supplement the provisions of the Second banking directive.

3.2.1. The First Banking Directive

The First Banking Directive of December 12,1977,took only a few steps towards the formation of an EEC-wide banking market. It provides that each Member State must require its credit institutions to obtain a license in that Member State before engaging in activities, and it establishes several minimum requirements for such a license. The First Banking Directive does not require Member States to automatically permit credit institutions licensed in other Member States to establish branches on their territory. On the contrary, it allows Member States to require that credit institutions from other Member States obtain an additional license for the establishment of a branch on their territory.

However, the First Banking Directive requires that Member States grant such a license on the basis of "national treatment", that is, "according to the law and procedure applicable to credit institutions established in their territory".

The First Banking Directive fails to provide protection from protectionist or discriminatory measures by Member States directed against the establishment and operation of branches of non-EEC credit institutions in Member States. On the contrary, Member States are obliged not to grant more favorable treatment to branches of non-EEC credit institutions than that accorded to EEC institutions, and to notify the Commission of all authorization of branches of non-EEC institutions. Even though, the directive does not mention anything about the establishment of subsidiaries of non-EEC credit institutions, it still can be considered as rather protectionist towards outsiders. This quality of the directive hinders the proper functioning of a liberal market to a great extent.

However imperfect it may be, the First Banking Directive is still the core of the EEC law regarding the establishment of branches in Member States by non-EEC credit institutions. From this perspective the First Banking Directive has not been superseded by the Second Banking Directive.

3.2.2. The Second Banking Directive:

The main goal of the Second Banking Directive is to create an EEC-wide internal market for services. Inspired by the strategy set out in the White Paper, the Second Banking directive abandons the idea of a preliminary generalized harmonization of the existing rules which appears in the First directive. Instead, it introduces a new approach the aim of which is to achieve the harmonization of only the matters which are regarded as essential. This new approach has brought great momentum to the integration process.

The Second Banking Directive applies to "credit institutions", that is, "undertakings whose business is to receive deposits or other repayable funds from the public and to grant credits for its own account". Credit institutions authorized in the Home Member State will have the right in each of the Member States to:

1) establish branches ,

2) to offer their services freely to individuals and businesses,

In each of the above cases these credit institutions will be entitled to operate without the need of any further authorization by the Host Member State. In other words, credit institutions authorized and supervised as credit institutions by the competent authorities of their Home Member State

benefit from mutual community-wide recognition.The Host country will, however, retain the right to establish regulations for such branches that are needed for the implementation of monetary policy, provided that such regulations are applied consistently to all banks operating in that country.

The recognition of the Home Member State license required by the Second Banking Directive is limited to certain specific banking activities and powers. Basically, the Home Member State license is valid in other Member countries only with respect to those specified banking activities that are listed in the Annex to the Second Banking Directive.

This Annex defines the scope of the principle of mutual recognition. In addition, each Member State will be responsible for ensuring that at least the activities listed in the Annex may be pursued in its territory by any credit institution authorized and supervised by the authorities of its Home Member State. These activities may either be carried out through the establishment of a branch or by way of the provision of services across the Member State border. This feature of the new banking framework requires Member States to permit banks authorized by their Home country to engage in activities listed in the Second Banking Directive even if such activities were prohibited to locally chartered banks.

For example, a bank permitted to underwrite and deal in corporate securities in its home country would be

permitted to do so in any Member State within the Community, even if local banks in a host Member State were prohibited from such securities activities themselves. This explicit right of expanded activities for non-local banks, based on activities permitted in their home country, has no precedent in international banking. Consequently, it will need to be monitored closely because it may have important implications for the types of European-based financial institutions that will emerge as major competitors of non-EC banks.

The second feature of the principle of mutual recognition is that it extends only to a branch of a credit institution and not to a subsidiary, because a subsidiary can not operate under the parents license. A subsidiary, being a separate entity, is required to have its own license before it can engage in banking activities.

On the part of non-EEC branches and subsidiaries in the EEC, the situation as regards mutual recognition tends to be slightly different. For example, the branches of non-EEC credit institutions are not authorized as credit institutions by a Member State and therefore do not benefit from mutual recognition.

However, subsidiaries established within the Community by non-EEC persons under a license for credit institutions are regarded as credit institutions benefiting from the principle of mutual

recognition. In other words, non-EEC ownership or control of a credit institution does not destroy the mutual recognition of its already acquired license.

The core of mutual recognition is that it applies only to financial institutions authorized as such within the Community by a Member State regardless of non-EEC ownership. However, the application of this principle is not as crystal clear as it sounds. From the point of view of non-members there is an important element of this principle which can not be ignored. This final provision having direct relevance to non-EEC participants, is that the Single EEC license will be issued only to banks of countries in which reciprocal treatment is granted to Member State banks. The concept of reciprocal treatment is very straight forward. It is based on the understanding that the EC shall not permit non-member firms to enjoy the benefits of an integrated market unless EC firms enjoy similar treatment in the non-members country.In other words, as emphasized both in the White Paper and the Cecchini Report, the EC will have the right to expect "appropriate responses" from its economic partners[4].

3.3. THE DISCUSSION OF THE CONCERNS OF NON-MEMBERS

Following its completion, the Common Market offering great opportunities as projected by the

Cecchini Report is to become one of the world's largest trading blocks(5). The size and the opportunities offered as well as its unique features naturally urge the other players in the arena to monitor the legal changes in this attractive market very closely. This is a necessity because according to the EC Commission the opportunities resulting from the integration are not reserved for EC firms only. To the contrary, the opportunities are there to be exploited by both member and foreign businesses. However, a potential threat to firms outside the EEC comes from the fact that an internal market could turn protectionist against non-members. In other words, now the question is "What will happen regarding the right of entry and expansion for foreign-based financial institutions in the new financial market of Europe?, Will the Community turn protective against non-members in spite of what is advocated by the EC Commission?". Even though, economically this is not in the long-term interest of the EEC and its non-member trading partners, a political deadlock could make it a reality. This uncertainty has led the non-members to adopt both opportunistic and cautious strategies in the EEC.

The starting point of the major concern is the Common Markets "internal" nature. According to a study by Glennon J.Harrison (1988,p.14-24) the most controversial, or rather worrying aspect of the famous 1992 Plan from the point of view of non-

members, is the omission of any discussion of the Extra-European effects of the plan [6]. The Commission has carried out rather detailed studies of nearly every aspect of the plan and has made detailed projections of the consequences of removing intra-EC barriers. However, no similar effort has been made with respect to Europe's main trading partners. This silence on the part of the European Commission has caused considerable speculation about the long term consequences of the 1992 plan for non-EC countries. The non-EC countries mainly fear that the internal market will lead to a "fortress Europe" that is no longer open to foreign trade [7]. There is a potential risk that the existing barriers throughout Europe will come down internally only to be replaced by a new common one around the European Community.

Another fear on the part of non-members is that the internal market may provide the European Community with an excuse for redefining the rules of trade to its own advantage. For example, the Community may request some changes in trade agreements at a multinational level in return for having opened its doors to non-members. The validity of this fear is another issue open to speculation, nevertheless controversy will no doubt continue over the 1992 plan because of conflicting interests as the Europeans try to come to terms with their trading partners.

There are several likely explanations for why the Commission has thus far has not made any attempts to deal with the external consequences of its plan.

One explanation is that the plan is so controversial within Europe that any attempt to deal with how the EC will function in the world economy would end up slowing down the progress toward the major goals of the 1992 plan.

The second explanation for the omission of external effects of the plan, may be the lack of consensus on the crucial decision that will have to be made with regard to EC's trade relations beyond the perimeter of the Community. This is a very delicate issue because the removal of internal barriers to trade will, if not coupled with some measures to restrict access to the EC market for outsiders, result in a free lunch for countries that do not grant reciprocal benefits to EC's Member States. Thus, the EC has to be particularly careful when granting this unilateral concession to non-EC countries that have been accused of restricting access to their markets.

The above mentioned situation may bring to mind the idea that the fears of non-members have sufficient grounds. The EC Commission has tried to calm down Europe's major trading partners by saying that the main thrust of EC integration is to expand trade opportunities by enlarging the Common Market.

Consequently, after its completion this market will become the world's largest trade block. Therefore, it must be very obvious that the EC has a vital interest in maintaining as well as expanding the world trade system, rather than disengaging from it.

The principles adopted by the EC Commission relevant to its trade policy after 1992 seem to be three fold. As EC Commissioner responsible for external trade Willy de Clerq puts it(8):

> " Firstly, the single market would not lead the EC into actions that conflict with its international obligations under GATT. Secondly, there would be a small hard core of areas such as motor vehicles, imports from certain East European and developing countries and textiles where import restraint would have to continue. Thirdly, the economic advantages of opening up the European Market should not be extended unilaterally to third country trading partners, from whom reciprocity would be demanded in return."

Facts such as the existing quotas and EC's strongly supported "get tough" policy towards Japan and more recently towards some Asian countries, show that there is degree of protectionism at least in the case of imported goods. However, the existence of a protectionist attitude is more difficult to identify in the case of services because the definition of services is not as clear cut as that of goods. Nevertheless, there are still some restrictions in member states on the operations of non-national firms in certain areas, such as financial services, telecommunications and transport. However, one must also bare in mind that these restrictions are not in many cases dissimilar from restrictions imposed in many non-EC countries.

The next issue to be tackled is reciprocity. Even though no one can precisely judge how reciprocity will be implemented, it is probably fair to say that those areas currently not covered by the GATT (services, investment intellectual property rights) will be the ones most affected by reciprocity. There have been attempts to include the financial services sector in the agenda of the yet to finalize Uruguay Round. The G-7 countries have shown in a recent summit held in Toronto on May 14, 1993 that they share the objective of reaching an agreement on market access (9). The main push for this commitment to reach an agreement on market access came from both the EC and US which shows these countries attitude at an international level.

On the issue of reciprocity de Clerq tries to explain the approach of the Commission by saying that " in many cases a symmetry not so much in the legal equivalence of conditions of access, but rather an equivalence in their economic effects will be sought".

The services sector seems to be a rather delicate one because the concepts applicable to it seem to leave room for protectionism. In order to clarify its position, the EC Commission has changed the wording of the Second banking directive. Now stating that the only circumstance under which they would even consider not granting a license to banks, that are otherwise qualified, would be if the

country from which they came discriminated on national grounds against European banks (10).

Thus far, having reviewed both the legal setting and the concept of reciprocity adopted by the Commission in dealing with the issue, it is very difficult to find sufficient grounds to accuse the Community of a discriminatory attitude against non-members with regard to access to the market.

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CHAPTER IV INTRODUCTION TO BANKING IN TURKEY

In the first part of our study our aim was to introduce the reader to the Single Market of the European Community with particular reference to the financial services sector. Then we went further into the regulatory framework of the financial services within the EC and have laid down the basic principles of law relevant in this field. After our review of the sector we finally reached a point where we came upon two different interpretations of the on going developments in the financial services sector of the Single Market.

One view was that the Single Market was expected to become more protective and conservative, in other words a "Fortress Europe" after its completion. Naturally, this is a view held mainly by non-members.

The second view is the one supported by the European Commission which argues that the Single Market is to be a more liberal market full of opportunities for everyone with a high degree of competition.

Turkey was chosen as the sample country in order to test the validity of these views. The main reason behind this choice was the ease at accessing

information and the Turkish Republic's "foot in the door" to membership position.

Before going into the results and the evaluation of the Turkish banks experience in the Single Market obtained through the survey, it is considered necessary to give a brief history of the Turkish banking sector.

4.1. BANKING IN TURKEY

The banking sector constitutes the greater part of the Turkish financial system. Nearly all of the activities taking place on both money and capital markets are carried out by banks. It is a consequence of the country's economical and historical development that Turkey's financial system and its banking sector are virtually synonymous with one another.

Various factors were combined to give banking such a broad function in the Turkish economy. Some of the major influences are as follows:

A- The economic structure of Turkey peculiar to itself.

B- The choice to turn resources into long-term investment through the banks for the objectives targeted in the development plans and programs, and the establishment of banks by the state to finance certain sectors.

C- Extensive application of Continental European banking practices as a model in the legal structure of the banking system, and

D- A recently-developing capital market that can compete with the banking sector.

4.1.1. BACKGROUND

When we examine the Turkish banking sector from the time of the formation of the EEC it is crucial to look at it as pre-1980 and post-1980. The reason for this separation is that these two periods were characterized by totally different economic policies that have had direct effects on the financial sector as a whole.

The first being the pre-1980, or more precisely the 1960-1980 so called Planned Development period, was a time when the financial system was developing in a tightly regulated environment. According to this system, the government would command the state sector and issue recommendations to the private sector through five-year plans prepared by the government to cover the whole economy. The main characteristics of this period were the conservative exit and entry policies coupled with administratively set interest rates as well as constraints on handling foreign currency. This restrictive financial policy was aimed at complementing the import substitution policy of the

government. The fixing of the interest rates below their equilibrium levels and the establishing of directed credit programs were used as tools which forced banks to channel investment in the desired direction. In fact, as was recommended in plans, several development and investment banks were established in order to finance various sectors such as tourism and industry (i.e. Turizm Bankası in 1960, Sanayi Yatırım Kalkınma Bankası in 1963). This intervention into the financial system as well as the restrictions (i.e. restrictions on entry-exit or types of services to be offered) urged banks to resort to non-price competition in the form of excessive branching and furthermore created a high level of concentration in areas such as deposits, loans and assets. The consequence of these trends was a non-competitive as well as an inefficient banking system dominated mainly by public banks and private banks owned by major industrial groups. The characteristics of the Turkish banking sector during this period are almost identical with those of the Spanish banking system before their system underwent the painful process of liberalization(1).

The post-1980 period however, was a period of remarkable change for the Turkish financial system. This rapid change was once again a consequence of the new economical policies announced by the government, best known as "Decisions of January 24,1980". These decisions, or rather reforms, were

aimed at integration with the world economies and with this intent in mind they have channeled the economy towards a totally new direction. This new direction called for the creation of a liberal market in a more stable environment where market forces determined the equilibrium. In order to achieve this goal a phase of deregulation and restructuring of the system along with the promotion of competition began to take place in the Turkish financial sector.

The first step of this process was the removal of interest rate restrictions, later followed by the easing of entry-exit conditions as well as allowing new kinds of financial instruments to be introduced to the system. The main aim of these reforms was to increase the efficiency of the financial system through fostering competition among the banks. The first responses to this process of liberalization were seen at the retail end of the market (particularly among smaller banks) where banks began to compete by increasing the interest rates that they offered for deposits. In spite of some of the major banks attempts to keep the rates at a lower level, time in such a fiercely competitive environment proved this silent agreement to be unsustainable. There were a few interventions by the Central bank in this period in the form of reregulating the interest rates, however, this time at much higher levels than the pre-1980 period. This

intervention, or rather corrections by adjusting the interest rates occasionally in order to maintain positive rates of return, that is, to facilitate the functioning of a safe and sound system, continued until late 1988. After this date deposit rates were once again liberalized and this policy has been rather consistent up until the present time with a few temporary exceptions. When interest rates were regulated competition could only take place through quality or convenience to customers. Therefore, we can say that the actual price competition in the financial sector began only after 1988 even though the system for change had been triggered way back in 1980.

These attempts to liberalize the market through deregulation and the relaxation of the levels of interest rates have contributed to the growth of the financial system as well as attracting new players into the market. Apart from deregulation and removal of restrictions on levels of interest rates, reserve requirements were lowered and preferential rates applicable to certain credit programs were also eliminated.

All of the above mentioned steps towards liberalization have facilitated the functioning of a system in which efficient allocation of resources could be achieved.

In 1986, the Inter bank Money Market was established for the purpose of regulating liquidity

in the banking system. Unified accounting principles and a standard reporting system were adopted in the same year.

Apart from the Inter bank Money Market there exists a young Stock Market which is growing rapidly. Organized option and future markets, in spite of some over-the-counter dealing, are still non-existent in the Turkish financial system.

In 1987, banks started to be audited by independent external auditors in accordance with internationally accepted principles of accounting. The success of the reforms had created a more stable as well as a liberal market which in return became an attraction to other investors. In parallel with the steady internationalization of the Turkish economy and economic development after 1980, there was increased demand for banking services. The increased demand, coupled with the incentives that have been provided to encourage foreign investment, resulted in a rapid increase in the number of both foreign and Turkish banks operating in the sector.

Turkish banks, like the foreign ones coming into the Turkish market, took an interest in doing business abroad whether by purchasing banks in foreign countries or by opening branches and representative offices.

The attraction of the Turkish internal market, on the other hand, caused an increase in the number of banks operating in the sector which reached a

total of 66 including the Central Bank, as of September, 1991 from only 42 in 1980 (2).

The increase in the number of banks, regardless of size, has contributed, however small, to the reduction of concentration in the field for it also brought about increased competition. As of May 1993 the number of banks has nearly reached 75. Some bankers regard this as a worrying increase because they believe that the increase endangers the stability of the functioning of the whole sector (3).

Besides all this, legal and institutional arrangements were also introduced to foster the development of the capital market. As a result, banks began to offer additional services such as trading in securities, underwriting fund management and financial consultation. However, none of the new-comers into the market chose to operate in the retail end of the market even though there were no restrictions to the scope of their activities. The large sums of capital required to set up the network necessary to perform the services in this end of the market was probably the main reason behind this choice of the new-entrants. Therefore, the retail end of the market remained to be largely dominated by the major banks which had expanded excessively in the pre-1980 era, and the new-comers chose to offer specialized services such as trade financing or investment banking activities. A recent study carried out by the Ekonomist Magazine(4) has

presented similar evidence, for example when we look at the list of banks in exhibit 3 we see the largest banks of the sector ranked according to the size of their Equity. In exhibit 1 and 2 we see the list of banks ranked according to the increase in their deposits and credits. When we compare the three lists we see that the small banks (according to the size of their equity) have started to increase their share in the market for deposits even though they lack the required branch network. Having realized the limitations of size the new-comers mainly chose to be active in field where they could offer specialized services. Evidence for this view can be found in the drastic increase in the smaller banks market share of credits which is much more drastic than the one in deposits. The increase in market share can also be taken as a sign of the intensity of competition resulting from the increase in the number of participants. In other words the increase has contributed to competition with particular significance in the field of corporate banking.

The new-comers to the market whether foreign or Turkish have urged the Turkish banking sector to improve the quality along with the variety of services offered, and the technology employed. The globalization of the sector too was a contribution of the new-comers as well as the increase in international trade made possible as a part of the

new economic policies (i.e. liberalization of foreign exchange regulations).

When we sum up all of the above mentioned developments in the Turkish banking system, the fact that the retail end of the market is still dominated by a few of the major banks suggests the existence of concentration. The dramatic increase in the number of banks operating in this end of the market has been less effective in reducing concentration. As Dr.Refik Erzan put it in a conference on Competition in the Turkish Banking Sector held by the Istanbul Chamber of Commerce on December 1992 "putting rats among elephants does not contribute to competition". This statement may underestimate the contribution of the new comers however we believe that there is a strong element of truth in it. In other words, we can speak of the lack of competition at desired levels and the existence of an oligapolistic(in spite of the slight reduction) structure in this end of the market. A recent study covering the 1960-1992 period of the Turkish banking sector carried out by Cevdet Denizer(1992) presents evidence supporting our evaluation of the market structure(5). In other words, his findings too show that there is a degree of concentration at the retail end of the market. Denizer suggests that new entry at a certain size (i.e branch network of 30-50) may be the solution to overcome the lack of competition at desired levels. This concept of

competiton at desired levels may soon become a reality because the new entrants (mainly small ones) to the market are rapidly increasing their networks. For example, Koçbank increased its number of branches from 6 in 1991 to 29 in 1993(6). The already existing large ones, on the other hand, are reducing thr number of their branches leading to more evn rivalry in the retail end of the market.

The rest of the market however, has become a highly competitive and efficient one over the past years in Turkey. According to the Ekonomist magazine the extent of competiton where banks offer specialised services (competing with foreign banks as well) is rather significant because banks had to bring their asset profitability margin below 4%(7). This figure which is regarded as a normal value in world-wide standards can be taken as a sign of Turkish banking sectors progress for it can meet international standards.

(TABLE -1-)

INCREASE IN DEPOSITS

NAME OF THE BANK	(%) TL	(%) $
TASARRUF VE KREDİ BANK	1195	668
İTHALAT VE İHRACAT BANK	503	258
DEMİRBANK	299	136
TURİZM YATIRIM VE DIŞ TİCARET BANK	199	77
FİNANSBANK	188	71
TEKSTİLBANK	147	46
MARMARA BANK	145	45
ŞEKERBANK	115	28
TÜTÜNBANK	101	19
TÜRK DIŞ TİCARET BANK	76	5

Source of data: Ekonomist Magazine, Hrg Gazetecilik A.Ş., İstanbul, 4 July,1993,p.44

(TABLE -2-)

INCREASE IN CREDITS

NAME OF THE BANK	(%) TL	(%) $
İTHALAT VE İHRACAT BANKASI	402	198
TASARRUF VE KREDİ BANK	310	143
FİNANSBANK	189	72
DEMİRBANK	186	69
TURİZM YATIRIM VE DIŞ TİCARET BANK	151	49
MARMARA BANK	147	46
TÜTÜNBANK	134	39
TÜRK DIŞ TİCARET BANK	127	34
ESKİŞEHİR BANK	118	30
TEKSTİLBANK	115	28

Source of data: Ekonomist Magazine, Hrg Gazetecilik A.Ş., İstanbul, 4 July,1993,p.46

(TABLE -3-)

RANKİNG BY SİZE OF EQUITY

NAME OF THE BANK	TL (MMM)	$ (MM)
TÜRKİYE İŞ BANK	4,055	473
AKBANK	2,923	341
YAPI VE KREDİ BANK	2,198	257
GARANTİ BANK	1,573	184
PAMUKBANK	1,488	178
TÜRK TİCARET BANK	983	115

Source of data: Ekonomist Magazine, Hrg Gazetecilik A.Ş., İstanbul, 4 July,1993,p.42

4.1.2. STRUCTURE

The Turkish financial system is based on a universal banking system which legally enables commercial banks to operate in all financial markets. The only two areas the commercial banks are not allowed to engage in are trading goods or immovables for commercial purposes and leasing.

Investment and development banks on the other hand may not accept deposits.

The Turkish State, apart from its intervention in banking transactions, also controls 49% of the total share in the system with its eight banks. The number of public banks has dropped to six in 1992 when the two public banks, Türkiye Öğretmentler Bank TÖBANK (with Halk Bank) and Denizcilik Bank (with Emlak Bank) merged with other banks.

There are no local banks and all banks are multi-branched. Most commercial banks have ownership linkages with non-financial corporations. Holding companies control the ownership and the management of these as well as that of industrial corporations (i.e. Akbank is largely owned by the SABANCI group and İş Bank by the KOÇ group which are the major industrial firms in Turkey).

Banks do not face any effective competition from other financial institutions such as insurance or investment companies. Firstly, this ineffective competition is due to the lack of financially strong intermediary organizations specializing in capital market activities. Secondly, most of the insurance and leasing companies in the sector are already affiliated to these banks. The recent trend in the Turkish financial arena is to form holding companies which cater to all of the financial needs of their customers. This trend is very similar to the "all finance" movement in the EC.

Another striking fact about the Turkish banking sector is the high degree of concentration. This concentration becomes very apparent when we look at the assets of the five largest banks and see that this amounts to more than half of the total assets of the banking system as a whole.

There are 24 foreign banks, 13 of which are established in the country and the rest are in the form of branches. In spite of their small share in the market they are still considered as important because of the new concepts and practices they have introduced to the system.

During the last decade the attractiveness of collecting deposits has diminished in parallel with the structural changes in the banking sector. Deposits are no longer regarded as a cheap source and therefore banks are trying to create new instruments in order to collect money (i.e. by creating funds). The diminishing attractiveness of deposits have resulted in a change in the strategies of banks(mainly retail banks). Most of the banks have shown their reaction to this change by starting to narrow down their branch networks. This process of narrowing is done generally by means of phasing out unprofitable branches.

As of September 1991, Turkish banks have opened 24 branches and 106 representative offices abroad. The Turkish banks have also increased their presence in the foreign market by participating in eleven

banks both in Europe and U.S.A., and very recently in the new Republics of the former Russia. For example Emlak bank has established a bank in Kazakhstan called Kazakhstan International, and Ziraat Bank has merged with banks in both Uzbekistan and Turkmenistan in other words Turkish banks are expanding into this new market. The expansion into the new Republics of Russia seems to be the recent preference because of the language element as well as(the language spoken in most of these republics is Turkish) the closeness of the market, and incentives offered to such investments. In addition, the lack of competition in this market and the superior condition of the technology used by Turkish banks in comparison to that of the banks of these republics make this market very attractive. However, the more experienced Turkish banks are still a bit reluctant because they are aware of the dangers involved in operating in such an unstable and volatile market.

On the part of profitability (with the exception of Ziraat Bank which is a public bank), privately owned banks display a much better performance than the state owned and foreign ones (see TABLE 4).

Another element of the Turkish banking sector noteworthy of attention is the high inflation rate (reaching 72% by the end of 1992). Banks operating in such an inflationary environment were forced to offer high interest rates ranging from 67% to 85%

per annum for deposits in Turkish Liras (TL), and for dollar deposits around 11%[8]. As of March 1993 there has been a decline in the interest rates dropping down to (61%-80% per annum)(9), however, this is still very high when compared with European rates. Corporate borrowers on the other hand pay

(TABLE -4-)

NET PROFITS (1992)

NAME OF THE BANK	TL (MMM)	$ (MM)
ZİRAAT BANK	5136	600
AKBANK	1258	147
GARANTİ BANK	1008	118
İŞ BANK	843	98
YAPI VE KREDİ BANK	509	59
EMLAK BANK	406	47
İNTERBANK	334	39
PAMUKBANK	262	31
BİRLEŞİK TÜRK KÖRFEZ BANK	229	27
FİNANSBANK	226	26

Source of Data: Ekonomist Magazine, Hrg Gazetecililk AŞ, İstanbul, 4 July,1993, p.44

between 95 and 120% per cent. Borrowing rates have actually fallen in the last year due to the difficulties faced in finding borrowers.

When looking at the above figures the profit margin seems fairly wide. However, in practice that is not the case. According to Mr.Erol Sabanci, vice-chairman of Akbank, Turkey's most profitable bank, required reserves, taxes and costs take away nine-tenths of every hundred Liras held by a Turkish bank(10). In this case, it naturally is very difficult to talk about proper deposit cost control.

Banks in Turkey tend to make money not by lending but by holding treasury bonds or other operations such as trade financing which is also the most lucrative form.

Nevertheless, there is frantic competition for deposits especially from smaller banks to the extent that small banks do not hesitate to offer rates that are up to six percentage points higher than those of large banks.

The main problem of the Turkish banking sector can be identified as high operational costs and low working capital. However, these problems are not there to stay because all of the Turkish banks are now moving gradually towards the international standards set by the BIS (Bank of International Settlements) for capital adequacy. In addition to this, the fact that there have been no actual bank failures since the first half of the 1980's suggests

that the Turkish banks have been able to cope with these problems.

Turkish banks partly owe their successful maneuvering in such a volatile market to the newly set infrastructure of a modern banking sector. This newly acquired identity of the Turkish financial sector is regarded as a great asset for it contributes to the markets potential for growth.

On the part of supervision, banks in Turkey are subject to general controls under the provisions of the Turkish Commercial Code and various tax laws. The reason for this type of a supervision is a result of the joint stock company nature of the Turkish banks. Besides this, banks are subject to special supervision by the Undersecretariat of Treasury and Foreign Trade (U.T.F.T.), and the Central Bank of the Republic of Turkey. The Bank Association of Turkey also acts as a limited organ of supervision and coordination.

State banks are required to be audited by the Supreme Audit Board. Besides this, they are also examined by their own inspectors. Additionally, the banks are audited by independent external auditors in accordance with internationally accepted principles of accounting.

The fact that the Turkish banking sector can now be measured against international standards is, a sign of how far it has come in the last decade. This situation also suggests that the banking end of

the Turkish financial market was successful not just in piloting its way through a hyper-inflationary environment, but in coping with high levels of non-performing corporate debt throughout the 1980's as well.

4.2. BANKING REGULATION IN TURKEY

Commercial banks, investment banks and development banks and special finance houses in Turkey are subject to the banking law of 1985 (no.3182) and to the provisions of other laws applicable to banking.

The establishment of a domestic bank depends on authorization given by the Council of Ministers. In order for a new bank to be established, it must be a joint-stock company, with at least one hundred shareholders and a minimum of TL 75 billion worth of total paid-up capital. The opening of branches of domestic banks require authorization by the Undersecretariat of Treasury and Foreign Trade. The amount of capital required for new branches depend on the population of the city in which they are opened.

Foreign banks can operate in Turkey only by either establishing a branch or a subsidiary or by going into a joint venture with a bank already established or to be established in Turkey.

Branches of foreign banks require permission from the Council of Ministers. In addition to this, foreign banks must bring their capital allocated to Turkey in foreign currency and sell it to the Central Bank of the Republic of Turkey. A reciprocity provision is also in force in the system. This principle allows the Council of Ministers to take counter measures if, the conditions in any of the countries in which the Turkish banks operate, change unfavorably.

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CHAPTER V METHODOLOGY

The problem which we meant to tackle in the beginning of this study was whether the European Community had a protectionist policy towards third-countries, or rather non- members in the sector of financial services within the Common market. There are two opposing views on this issue, one is supported by the non-members (major parties being US and Japan) who fear that the Common market may turn into a "fortress Europe" closing its doors to non-members. The second view is that of the EC Commission which argues that the opportunities are there to be exploited by any firm regardless of EC-membership. In this study we have regarded the conditions of access to the Common market as the key element in determining the existence of a protectionist policy. After reviewing the relevant legislation of the EC we have found out that the Second Banking Directive is the core of EC's policy as regards access to the financial services sector. We believe that this legislation answers most of the worries of non-members. In order to find more support for one of the above mentioned points of view we have examined the situation in practice.

Having realized the complexity and the wide range of financial services provided in the Common market we have decided to narrow down the scope of

financial services to banking activities only. Another reason for our narrowing down the scope of our study is the difficulties we have encountered in data collection, therefore we have chosen the most popular form of financial services which we thought would give us greater access to information.

The second reason behind our choice was the large scale of third country involvement in this sector of financial services. In other words we chose banking because of its global nature as well as its impact on the financial services sector at an international level.

After having completed the literature review with particular concentration on the relevant legislation of the European Community and the concerns, or rather the fears of non members we have pinned down the areas worthy of questioning.

In the light of the information obtained from the literature review a questionnaire was formulated. These pinned areas were incorporated in the questionnaire as the guidelines of our study.

When formulating the questionnaire we tried particularly to keep it short and make the questions very concise so as to be able to get a high degree of response. With each question we had given hints, or rather guidelines as to the kind of information we were looking for.

We chose to forward the questionnaires to the departments in the head quarters because we have

found out that almost none of the branches have detailed information regarding such strategic plans of the bank.

The first method which we have employed in forwarding the questionnaire was sending them through fax so as to avoid loss of time. Along with the questionnaire a cover letter explaining the purpose of the research was sent to both the Budget and Planning department as well as the Foreign Affairs department in the Head quarters of the banks. However, out of a sample of 20 banks we received only one reply, which shows that this method is not a good one for questionnaires of such a nature particularly if the survey is carried from abroad. Another possible explanation for the failure of this method could be the banks reluctance to disclose information concerning their strategies to inquiries in such form.

The second method which we have employed after our experience with the first one was carrying out the questionnaire in the form of an interview. This form proved to be rather fruitful because we were able to both clarify any misunderstandings and channel the viewer in the desired direction. The interview method also provided us the advantage to ask further questions arising from the replies we received.

We have encountered some difficulties in getting appointments because of our years end timing

which turned out to be a very busy period for the banking sector. There also were some difficulties in recording the interviews as well as some requests from the managers that their name not be disclosed. This attitude mainly encountered in relatively small banks may be considered as further evidence of these banks reluctance to disclose information.

Among the sample banks that were chosen in the beginning there were ones of various sizes. However, after reviewing some statistics and a couple of interviews with the small banks we have concluded that they may be ignored from our sample because none of them had the intention or the required capital to expand abroad.

After having completed our preliminary research we refined our sample as well as our questionnaire and conducted our survey in 10 of the major banks in Turkey. In our sample we also included a foreign bank (Citibank), which had the status of a third country bank in the European Community to see whether there were any similarities in their experience.

5.1. FORMULATION OF THE QUESTIONNAIRE

The questionnaire is composed of two parts. The first part being about the bank itself. In other words, the kinds of services it provides, whether it

has a presence in any foreign market, the reason behind their choice of the foreign market etc.

The second part consists of questions regarding the banks awareness of the on going legislative changes in the European Community, and how they see the future of banking in the Common Market.

The questionnaire was carried out in the following banks:

1- Akbank

2- Citibank Istanbul

3- Demirbank* (1)

4- Emlak Bank

5- Finansbank* (2)

6- Garanti Bank

7- Pamukbank

8- Tekstil Bank (Does not have a presence in Europe)

9 - Türkiye Cumhuriyeti Ziraat Bank

10- Yapı ve Kredi Bank

The banks which we have chosen to represent the Turkish banking sector are the ones that have a significant share in the market which in turn provides the required capital base presence in the foreign market. Including 8 of the 16 Turkish banks

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*The information regarding these banks experiences were not obtained as a result of our personal interview. The information was gathered from an interview published in the Economist magazine.

which have established banks in various parts of Europe in our sample, has made us to have a feel confident about the accuracy and reliability of our findings.

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CHAPTER V INTERPRETATION OF THE SURVEY RESULTS

6.1. SURVEY RESULTS OF PART I

1- *Can you define your banks "Mission Statement" ?(i.e.. From the point of view of target customer group and the types of services provided).*

Most of the banks which we have interviewed have a large spectrum of customers and they provide various types of services. Putting it bluntly they aim to reach anyone who may require a financial service. A separation between commercial banking or investment banking as seen in the American system (due to the Glass-Stegall Act) is not the case for Turkish banks. Except for the smaller ones like Tekstil Bank (can be classified as a commercial bank) they can be classified as multi-purpose banks engaged in universal or global banking. It is much more difficult to talk about specialization in larger banks for they seem to specialize in everything. For example, Emlak Bank provides special Mortgage services along with its recent service as a Marine Bank it also acts as a commercial bank, investment bank etc. The concept of "All finance" as is the case in the European banking

system, seems to be the trend in the Turkish banking sector. In other words banks are trying to meet all possible needs of their customers ranging from insurance and leasing to factoring. However, due to some legal restrictions (Turkish banks are not allowed to get directly involved in insurance activities) as well as difficulties encountered in managing financial activities of such a different nature these services are carried out by independent off-shoots of these banks. Even though the off-shoots tend to be independent from the parent on the part of management, their customer base is rather intertwined. As a result of this trend we see the formation of holding companies providing financial services taking the place of plain banks.

2- What are this banks plans for the year 1993 ?(Please answer from the point of view of market share)

All of the banks which we have interviewed have the plans of increasing their market share. The smaller ones like İktisat Bank and Tekstil Bank are planning on achieving this increase by opening up new branches. The larger banks on the other hand, have adopted the policy of increasing their share by improving their network and the quality as well as the variety of their services coupled with intense advertising. The Yapı Kredi Bank's recent campaign on mass media introducing

their new products as well as emphasizing the improved quality (the commercial also despises the banks that are still using the antiquated technology) services is a good example of this policy. The competition between larger banks is naturally more fierce than that between smaller banks.

3- *Market share-wise and characteristic-wise where does your bank stand in the Turkish Banking sector ? (i.e.. Is it the leading bank, innovative, dynamic etc.)*

All of the banks which were interviewed believe that they have a dynamic nature. On other issues they have given various responses i.e. Yapı Kredi Bank regards itself the innovator. Akbank considers itself one of the leading banks as far as the quality of the services is concerned. However, from the point of view of innovation Akbank does not regard itself the leader, in fact it regards itself as a follower because with its large number of branches Akbank can not afford to experiment with new ideas. Consequently, Akbank prefers to compete at different levels such as the quality of services. Tekstil bank on the other hand because of its relatively smaller size can afford more flexibility. Citibank considers itself the innovator in introducing new off balance sheet products to the financial services sector.

4- Does this bank have a presence in the international Market ? If so in which countries ?

All of the banks which we have interviewed regardless of size have a presence in a foreign market be it in Cyprus, the newly established Russian Republics or in Europe, the US and the Middle East.

a- What are the reasons behind your choice of country ? (incentives, legal convenience etc.)

The major determinants of the decisions by Turkish banks to enter and operate in foreign markets have been three fold:

The first reason is the incentives given in the foreign country to provide banking services. For example Yapı Kredi Bank has chosen to operate in Bahrain, Emlak Bank has chosen to operate in the new Republics and Tekstil Bank has chosen Cyprus for this reason.

The second reason is the existence of a large number of Turkish workers as well as the intensity of business with the foreign country due to the presence of Turkish firms. Germany, Holland and more recently France have been chosen for this reason. The size of the business have shifted the Turkish banks policy into a new direction by which they eliminate the intermediary bank and retain the commission as a result of opening a branch or a subsidiary in the foreign country. The maximum number of branches of most of

Turkish bank does not exceed three in any one of the EC countries (1). However, branches aiming to replace the middle bank have not realy been successful in creating value added business for the parent, neither have they been able to contribute to increasing the market share in the foreign country (Citibank, Yapı Kredi Bank, İktisat bank all share this view for it has been their experience). Therefore, the opening of branches solely for this reason is questionable from the point of view of efficiency. Increasing the branch network in the EC may be a method of overcoming this handicap. According to a study conducted by Aydın Argın(2) for Garanti Bank, increasing the number of branches in the EC will also contribute to improving the competitiveness of Turkish banks operating in this market (for this will enable them to get full use of economies of scale as well as enabling the banks to reach a larger customer base).

The third reason is a relatively new concept for the Turkish banking sector. Banks claim that they choose the locations that are the world's financial centers such as London, New York, Frankfurt, Paris etc. in order to be able to integrate with the world markets. On this issue we feel the need to remind the reader of the earlier mentioned characteristic of the Turkish banking sector which we believe is the source of the impulse to expand abroad. When we look behind

the scenes we see the lager industrial groups expanding and getting more and more involved in international trade. This trend of internationalization creates the need to integrate with the world markets. Consequently, it is these industrial groups most of which have linkages (in many cases ownership) with financial institutions that force their banks to expand abroad to markets which offer global convenience. From the point of view of banks this presence in the world's financial centers allows them to participate in the Euro-currency and Eurobond markets to profit from opportunities where high margins are offered for their specialized expertise. In the case of Turkish banks their role as a bridge (resulting from the cultural similarities as well as the language and market specific knowledge) or a guide to the new Republics and the Turkish market can be regarded as their expertise. However, the higher margins are reserved for the fields of expertise only, because the banks in Turkey enjoy a much wider profit margin then they do abroad. For example, roughly speaking they get deposits at a rate of 77% and give credits at a rate of 120% (after deducting operating costs which are high compared to European ones the remaining spread is still very wide). In the case of foreign currency Turkish banks barrow at a rate of LIBOR+ 1.5 and loan at LIBOR+2.5 leaving them with a fat margin of 1%. However, in Europe in order to

achieve the same spread they would have to increase their volume eight times because the margin drops down to 1:8. Therefore, it is very difficult to see the Turkish banks fighting fiercely in Europe for something that is almost handed out in the Turkish market. We believe that they will try to exploit this opportunity till the very end (which is nearing with the increased competition).

b- How did you establish your presence in the foreign market ? (through branching, subsidiaries, merger or share-holding in another bank etc.)

Once again banks have displayed varying strategies. In the past, or rather their first presence in the foreign market has been through a branch or a subsidiary. However, in the past five years their policy has shifted towards establishing a bank either independently or by share holding with other Turkish banks or with foreign partners. Sixteen Turkish banks have established twenty-one banks in various European countries (i.e. Finansbank in Switzerland, France and Holland, Vakıf Bank in France and Austria, İşbank in Germany and Akbank in England). According to the Hürriyet newspaper the most popular countries for the newly established Turkish banks in the EC are Germany followed by Holland and France(3).

c- What kind of strategies has your bank adopted in order to protect or increase this market share in the foreign market?.

On this issue the strategies adopted by the Turkish banks differed according to the reasons behind their existence in the EC market. Some banks such as Yapı Kredi and Akbank could not see themselves competing with the larger EC banks for a stronger capital base. More precisely, they see themselves as competitors of other Turkish banks providing similar services rather than seeing EC banks as competitors. The method which they employ in competing with these banks generally takes the form of increasing service quality, variety and speed.

The second group is composed of Turkish banks which have established banks with an EC partner (i.e. Emlak Bank, Garanti Bank) or which have shares in another EC bank (such as Finansbank, Şktisat Bank, Demirbank). Banks in this group feel prepared to compete with other EC banks and they do not feel at a disadvantage at all. Even though it may seem like there is no difference for these Turkish banks between operating in the EC or Turkey as regards competition, the truth is slightly different. This comfort or the "at home feeling" is a result careful planning to avoid possible prejudice on the part of customers in the new market. First, all of these banks have preferred to

pick an international name for their new establishment. Secondly, they have tried to employ mainly local personnel for front office type of jobs so as to provide ease at acceptance. Other than these additional efforts to overcome psychological resistance they too are trying to improve the types and the quality of services supported with intensive campaigning.

d-When entering the foreign market did you encounter any difficulties, such as legal constraints or discrimination on the basis of nationality ?

None of the banks which we have interviewed mentioned having confronted any form of discrimination on the basis of nationality as long as they complied with the regulations of the country. They all went through the long examination period (a year or a year and a half in some cases, but this period is valid for any bank) before getting a license to operate.

5- Do the services that you provide in your home country differ in any way with the ones your bank provides in the foreign market ? If so, please state the reasons behind this practice.

The types of services (particularly as of 1987) provided by the banks in the foreign market do not differ greatly, and the existing differences are there for two reasons. The first reason is the nature of the market. One can not expect to find the same standards

every where because the needs of the customers may vary from country to country and therefore the services provided will have to vary. The second reason that leads to these variations is the regulatory differences in these countries. For example the types of financial instruments that can be offered are limited in Turkey (i.e. forwards, swaps, options and futures are not common yet).

6- What do you think is the main reason that makes the customers of the foreign market choose your bank?

The answer to this question must be looked at from two different angles. One is that of Turkish customers abroad who prefer to work with the Turkish banks out of habit and the comfort of their native language. The foreign language handicap of the Turkish workers abroad when coupled with the unwillingness to provide services on the part of foreign banks in certain countries naturally urges these customers to prefer a more understanding ones. The foreign customers on the other hand, prefer to work with the Turkish banks mainly if they have plans to engage in business in Turkey or with a Turkish company. In other words, they prefer to work with a Turkish bank mainly if they need the use of the banks expertise on the Turkish market. For the average person on the street there is a psychological barrier that channels the customer to a

domestic bank rather than a foreign one. Citibank on the other hand seems to be among one of the few banks for which psychology works in favor of. The rightfully earned image of a reliable bank has made the customers both in Turkey and in the EC prefer to work this bank in their international transactions or to use it as a custodian.

7- Could you evaluate the changes resulting from competition in the domestic market ?

All of the banks agree that both the liberalization of the market after the "Decisions of January 1980" and the presence of newly coming foreign banks have urged the Turkish banking sector to got through rapid restructuring. This phase of change and competition has brought new higher standards, new products and dynamism resulting from the fear of loosing customers to other banks.

8- How did your bank adopt to this environment of increased competition ? (i.e.. use of technology, structural reorganization, diversification in the types of services provided etc.)

The reactions to the changed market rules has been common among banks. Their first response has been the reorganization of their institutional framework. Then came the implementation of new technology and the education of the staff. The last ring has been improved

quality and speed coupled with a larger variety of services (introduction of new financial instruments). The concepts of "the customer needs us" has shifted to "we need customers" and therefore reaching the customers and customer loyalty became very important. This urged the banks to use methods such as advertising and public relations which they had ignored in the past. These developments, particularly when compared with the past 15 years, have changed the face of banking in Turkey dramatically. The pace in which the banks have successfully adopted to the new market conditions can be taken as a promising sign for the future of Turkish banking.

9- Do you think that competition encountered in the domestic market differs in any way with the one faced abroad? If so in what respect ?

The competition in the domestic market naturally differs from the one experienced in the foreign market. It is difficult to speak of a fierce competition for Turkish banks operating in the EC, particularly for the ones offering specialized services regarding trade with Turkey or the new Republics. The only match for these banks can be other Turkish banks operating in the EC. In other areas most Turkish banks lack the necessary capital base to compete with their EC partners.

Regulation is another issue which influences competition for example the use of certain financial instruments such as forwards and futures are not allowed in Turkey which limits the field in which to operate. In a sense the Turkish market is more restricted than the EC markets as regards the types of services to be provided. However, other than this issue there are not such dramatic differences.

6.2. SURVEY RESULTS OF PART TWO

I- Is this bank following the developments in the EEC's Single Market ?

All of the banks claim that they are following the developments in the EC's Single Market, however the answers we have received to the following questions made us doubt the accuracy of this answer. We have gotten the impression that their interest is of a rather superficial nature and that just following the developments through the press seems to suffice. Most of the banks in our sample have carried out a research concerning the EC particularly around the time when Turkey made its application for full membership(i.e. Garanti Bank, Yapı Kredi Bank, Akbank). However, after the Commission announced its opinion regarding Turkey's application, membership no longer seemed likely in the near future and this dimmed the interest of the Turkish

Banks. These studies were generally related to Turkey's membership to the EC and the integration as well as the adoption of the Turkish Banks to the system of the EC. We have not come across any that had been carried out with the intention of getting a market-share in the EC.

II- Does your bank have any information concerning the Second Banking Directive of the EEC ? Do you think that it will have any affect on this banks future in the EC market?

Most of the managers had heard about the Second Banking Directive, however, only a few a had a general understanding of what kind of changes this regulation brought to the system. We have interpreted the lack of information as a sign of lack of interest. The newly established ones aiming to compete in the EC market on the other hand were the ones fully informed of the opportunities offered by the change. These banks have devoted considerable attention to the timing (prior to the completion of the Common market on January 1993) of their entry into the EC market (i.e. Emlak Bank with its new bank in Italy). This particular attention on timing is like a last minute attempt to buy a ticket just before the boat leaves.

The ones previously established in the EC several years ago (i.e. Akbank in England in 1981) do not see their position changing in the market for they have already acquired the identity of an EC bank.

III- Are you anticipating any changes in the Single Market after the end of 1992 ? If so, what are these and is this bank prepared for them ?

All of the banks which we have interviewed agree that for the first five years there will not be such a significant change in the Single Market. They find justification for this belief in the still existing divergence's of the member countries regulations. Some others fear that (these are only personal views of some managers) the Single market may close its doors to any other new-comers so as to achieve the goal of complete harmonization within itself.

The ones already established in the EC market feel more confident of their position but still expect the competition to get more fierce which may mean an initial shake-out. In order to secure their position in the market they are have adopted some strategies which will give them a competitive advantage. For example, they are trying to improve the quality of their services, some are trying to improve their capital base (i.e. Akbank international) by increasing the capital themselves or through partnership.

The ones that have not been able to establish a bank in the EC market to this date are looking into mergers or joint ventures with foreign partners. Another alternative which they tend to consider as a means of entering the EC market is taking over banks already established in the EC. This method is

particularly attractive for it provides the banks with an already acquired market share and leaves them with the only worry of protecting as well as increasing this share.

IV- Do you think that the EC is going to become a more liberal market or a more constrained market, at least for the outsiders (Non-Members), after this date?

Almost all of the bank Managers with whom we have interviewed first of all do not regard the Common Market for Financial services within the Community as complete in the absence of a single currency. The benefits of an integrated market could only exist when there are no additional transaction cots to exchange currencies that may put some of the participants in a disadvantaged position against its rivals. Therefore at this stage it is difficult to regard the financial products as freely exportable goods.

Secondly, they expect the Common Market to become more conservative untill it has become a homogenous body within itself. They consider the starting date of the Single market as a theoretical figure only. In practice they believe that the process of integration, or a truly liberal market will go on for nearly another 10 years. However, they can not really offer any evidence which makes them see the situation in such a way. It all stems from either past experience or the precautious approach towards the unknown.

CONCLUSION

On the decision to enter the EC market, only the recent entrants seem to have chosen to have a presence in this market inorder to exploit the opportunities. In other words, they seem to be more cautious about the current competition. They aim to serve a larger customer base and are aware of the psychological obstacles. In addition to their awareness they also have developed strategies to cope with the disadvantages of being a foreigner in the market. For example they chose to merge with a domestic bank, or used an international name, and domestic employees so as to provide ease at acceptance.

The ones having entered the EC market several years ago had targeted to serve mainly the Turkish workers (a narrower scope). They only meant to serve an already existing customer base to whom they could offer the convinence of native language.

On the choice of field, the fact that they offer specialised services is a good move because they can have a competitve advantage in this area.

Even though, the EC may seem like an attractive market we believe that banking in Turkey has a promissing future too and it would be more feasible for Turkish banks to try to improve their market share in the domestic market rather than abroad where the risk of failure may be higher. Risk is an issue for banks to

evaluate themselves. However, once deciding to operate in the EC market we see no reason for Turkish banks, or any other third country banks to be reluctant. The reson behind this confidence is that The findings of our survey show no evidence of any kind of difficulty encountered by the Turkish banks when accessing the EC market. The bank managers claim that they had to go through the same procedures as the domestic ones, therefore it would be irrelevant to mention a form of discrimination.

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CHAPTER VII CONCLUSION

The restructuring of financial markets began as a trickle and then took the form of a tidal wave having an effect on the system world wide. For the past two decades deregulation has became the world-wide name of the game in the financial sector. Banking systems began to show parallel changes. The increasing number of signatories to the Basle Accord show the readiness of the world of finance to shift into a uniform sytem with common standards. Thus began the wide-spread expectation that barriers to cross-border banking could come down, as in the case of the EC as well as the US. However, not every country is eager to open its doors to the outside world, for example Japan, has been rather reluctant in granting access to foreign banks.

The internationalization of financial markets had been reviewed by bankers as presenting opportunities for profitable expansion. However, the recent wide-scale fiascos of Bank for Credit and Commerce International (BCCI) and Olympia & York (O&Y), have urged bankers and bank regulators to concentrate more on the pitfalls of bringing down barriers to doing business across national frontiers. Consequently, on the one hand, banks seeking to do business in a foreign

market began to adopt more cautious strategies before entering the new market. On the other hand, domestic banks too began to adopt more cautious strategies towards foreign new entrants in their market.

The process of world-wide deregulation coupled with internationalisation has also brought about intense competiton to the financial sector. Competitve pressures resulting from deregulation in turn have pegged back the rate at which banks can make profits from their core lending activities. In other words, banks began to operate at much tighter margins than before which forced them to seek ways of increasing their productivity and reduce costs by making greater use of their networks of bank branches.

The most striking change in the world of finance which has no precedent is probably the change taking place in the European Communities Single market which, acccording to the EC Commission, offers great opportunities for everyone, regardless of EC membership. After a rewiev of the relevant legislation concerning banking in the EC with particular reference tothe granting of access to the market, we could not find any significant evidence that would give us the right to question this statement of the Commission. The issue of equal opportunity too has been scrutinized a lot, however, after having carried out a survey with the banks of a non-member county (Turkey) about their

experience in the EC market we could not find any support for this view either. Even though, the concept of equal opportunity has been questioned by the non-members to a great extent, in practice bankers planning to expand across frontiers are faced with similar strategic decisions, once again regardless of EC membership.

The development of the European Single market has confronted bankers with a dilemma. On the one hand, they feel under pressure to expand across the national frontiers that have long divided them. On the other hand, they also know that, even if the theoretical barriers to such expansion have broken down, differences of market practice and tradition remain a fearfull obstacle.

The problem happens to be less serious in the case of specialised wholesale banking which is virtualy global business anyway. However, in the case of retail banking which requires a physical presence in the foreign market the situation is more complicated for it raises the question of how such a presence should be established. Should it be through merger and acquisition or by collabrative alliances which may involve exchange of shares? Or should it be a direct attempt to establish a presence from scratch?. The last option may be the most difficult but the others are not easy either.

When entering a foreign market starting from scratch the most serious obstacle awaiting the new-comer is the fact that customer preferences are deeply engrained in national markets. Therefore, the new comer is bound to face stiff psychological resistance. It is probably this obstacle that caused even the EC member country banks to prefer to consolidate at the national level. Cross-border mergers of banks in Europe are more likely to make a great deal of sense only after a single currency is being used overall the EC. Many experts consider acquisitions and mergers the more likely routes to cross-border banking links , both from the point of view having a sronger capital base and overcoming psychological barriers. In order to have a true competitve edge it is better to have the benefit of an enlarged branch network and achieve economies of scale if the bank is planning on operating at the retail end of the market.

On the part of suggestions we can say that Turkish banks, most of which are offering specialised services in the EC have used rather successfull strategies in coping with the psychological obstacle and therefore may have a competitve edge in the market. However, they must also be aware of the fact that they will have to improve their productivity and reduce costs for they may see some foreign banks starting to offer the same specialised services. As regards, the retail end of the

market we would not suggest starting from scratch because this field can be profitable only if economies of scale could be attained. Therefore, the merger or acquisition with an already established bank having a large network would be much more feasible. Banks planning on operating at this end of the market must also bare in mind the disadvantages of having to deal with 12 different currencies that take away a considerable amount of the profits.

To summarize our study we can say that the findings of our survey have shown no significant difficulty experienced in accessing the EC market or discrimination as regards treatment. Therefore, after having weighed the pro's and con's of entering the EC market and finally decidindg to enter it, we see no reason for third country banks to fear that they may encounter any difficulties as regards access. The main difficulty is the intensity of competiton and the psychology factor against foreigners. However, with the right strategy these obstacles may be reduced or eliminated leading to a large portion of market share in the EC.

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APPENDICES

QUESTIONNAIRE

PART I

I- Can you define your banks "Mission Statement" ?
(i.e. From the point of view of target customer group and the types of services provided)

II- What are this banks plans for the year 1993 ?
(Please answer from the point of view of market share)

III- Market share-wise and characteristic-wise where does your bank stand in the Turkish Banking sector ? (i.e. Is it the leading bank, innovative, dynamic etc.)

IV- Does this bank have a presence in the international market ? If so in which countries ?

a- What are the reasons behind your choice of country ? (incentives, legal convenience etc.)

b- How did you establish your presence in the foreign market ? (trough branching, subsidiaries, merger or share-holding in another bank etc.)

c- What strategies are you employing so as to maintain or increase your share in the foreign market ?

d- When entering the foreign market did you encounter any difficulties, such as legal constraints or discrimination on the basis of nationality ?

V- Do the services that you provide in your home country differ in any way with the ones your bank provides in the foreign market ? If so, please state the reasons behind this practice.

VI- What do you think is the main reason that makes the customers of the foreign market choose your bank?

VII- Could you evaluate the changes resulting from competition in the domestic market ?

VIII- How did your bank adopt to this environment of increased competition ? (i.e. use of technology, structural reorganization, diversification in the types of services provided etc.)

IX- Do you think that competition encountered in the domestic market differs in any way with the one faced abroad? If so in what respect ?

PART TWO

I- Is this bank following the developments in the EEC's Single Market ?

II- Does your bank have any information concerning the Second Banking Directive of the EEC ? Do you think that it will have any affect on this banks future in the EEC market?

III- Are you anticipating any changes in the Single Market after the end of 1992 ? If so, what are these and is this bank prepared for them ?

IV- Do you think that the EC is going to become a more liberal market or a more constrained market, at least for the outsiders (Non-Members), after this date?