GLOBALIZATION OF TURKEY'S BANKING SECTOR: THE DETERMINANTS OF FOREIGN BANK PENETRATION IN TURKEY

Abstract

Motivated by the increased importance of foreign bank entry, this paper takes a look at the issue from the perspective of both foreign entrants and the host country. What are the conditions that make the host country market attractive to foreign entrants? What changes in the home country motivate foreign banks to expand abroad? Attracted by the "pull" and "push" factors, foreign banks enter into the banking sector of the host country resulting in both benefits and costs to the domestic sector. Having given the reasons and the effects of foreign entry in a theoretical framework, this study attempts to find out any match of the theory with the evidence.

Key words: Foreign Bank Entry, Internationalization of Banking
JEL Classification: F23, F36, G21.

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1. INTRODUCTION

The question of "What should be the maximum share of foreign banks in the Turkish banking industry?" still remains unanswered in spite of various views. Therefore this study aims at laying the foundation for future studies to find a proper answer taking into account the evidence from different countries.

Driven by the pull- and push-factors, foreign banks enter into the host country's financial market. While foreign entry may come after financial crisis in developing countries, it is low level of competition in the host country, deregulation and access to new customer base that lead to foreign entry in developed economies. In addition to these "pull" factors, low profits and regulatory restrictions in the home country bring about the widespread internationalization acting as the "push" factors.

Along with the underlying reasons, this study examines the effects of foreign bank entry. Foreign banks bring both benefits and costs to the host country's banking industry. They bring with them new technology and risk management techniques; funds for the banks in need; regulations that can reduce the amount of financial capital that may flee the country in times of crisis; continued lending following shocks that can affect the local banking sector negatively. Additionally, foreign banks improve the quality of corporate governance increasing the efficiency of banks and stabilize the economy. Risks from foreign entry are the other side of the coin. Among the possible risks are negative shocks causing instability in the domestic market; increased competition leading to weaker local banking sector; the possibility of the foreign banks' not providing funds in times of trouble; the inability of regulations in the host country to control foreign bank operations.

Built on this basis, in the next section motivations behind foreign entry are explored which is followed by the section covering the case of Turkey.

2. REASONS FOR THE RECENT SPREAD OF FOREIGN BANKING

Looking at the issue from the perspective of both foreign entrants and the host country is crucial to understand the subject better. What attracts these banks so much that they are ready to undertake the risks of expanding abroad? What do the two sides expect from internationalization? This section deals with the issue under two headings, one dealing with the "push" factors and the other dealing with the "pull" factors. (Kraft, 2002 :7)

2.1. Expectations of the host country from foreign entry

Countries that are in the process of liberalization or that have high amounts of debt see internationalization as a solution. Increasing the international trade, improving technology in order to modernize the domestic banking sector, increasing the product and service variety, encouraging savings are some other expectations of the host country from internationalization. Moreover, some countries prefer to finance growth with minimum cost and on a long term basis when possible. After a crisis period, for instance, these countries try to attract foreign banks which, in return, could take advantage of the lower prices in the host country market. (Çakar, 2003:21) As an evidence, following the Asian crisis, governments relaxed entry barriers resulting in an increased amount of foreign participation. (Domanski, 2005:71; Montgomery, 2003:3) In addition, low level of competition in the host country and access to new customer base also act as pull factors that motivate countries to expand abroad. (Kraft, 2002 :7) In contrast to Kraft (2002), however, Coppel and Davies (2003 :22), Weller (2001 :12), Berger *et al*. (2000 :7) conclude that deregulation, but not the pull factors, attract foreign entry.

2.2. Expectations of foreign banks from internationalization

In addition to the above factors, low profits and regulatory restrictions in the home country lead to the widespread internationalization acting as the "push" factors. (Kraft, 2002 :7) Historically, bank internationalization followed the economic integration of countries. Currently, however, there is more than this in expanding abroad. Grubel's theory of internalization has lost its relevance. Grubel suggests that the main advantage of foreign banking is the *information and personal contacts between banks and a manufacturing firm's parent in a foreign country at a low cost*. Supporting this view, Buch (2000 :37) and Green, Murinde and Nikolov (2002 :178) also suggest that foreign banks go after their customers, which has been possible and much easier thanks to globalization and the removal of entry barriers along with the reforms facilitating their entrance into the host country market. (Tschoegl, 2003 :20) However, Du (2003 :287) found that while lending, foreign banks give priority to the borrowers other than the ones from the home country. Therefore, Grubel's explanation becomes less relevant for foreign entry to emerging economies' retail banking sector as in Latin America where some European banks (BSCH, BBVA, HSBC and ABN Amro) have customers without any relationship before the entry. In the past, multinational banks mainly worked for home country customers and provided local firms with access to international financial markets. Today, main purpose of these multinational banks is diversification and integration to domestic markets. (Paula, 2003 :3)

On the determinants of foreign entry, Magri et al. (2005 :1299) study for the case of Italy suggests that one reason for the entry is the difference between the domestic and foreign interest rates. This view is also shared by some studies on the U.S. case. With respect to the US case, it is also shown that there is a positive relationship between bank presence in the US and the variables such as foreign investment, foreign trade and the size of banking sector in the parent country.

3. COST-BENEFIT ANALYSIS

Driven by one or more of the above motives, banks expand abroad. But, what do they bring to the host country's financial system, especially during times of crisis? On the effects of foreign bank presence in the times of crisis, Beck et al. (2003 :10) found that the likelihood of a crisis and the number of restrictions for foreign entry are positively correlated. Therefore, the liberalization process makes countries stronger against a possible crisis since with less regulatory restrictions, domestic banking system becomes more efficient and stronger against possible crisis. Tschoegl (2003 :20) stresses this point suggesting that banking crises have more to do with the limitations on foreign entry rather than mere entry.

In the literature, many results are put forward as benefits of and costs from foreign entry. Foreign banks bring with them 1) New technology and risk management techniques (this is defined as the rehabilitator role of foreign banks in the literature); 2) Increased aggregate lending leading to higher growth rates and acting as a buffer following possible negative shocks (these funds benefit the domestic sector as long as they complement rather than substitute for domestic sources of finance); 3) Regulations reducing the amount of financial capital that may flee the country in times of crisis. (Gupta, 2002:27; Jeon et.al., 2006 :84; Claessens and Lee, 2002 :22) Moreover, foreign banks gain the confidence of the customers based on their reputation in their country of origin and they bring potential entrepreneurs and investors for other sectors as well as networks for foreign trade. (Keren and Ofer, 2002:17)

In addition to the above factors, Bonin et al. (2005 :49) and Levine (2001 :689) support the view that foreign banks bring more benefit than harm to the domestic market, and argue that foreign banks help improve the quality of corporate governance, which increases the efficiency of banks. Furthermore, weak domestic banks taken over by foreign banks are upgraded by international rating agencies (Cardenas et al., 2003), new financial products and services are introduced which increases the competition in the domestic banking sector. (Lwiza and Nwankwo, 2002 :42; Guillén and Tschoegl, 2000 :10) Foreign banks also act as an instrument of reform when the governments permit foreign banks to change the structure of the banking system. (Tschoegl, 2003 :23)

Stabilization is another effect of foreign penetration. As a result of being more conservative during the lending process and being less prone to domestic business cycles, foreign banks are not much affected by the crisis in the host country as the domestic ones. This stabilizing role and the other benefits, however, are limited by the fact that foreign bank share in the market is little, they operate at a distance and in a foreign environment, and this limitation may be directed from the parent country. (Tschoegl, 2003:31; Cardenas et al., 2003:9) With respect to the stabilization effect, Martinez Peria et al. (2002 :6) study on Latin American countries showed that foreign bank responsiveness to the host country shocks increased in time, and this response is more towards the positive shocks in the host country than to the negative ones. At this point, one thing that deserves to be mentioned is the finding by Peek and Rosengren (2000:3) that the reverse could also be the case, as in Japan where foreign banks were much more affected than the domestic ones by the crisis.

Berger et.al. (2000 :23) show that foreign banks are less efficient in terms of profits and costs than domestic ones in the case of developed countries. However, when developing countries are concerned, foreign banks appear to be more efficient than domestic banks. (Jeon et.al., 2006 :100) One challenging view comes from Montinola and Moreno (2001:16) who suggest that, in the short run, efficiency increase is not guaranteed and that foreign bank entry improves efficiency only if it exceeds a certain level that can offset the negative incentive effects.

Lensink and Hermes (2004:8) analyses the short term effects of foreign entry on the local bank behavior. Their conclusion is that the less developed the country, the higher the cost of foreign entry. For the highly developed countries, however, it is harder to reach a conclusion since foreign entry may be related to some factors other than the cost of entry.

It is not always the case that foreign banks bring benefits to the local market. In fact, risks from foreign entry are the other side of the coin. Among the possible risks are; 1) Negative shocks causing instability in the domestic market; 2) The possibility that the foreign banks may not provide funds in times of trouble; 3) The inability of regulations in the host country to control bank behavior; (Gupta, 2002 :28) 4) Weaker local banking sector and lower asset quality of local banks resulting from increased competition; (Mathieson and Schinasi, 2000 :155; Jeon et al., 2006 :84; Gupta, 2002 :28) 5) Increased foreign deficits as a result of profit transfers. (ATO Report, 2006)

Researchers against foreign bank entry claim that foreign banks capture the best customer segment and leave the domestic banks with the remaining risky customer group. However, Montgomery (2003:8) claims in response that foreign banks enter the banking sector targeting a specific segment, and thus they will not dominate the whole market.

There are arguments that foreign banks have a destabilizing effect because when the conditions that attracted foreign banks disappear, foreign banks tend to sell their subsidiaries to local banks and investors. (Tschoegl, 2003:9) This destabilizing effect from foreign bank presence may lead to a crisis. Crystal, Dages and Goldberg (2002:4) suggest, however, that there is no evidence of foreign banks leaving the country immediately after a possible crisis. Another view in this respect comes from Demirgüç-Kunt and Detragiache (1998:26) who suggest that bank crisis can also occur even if depositors do not withdraw their money. The reason may just be creditors' exiting the country or banks' becoming insolvent.

While the above arguments apply to all banks in the sector, the biggest impact of foreign banks is unlikely to be on every existing bank in the host country. The chances that the least efficient domestic banks will improve after foreign entry are lower compared to those of banks already operating closer to international standards. (Green, Murinde and Nikolov, 2003 :15)

Literature on foreign bank entry cannot be covered without mentioning its effects on development which is the eventual aim of economic policies. According to Lee (2004:13), as the number of foreign banks increase, excess profits are eliminated, resulting in socially optimal results. A stable and well-functioning banking system is critical for economic growth and development and this makes the relationship between bank performance and development crucial. (Barth and Caprio, 2005:178) Research shows that restrictions on foreign entry constrain productivity growth and financial development, and increase risks in the financial sector. (World Bank, 2005) Gupta (2002:28) supports this view arguing that international capital flows, thus foreign entry is crucial for long-term development. However, for this aim to be reached, long-term reforms should be undertaken which help the financial development of the region. Import tariffs should be decreased, cronyism should be eliminated, foreign exchange regime and bank regulations should be strengthened, technology and human skill in private sector need to be supported. In contrast to most of the existing studies on the relevant subject, Lensink and Hermes (2004:8) suggest that the impact of foreign entry varies with the level of economic development.

One line of study about foreign entry concerns the regulations in the banking sector. There is an important relationship between the type of the regulatory system in a country and the development of the financial markets. The weaker the bureaucracy, the stronger the regulations are and the more fragile the banking system against crisis is. (Demirgüç-Kunt and Detragiache, 1998:32) Regulation also affects the activities of foreign banks. In Slovenia, for instance, liberalization of foreign borrowing by residents and the abolition of interest rate ceilings on deposits led to a more competitive environment after 1999.

There is great diversity in banking supervisory and regulatory practices around the world (Barth and Caprio, 2005:39). In countries with an open, democratic and competitive environment, restrictions to foreign entry is less relative to in countries with a closed, autocratic and uncompetitive environment. Based on their research, Barth and Caprio conclude that countries should not impose strong restrictions on bank activities, should support transparency and private monitoring. They also suggest that governments should not intrude into the financial market, but just support it. In line with this view, Demirgüç-Kunt and Detragiache (1998:32) found out that financial liberalization increases the probability of foreign entry. However, the impact is less in the case of strong institutional environment where there is less corruption, more efficient bureaucracy and effective law enforcement, supporting the findings of Lensink and Hermes (2004:4).

In addition to the above risks and benefits to the host country, there are also studies mentioning the costs of internationalizing to the foreign entrant. These banks incur costs while searching for where to expand, and during the period of adaptation to the new legal environment. (Keren and Ofer: 16, 2002)

As an addition to the numerous studies on foreign bank behavior which focused on the developed countries, Goldberg, Dages and Kinney (2000 :18) extended the case for developing countries and suggest that in Argentina and Mexico, the differences in behavior during crisis do not stem from the origin of banks (foreign or local) but from their status (public or private). They also suggest that there is no evidence of foreign banks causing instability in the local market. Following the same line of study, Clarke et al. (2002 :18) have tried to find out the reasons and results of foreign entry. Previous studies on developed countries show that foreign banks are less efficient than the local ones as in the case of the USA which may be due to cultural or linguistic reasons. However, as far as developing countries are concerned, the relationship turns upside down.

Looking at the issue from the perspective of UN, the conclusion is that foreign banks have not satisfactorily played their role meeting the expectations: Foreign entrants were supposed to decrease the vulnerability to adverse shocks, but the result was just contrary to the expectations. While they were supposed to improve the risk administration techniques, they used conservative policies. Furthermore, limitations were imposed on the home country support although unconditional support was expected. (ECLAC, 2002)

4. FOREIGN ENTRY TO TURKEY

4.1. A brief historical account of financial liberalization in Turkey

November 2000 and February 2001 financial crises led to a process of restructuring of the Turkish banking sector as a result of which banks and financial institutions started to operate in a more efficient way. In 2000, Banking Regulation and Supervision Agency (BRSA) was established in order to undertake the task of auditing the sector in single hand. (Al and Aysan, 2006 :3) In 2001, Central Bank Law was modified so that price stability became the primary goal of the monetary policy which alleviated the problem of chronic inflation. Since the crises period, Turkish banking industry grew in size, reaching 75% of the financial system. In 2003, credit volume increased in the domestic banking sector among the possible reasons of which are the trend towards consumer banking, increase in consumer credits and credit cards. (Activeline, Sep.2005:1) November 2000 and February 2001 crises also increased the desire of foreign banks to take over Turkish banks cheaply, and the number of branches and personnel decreased due to mergers and acquisitions following the crises. (Çakar, 2003:24) However, foreign bank share did not shrink after the crises. On the contrary, foreign banks accepting deposits increased their share from 6.64% in September 2000 to 7.3% in March 2001. Additionally, these banks provided the domestic banks that are liquidity constrained with funds and increased their interest income. These foreign banks were the only group of banks that made profits during September 2000-December 2001 period and were the ones with the highest interest margin. The fact that foreign banks decreased in number is just due to some foreign banks' changing status and being classified under the private bank group thereafter.

Since 2002, Turkish banking system has recovered from the effects of crises and as of 2004 the system has become stronger. The share of the foreign banks in Turkey has now reached 28.3% which increases to 50% if the shares they purchased in the stock exchange are taken into account. Moreover, the asset size of some foreign banks in their home countries is bigger than the size of Turkish banking industry as a whole. All these reduce the competitive advantage of domestic banks. Therefore, as BRSA Report suggests, foreign banks that will enter the industry should not only be the ones seeking high profits but also the ones that could act as a bridge between the home country and the host country industries.

4.2. The Underlying Reasons for Foreign Entry to Turkey

Foreign banks, which are stuck at low profit levels and which do not have further growth opportunities in their home countries can experience higher profits by increasing their share of domestic debt in the host country market they enter into. (Beşinci, 2005) As an example, the European Union banking system which has been growing on average at 1% has not been much profitable for about ten years, and this motivated the banks in the EU towards consolidation. However, in time, after large scale consolidations, the only possible way to increase profits remained internationalization. Moreover, the consolidation in the American banking sector created giant financial institutions such as JP Morgan Chase's taking over Bank One. Additionally, some big American financial institutions have already reached the maximum allowable market share in their home countries and are looking for opportunities for mergers in Europe. This is another reason for EU banks' expanding abroad. At this point, Turkey with its high growth potential, acts as a strong candidate country to enter into. (Activeline, Sep.2005:4) The possible reasons of foreign entry to Turkey are summarized in Table-1 below.

Table-1: Factors Pulling Foreign Banks to Turkey

Population		No limitation to foreign ownership of banks(*)
Per capita income		Easier entrance to the Turkish market(*)
Reforms in the investment area(*)		Interest rates
Foreign trade and growth potentials		Inflation rates
Geopolitics		Corporate governance system
EU accession process		Auditing and regulation(*)
Easy takeover of Turkish banks		Exchange rate system
Size of Turkish banks		Basel II Agreement
Equal treatment of Turkish & foreign banks(*)		Consumer credits and mortgage

Source: Authors' tabulation of data from various sources

(*) These are due to regulatory changes following the external financial liberalization process in Turkey starting in 1984.

Three factors attracting foreign entry to Turkey are its increasing population and per capita income and the fact that it is located at the intersection of Europe and Middle East. Reforms carried out in the investment environment, improving macroeconomic performance along with the high foreign trade and growth potentials of Turkish economy relative to neighbor economies are additional factors pulling foreigners. Moreover, Turkey is in the EU accession process and Turkish banks are relatively small in size and easy to be taken over. (Tatari, 2005:1; Activeline, Sep.2005:1) In addition, there being no difference in the treatment of the Turkish and foreign banks and no limitation for the share of foreign ownership of banks are some factors attracting foreign banks to Turkey. Furthermore, it is now easier to enter into the Turkish market. Interest rates are lower, inflation rates have reached single digit numbers. Corporate governance system is improving. There is better auditing and regulation in the banking system and flexible exchange rate system is in effect. (Tatari, 2005:2) One more thing that will attract foreign banks is the Basel II Agreement, which will be in effect in 2007, according to which cost of capital will be lower for the banks with high quality customers and advanced risk measurement systems. Capital adequacy ratio, which was set at 16.9 % by the Basel II Agreement, has also been exceeded which signals a strong banking structure. (Activeline, Sep.2005 :3)

Table-2 shows which of the general reasons mentioned in the second section correspond to the evidence for the case of Turkey. One thing that has been inferred from the various issues of newspapers is that most foreign banks enter in order to take advantage of the growth opportunities in the host country. Indeed, foreign banks experiencing slow growth in their home countries search for new markets like Central and Eastern Europe with high growth potentials and Turkey's being the biggest and fastest developing market in this region justifies the increasing appetite of foreigners for the Turkish financial market. Although in the literature, technological improvement is suggested as one of the host country expectations from foreign entry; this study reveals that the reverse could also be the case. Indeed, Finansbank, Tekfenbank and Garanti Bank are mentioned to be technologically stronger and more modern than their foreign partners. Similarly, increasing the product and service variety is found to be one of the expectations of foreign entrants in contrast to being an expectation of just the host country as revealed in the literature. As an example, Finansbank attracted National Bank of Greece with its high quality retail products such as car loans, consumer loans, insurance, and checks. In this study, Fortis was the only bank reporting the relatively few number of foreign competitors in the Turkish market as a factor affecting their decision to enter into Turkey. Most foreign banks come to Turkey not just to buy a bank but to increase their market share. By purchasing Denizbank, for instance, Dexia could increase its customer base reaching nearly 1.4 million retail customers in Turkey.

Low profitability in the parent country is one of the mostly cited push factors of foreign entry. Indeed, high profit potential in Turkey was what attracted Fortis, an already profitable company. Diversification is another reason why foreigners decide to expand abroad. An example could be GE which has operations in more than 100 countries and aims to expand into countries such as Russia, Netherlands, Turkish Republics and Middle East together with Garanti Bank. One other reason to expand abroad is to increase international trade and investment. Greece enters into Turkey in order to make investments in sectors such as industry, tourism and navigation although their main interest is in the financial sector. Small size of banking sector in parent country is also classified under push factors. Greek banking sector with its small size was a reason for Greek banks to expand into Turkey. In this study, NBG and EFG Eurobank are said to follow their customers which are industrial and commercial enterprises.

In spite of the deep insight we gained from newspaper issues and other sources, we have not been able to find an explicitly stated relation between theory and evidence on some of the issues in the table. In none of the foreign entry cases studied, for instance, were deregulation in the host country and regulatory restrictions at home stated explicitly as factors affecting their entry.

Table-2: Factors Leading to Foreign Entry							
Banks	*NBG-Finans bank*	*EFG Euro bank-Tekfen bank*	*Fortis-Dış bank*	*Dexia-Deniz bank*	*GE-Garanti bank*	*HSBC-Demir bank*	*Uni Credito-Koç Group-Yapı Kredi*
Pull Factors:							
High amounts of debt	*	*	*	*	*	*	*
Increasing international trade	*	*	*	*	*	*	*
Improving technology	*	*			*		
Increasing the product and service variety	*		*	*		*	
Growth opportunities	*	*	*	*	*	*	*
Low level of competition in the host country			*				
New customer base	*	*	*	*		*	*
Deregulation([a])							
Push Factors:							
Low profits	*	*	*	*	*		*
Diversification	*	*	*				*
Foreign trade	*	*	*	*		*	
Foreign investment	*	*					
Size of banking sector in the parent country	*	*	*	*			
Going after their customers	*	*				*	
Regulatory restrictions at home([a])							

Source: Authors' tabulation of data from various sources. ([a]) No explicitly stated fact with respect to this factor

The banking industry, which primarily focused on the tasks of collecting deposits and providing loans, modified its strategy following foreign bank entries. Adopting to technological developments and utilizing alternative forms of investment were followed by increased efficiency. Yet, the banking sector has not completely returned to its primary duty of intermediation. If the financial stability continues and banks are able to return to their task of intermediation, branches in the domestic sector and customer portfolio will gain importance, and foreign banks which do not have to physically exist in Turkey in order to be eligible to invest in T-bills now have to take this into account. (Yayla et al., 2005:36)

Foreign banks in Turkey are interested in the domestic banks that focus not only on corporate clients but also on consumer and home credits. Since the consumer and home credits have been increasing in importance, foreign banks are becoming more and more interested in the Turkish financial sector. Moreover, in the future, with foreign banks' taking part in the privatization process, the foreign share in the domestic sector is expected to increase. (Yayla et al., 2005:4)

Along with all the factors that pull foreign entrants to the Turkish financial market, Turkey is still experiencing some structural problems. While deciding on entry, foreign banks take into account political and economic stability and the possibility of unfair competition. The fact that there have been 59 different governments in the 83-year-history of Turkish Republic may be taken as a sign of political instability just as many years of high inflation signal economic instability. Moreover, the unfair competition created as a result of providing unlimited guarantee to small banks act as a factor keeping foreign banks away from the Turkish financial market. In addition, Çakar (2003:53) suggests that the difficulty of converting savings into deposits and the fact that banking industry is considered as a medium of financing public deficit are some reasons of the low share of foreign banks. Due to the reasons mentioned above, in spite of the increase in number, from 4 in 1980 to 21 at the end of 2000 and to 15 at the end of 2004, the foreign bank assets-to-total assets ratio in Turkey just remained under 5% as opposed to the high percentages corresponding to the CEEC such as 67% in Hungary, 66% in Czech Republic. (Tatari, 2005 :1)

One other reason for the low level of foreign entry to Turkey is the need for the banking system to make adjustments in the legal environment. A lot of decrees in the body of current banking law can create problems for the owners of and the workers in banks and the legal environment does not give confidence. Today, the number of foreign banks providing financial services for Turkey is more than the foreign banks established in Turkey. Because of high costs due to taxes that have to be paid, a lot of banks find it more suitable to collect funds and give credits outside Turkey, and they can also perform corporate banking without establishing banks in Turkey. These costs motivate even the Turkish banks to expand abroad. (Activeline, Sep.2004:12) In the law, it is indicated that the foreign banks established abroad but operate at branch level in Turkey must have paid-in-capital reserved for Turkey no less than the required amount. These banks should also not have been forbidden to accept deposits or carry out banking operations in the countries where they operate or are established. This part of the law decreases the competitive power of the already established banks against foreign banks.

4.3. Effects of Foreign Entry to Turkey

In 1990s, foreign entry to Turkey was in a way that foreign banks either acquired small shares or shares of more than 50%. Today, foreign entry is realized with acquisition of at least 50% share. Yet, due to their small share in the Turkish market, foreign banks have not much affected the oligopolistic structure and high concentration of the Turkish banking system. (Çakar, 2003:45)

Banks are affected by the financial liberalization process in different degrees depending on their missions, composition of assets and liabilities in their balance sheets, degree of risk aversion, degree of governmental support, their ability to deal successfully with the changing environment and the incentive schemes as a solution to possible conflicts of interest between managers and owners of banks. As a result of this, some banks may be affected negatively while some others gain from the process.

After financial liberalization, it has been observed that net interest margins, asset returns and cost per person declined as a result of which competitive pressure in the Turkish banking sector increased. (Denizer, 1999:4) In addition, during the crisis period, foreign banks have not behaved in a way that minimized the distortionary effects of crisis; but in a way that triggered crisis leaving the host country with a negative effect on the balance of payments. That is one reason why physical entry is given much importance. (Yayla et al., 2005:36; Çakar, 2003 :44)

In the literature, it is suggested that the number of foreign banks is more important than their share in the sector. Therefore, in spite of the low share of foreign banks, there have been some structural changes in the sector following the entry of a number of foreign banks. Contributions of foreign entrants have been in such areas as financial and operational planning, credit analysis, marketing and human capital. (Denizer, 1999:20) The entry of foreign banks has deepened the Turkish financial market as a result of which domestic banks are stronger against crisis, interest rates have declined and credit markets have become more active. Transparency and risk management improved with the new entries. Among other benefits from foreign entry are technological transfers from foreign banks, increasing variety of services and financial instruments, and widespread use of internet banking. (Çakar, 2003:26)

The most important effect of foreign bank entry is efficiency increase as a result of fewer worker- but more technology-intensive work. Studies on the efficiency effect of foreign bank entry show that new banks have been more efficient than the established ones for especially in the first ten years. After ten years, however, there is limited gain from the scale economies. Denizer et al. (2000:15) studied the efficiency effect of foreign entry along with the issue of ownership structure. They showed that foreign banks and private domestic banks have similar scale efficiency.

One effect of foreign banks has been on the balance of payments in proportion to their shares in the sector. They provided financial support to large scale projects and through their relationship with the international financial markets, they facilitated the entry of foreign capital to Turkey. Foreign banks have chosen to work with a smaller number of clients than their domestic counterparts have done. However, with this small number of clients, they engaged in transactions of higher volumes. Moreover, foreign banks provide education to the workers as a result of which the banking sector will have higher quality work force in the future. (Çakar, 2003:43)

5. CONCLUSION

In an era when the word globalization is being pronounced frequently, foreign banks have not been late to show their presence in the Turkish financial market. The recent increase of the foreign bank share in the domestic market coupled with insufficient research on the topic has been the main driving factor in this study. In the first section, we review the literature on foreign bank entry looking at the issue both from the host country and foreign bank perspectives. In particular, the motivating factors behind the decision to internationalize, and the subsequent benefits and risks incurred have been explained along with the effects on financial development. The next section is devoted to the case of Turkey. Here, the pull factors specific to the Turkish case are associated to the general reasons mentioned in the second section.

What has been observed is that all the foreign banks included in our study mentioned about the high growth potentials in Turkey which is the biggest and fastest developing country in the Eastern European area. Technological improvement and increasing the product and service variety are two factors in the literature usually included under the expectations of the host country. In this study, however, they are counted also among the expectations of the foreign entrants. Low profitability in the home country was one of the mostly cited push factors that led foreign banks to pursue opportunities in the Turkish financial market with high profit potential. In our study, we have not been able to match such factors as deregulation in the host country and regulatory restrictions in the parent country to corresponding evidences.

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