The Impact of Foreign Banks' Operations on Credit Growth of the Banking Sector in Turkey

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Submitted to the
Institute of Graduate Studies and Research
in the partial fulfillment of the requirements for the Degree of

Master of Science
in
Banking and Finance

Eastern Mediterranean University
June, 2014
Gazimağusa, North Cyprus

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ABSTRACT

This study attempts to analyze the impact of foreign banks on the Turkish banking sector. It is generally accepted that foreign banks have a positive effect on the host countries financial sector in terms of increasing credit to the private sector and improving efficiency in the banking sector through competition. These outcomes however, may vary from country to country. This research examines whether the growing existence of foreign banks in Turkey had a significant impact on credit supply to the private sector. The empirical results showed that there is a positive relationship between the foreign banks existence in Turkey and the credit supply to the private sector.

Keywords: Foreign banks, banking sector, credit supply, private sector, Turkey.

ÖZ

Bu çalışma, yabancı bankaların Türkiye bankacılık sektörü üstündeki etkilerini incelemeye çalışır. Yabancı bankaların genellikle, yurt içi tasarrufları ve kredileri arttırıcı bir etkiye sahip olduğu, ayrıca rekabet yoluyla bankacılık sektöründeki verimliliği artırıp ülkelerin finans sektörü üzerinde olumlu bir etkiye sahip olduğu kabul edilmektedir. Ancak bu sonuçlar ülkeden ülkeye değişebilmektedir. Bu araştırma, Türkiye'de gittikçe artan yabancı bankaların kredi arzına önemli bir etkisi olup olmadığını inceler. Ampirik sonuçlar Türkiye’de yabancı bankaların varlığı ile bankacılık sektörü’nün özel sektöre kredi arzı arasında pozitif bir ilişki olduğunu göstermiştir.

Anahtar Kelimeler: Yabancı bankalar , bankacılık sektörü, banka kredi arzı, Turkiye

ACKNOWLEDGMENTS

I would like to thank my God who is the most competent creature for eulogy and worship.

After that, I honestly confess that I am completely in debt to my mother and father because of their perpetual supports of me in the path of success.

Moreover, I am especially grateful to my thesis supervisor, Prof. Dr. Hatice Jenkins, because of her great help, valuable advice, and constant guidance in doing this study. I also would like to thank Prof. Salih Katırcıoğlu and Prof. Cahit Adaoğlu for their valuable comments and suggestions in the analysis part of this thesis.

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Chapter 1

INTRODUCTION

Foreign banks play an important role in the international business environment. There are various motivations for them to expand abroad. They try to follow their customers and retain their relationships while they hope to take advantage of the existing opportunities in the host countries as well. On the other hand, host countries also benefit from the participation of foreign banks including diversification of products, increasing competition, modernization of operations, improving product quality, mobilization of savings.

Generally, it seems that higher participation of foreign banks in domestic markets leads businesses to better access to financial services with lower cost and higher quality services. Moreover, a higher foreign banks presence results in an easier availability of credit for small and medium size businesses.

After the recent global financial crisis, the impact of foreign banks on lending stability has become a hot debate. While some researchers argue that foreign banks help host countries to absorb the financial shocks since they are supported by parent banks financially, others believe that foreign banks may spread crisis and act as a contagion. They claim that practically when foreign banks deal with tight liquidity at the home country, they have to decrease their supply of credit to host country as well (De Haas and Van Lelyveld, 2010; Crystal et al., 2001; Peek and Rosengren, 2000).

The characteristics of foreign banks that expand abroad are important as well. Larger banks have relatively more tendency to expand their operations abroad as international firms are usually are clients of bigger banks. So, the following of clients and starting services abroad is much more necessary for these banks. Furthermore, since they have a large portion of their home banking sector share, they might have more pressing reasons than other banks to seek for risk diversification in other countries.

After 1980, when Turkey started its liberalization program, it greatly embraced foreign banks entry. This process was mainly based on a stabilization and adjustment program containing some key elements including liberalization of interest rate, liberalization of exchange rate, institutional reforms, and capital and monetary market reforms. In 1981, Turkey tried to maintain an unchanged real effective exchange rate by applying a flexible exchange rate through daily balances in the nominal rate.

Liberalization of Turkish economy motivated foreign banks to step into the country. There were various motivations for foreign banks to enter in the Turkish market including high population, growing per capita income, increasing foreign trade and growth potentials, geopolitics, EU accession process, easy takeover of Turkish banks, and the small size of Turkish banks (Denizer, 2000; Yayla et al., 2005; Beşinci, 2005; Tatari, 2005). It is stated by Pehlivan and Kirkpatrick (1992) that the entry of foreign banks in Turkey modernized the banking sector significantly and improved the sector in terms of planning, loan assessment, marketing and recruitment.

The first two foreign banks that opened branches in Turkey in 1981 were American Express Bank and Citibank. The number of foreign banks increased sharply from 4 in 1980 to 13 in 1984, 23 in 1990, and 17 in 2104. These foreign banks were from various countries including UK., US., Netherland, Italy, France, Luxembourg, Iran, Saudi Arabia, and etc.

The aim of this study is to investigate the impact of foreign banks' operations on credit expansion to the private sector. We expect that increase in the foreign banks' existence in Turkey will also increase credit availability to the businesses. It is observed that the foreign banks in Turkey mostly entered the country through buying small domestic banks with existing branch network and personnel which allowed them to grow faster. Also most foreign banks kept opening branches across the country and behaved like a local bank delivering services at the local level. This research will help to understand whether the foreign bank entry in Turkey benefited the country through increasing credit to the private sector.

The second chapter of this thesis will review the existing literature on foreign banks operations and their impact on the domestic banking sectors. Third chapter will provide an overview on the Liberalization of the Turkish banking sector and foreign bank entries into the country. Chapter four will discuss the research methodology and related data. Chapter five will report and discuss the results. Finally, Chapter 6 will summarize the research findings and conclude the research.

Chapter 2

LITERATURE REVIEW

This chapter overviews the literature on foreign bank operations in host countries. There is an extensive number of research on foreign banks. While some studies have investigated about the reasons of the expansion of foreign banks abroad, others examined the characteristics of the banks that have the potential to become foreign banks in various host countries. There are some studies believing that the type of entry of foreign banks matter. These research categorized and specified various types of foreign banks entrance in host countries and examined the possible implications for each type of entry. Some researchers have also tried to explain the activities, impacts, performance, and trend of foreign banks in different countries. The following is a summary of the literature on foreign bank operations.

2.1 Causes of the Expansion of the Foreign Banks

According to the literature there are various reasons for the expansion of foreign banks. While there are some motivations for the foreign banks to expand, host countries also provide some incentives to attract the foreign banks (Kraft, 2002).

According to the studies in this subject the major factors that affect foreign banks' expansion abroad are the retention of existing clients, the degree of economic integration between the home country of foreign banks and the country which they enter (host country), available profit opportunities in the host country, legal entry restrictions, regulatory laws (such as tax treatment).

2.1.1 Expectation of the Foreign Banks

According to studies, there are some factors motivating foreign banks to expand abroad which are mentioned below.

2.1.1.1 Following Clients and Home-host Country Economic Integration

The customer-following opinion proposes that banks move overseas to keep offering services to their home customers and making sure of the continuation of their relationship with parent corporations by preventing foreign corporate affiliates from turning to new banks (Nigh et al., 1986).

Generally, research on the cases from the North America imply that foreign banks go into the US or US banks broaden abroad to deliver their services to their home clients (Goldberg, 1992; Goldberg and Johnson, 1990; Grosse and Goldberg, 1991; Hultman and McGee, 1989; Miller and Parkhe, 1998; Sagari, 1993). Research in other countries especially European countries, also provide common evidence that banks follow their customer abroad (Buch, 2000; Fisher and Molyneux, 1996; Magri et al., 2005; Wezel, 2004; Yamori, 1998).

Some studies have evaluated the relationship of the economic integration and foreign bank entry from both many-to-one-host and one-to-many-host perspectives in countries such as the U.K., U.S., Japan, and German (Hultman and McGee, 1989; Budzeika, 1991; Fisher and Molyneux, 1996). These research also provided some proofs for the view that some banks follow their clients over borders.

Seth et al. (1998) study the lending scheme of foreign banks from countries such as Netherland, France, Canada, Japan, Germany and the U.K. in the United State banking sector. They investigate the borrowing behavior of non-bank U.S. affiliates of firms from those countries. Contrary to the other research, they discover that banks from the U.K, Netherlands, Canada, and Japan extend major part of their loans to non-home country borrowers. The authors infer that the consensus of ‘following the customer’ might have more limited application than previously speculated. Moreover, Miller and Parkhe discover that except for the developing countries, there is a positive relationship between the level of FDI and foreign banks existence in these countries.

2.1.1.2 Available Profit Opportunities in the Host Country

Some research provide proofs for the point that potential profitable opportunities of target countries encourage foreign banks to start their operation there. Claessens et al. (2000) investigate about the foreign banks existence in a sample of 80 countries. They discover that foreign banks are interested in countries with high-income level and low tax rates. Similarly, Yamori (1998) reports about a positive connection between the foreign banks existence and the GDP of target countries. It implies a key role of profit opportunity in the host country in the decision of foreign banks regarding expansion.

In addition, Focarelli and Pozzolo (2000) and Levine and Zervos (1998) investigated about a broader group of variables to assess host country market profit opportunities. They found that in countries where the expected economic growth is appropriate, there is a higher entrance rate for foreign banks. These research also reported about a negative relationship between foreign banks existence and inflation rate in the host country.

According to these authors, foreign banks tend to enter host countries, which have higher probability of economic growth. It complies with the view that foreign banks utilize their comparative advantages over domestic banks. Interestingly, in the countries with a smaller average banking sector size, the higher foreign banks presence exists which may be due to the easiness of acquiring such small banks and obtaining greater market share in host countries.

Focarelli and Pozzolo's (2000) research included 29 host countries mainly from developed countries and from several developing countries such as Turkey, South Korea, Mexico, Hungry Poland, and the Czech Republic. This research supports that due to relative weaknesses of the domestic banks in the developing countries, foreign banks are more likely to be attracted by profit opportunities in these countries rather than following their clients. Furthermore, according to Bonin and Abel (2000) in case of Hungary, foreign banks are highly engaged in consumer lending and deposit taking. Contrary to these studies, Magri et al. (2005) recognize that the trade factors are more influential than the profit opportunities in addressing the entrance of foreign banks into the Italian banking system.

Haselmann (2006) investigates the motivation of Western European banks for spreading into the economies of Central and Eastern Europe. Using GDP per capita growth as an indication of the host-country market condition, the research discerns that foreign banks loan supply was positively linked to GDP per capita. Hryckiewicz and Kowalewski (2010) expanded the aforementioned analysis to interrogate the motives of OECD banks spreading to Central Europe. Utilizing a variety of host country macroeconomic indicators to measure the local profit opportunities, they distinguished that these are positive and statistically significant determining factors of the entrance of foreign banks between 1995 and 2008. However, they observe that their bilateral trade proxy has a negative connection with foreign bank entry.

To sum up, although according to Cull and Peria (2013) foreign banks motivations for expansion are not necessarily mutually exclusive, the symptoms to date imply that foreign banks have different priorities for entering developing countries than developed markets. Specifically, in the case of developing countries following of the customers is of less significance than for developed countries that foreign banks are more encouraged to exploit opportunities in the host country.

2.1.2 Expectation of the Host Country

Generally, countries that are in the process of liberalization or encounter with high amounts of debt consider internationalization as a solution. There are also some motivations for host countries including modernization of the domestic banking sector, intensification the international trade, product and service diversification and savings encouragement. Furthermore, some countries tend to finance their growth on the long-term basis with minimum cost. Specially, after crisis periods these countries attempt to attract foreign banks, which could speculate from the lower prices in the host country market (Çakar, 2003). For example, after the Asian crisis, governments relaxed entry restrictions leading to expansion of foreign banks participation in these countries (Domanski, 2005; Montgomery, 2003). Coppel and Davies (2003), Berger et al. (2000) also pointed on the role of deregulation by the host countries for entry of foreign banks. Moreover, low degree of competition which could be enhanced by entering of foreign banks in countries could eliminated resulting in higher efficiency for the banking system and consequently for the capital market of the host country (Kraft, 2002). In contrast to Kraft (2002), however, Coppel and Davies (2003), Berger et al. (2000) conclude that deregulation, but not the pull factors, attract foreign entry.

Degirmen (2011), who studied the effects of foreign banks in the Turkish banking system in the period of financial crisis, states following items as the potential benefits for the host country (Degirmen, 2011, p. 518-519).

- Assisting the national financial markets in their way of development,
- Helping to the absorption of the fluctuations in loan supply,
- Leading to a less crowding out effect in the host country financial sector,
- Enhancement of capital inflows and leading to greater competition,
- Bringing new technology and consequently modernization of domestic banks leading to more efficient financial system,
- Motivation of domestic banks to utilizing new and up-to-date techniques,
- Better mobilization of national saving,
- Increasing and intriguing organizational transparency,

Besides the aforementioned positive effects, there are some disadvantages associated with the existence of foreign banks for the host countries; first, since foreign banks operate more conservative compared to domestic banks, they leave out the host country very fast in the condition of financial crisis resulting in a rapid capital outflow. Second, if the share of foreign banks in national banking system enhances, it might increase a crowding out effect on other national banks. Moreover, as foreign banks usually cooperate with big multinational companies, the supply of loan to the national banks may decrease because of the absorption the supply by the big firms. Most significantly, as the participation of foreign banks increases, the management power of the government over economy and its ability on the direction of markets might weaken.

2.1.3 Host Country Regulation

Host country regulations have an important effect on the foreign banks entrance. They might constrain the competition or may lead to inefficient domestic banking sector. Focarelli and Pozzolo (2000) discover that foreign banks prefer investment in those regions in which there are fewer regulatory restrictions on foreign banks activities. Barth et al. (2001) analyze banking sector related data of 107 countries and observe that existence of strict restrictions for entrance into the banking system lead to higher overhead expenses and interest margins. Moreover, these authors find a positive relationship between the likelihood of the occurrence of crisis in banking system and the limitations on foreign bank entrance and ownership.

Goldberg (1992) studied the regulatory limitations over the foreign and domestic banks operating in the United States. He reported that before enacting the International Banking Act (1978), there were asymmetric regulatory limitations on the operation of foreign and domestic banks. In this condition, domestic banks was suffering from an unfair competition. For example, while domestic banks were severely restricted, foreign banks were allowed to establish offices beyond state borders. This act restricted the foreign banks' operations beyond state borders and brought their activities in inside state. Foreign banks had the permission of continuing their existing interstate activities that they had begun before effective date of the law. This led to enhancement of activities of foreign banks over state borders prior to effective date of the act. According to Kroszner and Strahan (1999), even though foreign entry limitations became more homogenous because of the inactions of the constraints on over border banking activity, state laws also had significant influences on the activity of foreign banks. In addition, Hultman and McGee (1989) who studied about the states laws on reciprocity provisions, geographic restrictions, and deposit requirements or asset maintenance claim that tax laws have significant effects on the decisions of foreign banks regarding location allocation and appropriate type of office to build. Claessens et al. (2000) also indicate that higher tax rates discourage foreign banks entrance. Moreover, Hao et al. (2001) indicate that strict regulatory laws on the operation of foreign banks lead to meager benefits.

2.2 Characteristics of the Potential Foreign Banks for Expanding Abroad

The features of the foreign banks that expanded abroad give us beneficial clues for the recognition of the nature of their involvement in the destination country. As an illustration, according to Damanpour (1990) in the late 1980s, there were some foreign banks operating in at least one state of U.S. from different sixty countries. Probably, this rich diversity in participation, entry mode, and location selection provide evidences regarding the ownership-specific factors. But, it should be taken into account that most of theoretical interpretations about how ownership-specific factors influence the entry emphasize comparative advantage. As obtaining data that could assess the comparative advantage is so hard, most literatures have concentrated on location-specific elements. In spite of these data restriction, there are some clues about the foreign banks size, efficiency that expand abroad and also about home country restrictions on banking system that all of them are significant determinants in the banking environment.

2.2.1 Size

There are various reasons that larger banks have relatively more tendency to expand their operations abroad. As mentioned before, following of clients and taking advantage of the profit opportunities abroad are among the most important motives of foreign banks. Therefore, characteristics of banks have to be compatible with the aforementioned motives.

According to Focarelli and Pozzolo (2000), international firms usually are the clients of bigger banks so, naturally there is higher probability that these kinds of banks start operating abroad in order to retain their customers. Second, those banks that hold a large portion of their own country's market share, have more persuasive inducements in comparison to the other banks to diversify their risk in other countries.

Tschoegl (1983) has provided some proofs for the view that there is a positive relationship between the extent of international activities of a bank and its size. Moreover, according to Grosse and Goldberg (1991), it seems that the size of banking sector is directly connected to the foreign banks participations inside the U.S. in the period of 1980 to 1988.

Ursacki and Vertinsky (1992), who study the characteristics of Japanese banks operating in Korea, discover a straightforward link between the asset size of a bank and the number of its operating branches. Williams (2003), deduces alike findings about the presence of foreign banks operating in the Australia. Furthermore, Focarelli and Pozzolo's (2000) research about the features of foreign banks in 28 OECD countries, provides supports that there is a positive relationship between the bank size (measured by total asset) and its extent of international activities.

2.2.2 Efficiency

Generally, the existing literature about the matter of banks efficiency could be categorized as; first, those which compare the efficiency of foreign entrants with the host country domestic banks and second, those which focus on the comparing of the efficiency of foreign banks that have expanded abroad. As illustration, Berger et al. (2000), and Mahajan et al. (1996) have found, on average, domestic banks of developed countries have higher efficiency in comparison to foreign banks operating in these countries. On the other hand, some studies have also reported about a same degree of efficiency between foreign and domestic banks (Hasan and Lozano- Vivas, 1998).

Interestingly, studying developing countries results in different findings. Claessens et al. (2000) observe that domestic banks have higher interest margins, profitability, and overhead costs in comparison to foreign banks in developed nations. They explain the difference in the results in a way that the reasons of foreign banks for entrance vary meaningfully between developed and developing countries.

Studies about the developing countries banking sector show that foreign banks are more efficient than the developing nations' domestic banks. Barajas et al. (2000), investigate about the performance of foreign banks with domestic banks of Colombia in the period of 1985 to 1998. They find that, without consideration of the home country of the foreign banks, they are more efficient. Clarke et al. (2000) remarks a same performance advantages for foreign banks operating in Argentina.

There are some other factors beside the matter of size and efficiency affecting the decisions of banks to expand abroad. As an illustration, deregulation of the financial system in the host country may motivate domestic banks to invest abroad (Calderon and Casilda, 1999). Moreover, availability of fund in a country may also attract foreign banks to start their operation in that country as well (Goldberg, 1992). Briefly, beside the size and efficiency, other home country factors might play important role in the process of expanding operations abroad.

2.2.3 Home Country Regulation

Home country regulations have some influences on the process and type of foreign banks expansion. There might be legal limitations on foreign investment or restrictions on the bank behavior that have some indirect effects over the character of the behavior of a bank in the host country. Some authors provide proofs for the view that distinctions of cross-country legal limitations might decrease the relative constraints of foreign banks over domestic banks and consequently increasing their competitiveness (Frankel and Morgan, 1992).

According to Focarelli and Pozzolo (2000) the probability of expansion abroad for foreign banks is negatively related to the limitations of outward foreign direct investment. The authors' results implies that limitation on the operation of domestic banks reduce the likelihood that they expand abroad. Their results indicates that existence of these kind of restrictions in a country may decrease the efficiency of bank operating in this country.

In addition, according to Barth et al (2001) there is a negatively related connection between limiting the range of domestic banks' activities and bank performance and stability.

2.3 Types of Entries

Different countries prefer different kind of foreign banks entry and through providing some inducements they try to shift foreign banks toward specific type of entries. As illustration, once Egypt allowed foreign banks entrance just by joint ventures with the state (Caprio and Cull, 2000). Some countries restrict the issuance of banking licenses and so limiting the entry of foreigners to obtaining domestic bank's license.

However, still there are countries, such as Argentina, that do not prefer a particular organizational type of entry. The following section discusses about the two possible kinds of entry and possible organizational forms that foreign banks may choose.

2.3.1 Merger and Acquisition

According to Berger et al. (2000), who have summarized several hundreds of articles, most of the studies about the mode of entry concentrate on developed countries, especially the European Unions and the United States. They stated that the scale, and scope literatures give unclear conclusion on the influences of merger and acquisition. In addition, within the host country literature mostly discovered that scope and scale are not clearly related to the efficiency matters. They also report a lower efficiency for foreign banks in comparison to domestic banks, operating in United States, United Kingdom, Spain, France, and Germany, both from cost and profit perspectives. These results may be explained by the advantages of domestic banks in the domestic market.

As the efficiency of domestic banks are higher than foreign banks, Berger et al. (2000) claim that the worldwide consolidation of financial institution might be restricted by efficiency issues. In addition, as banks which operate in developed countries such as the U.S. can manage themselves across the border more efficiently than others, they may have a bigger share of the global financial services. It implies that if foreign banks from developed countries that operate in developing countries acquire (or merge with) inefficient domestic banks, there are some possible benefits to the host country as well. In other words, there is higher likelihood that most of the future merger and acquisition in banking sector to happen in developing nations since they have relatively inefficient domestic banks.

According to Berger et al., the scale of economies in providing technological developments might be enhanced by technological developments. The authors further note that the recent technological developments may have enhanced scale economies in producing financial services. The economies of scale might be higher for some new services including phone centers, ATMs, and internet banking (Radecki et al., 1997).

Beside the matter of technological improvements, some studies have tried to clarify the influence of foreign banks entry through consolidation on credit availability to domestic businesses, particularly small and medium sized enterprises (SMEs) that depend mostly on bank credit for financing. As mentioned before, in developed countries such as the United States bigger banks, contrary to the small banks, are relatively more interested in providing credit for large corporations. As a result, if large foreign banks from developed countries step into the developing countries through the acquisition or merger with domestic banks, the supply of credit to SMEs might decrease. However, mergers and acquisitions between small firms mostly imply increase in SME lending.

2.3.2 De Novo Banks

De novo is a shape of entrance that new banks form in markets from beginning. De Novo banks may increase because of external effect (Berger et al. 2000). According to DeYoung et al. (1999), there is a negative relationship between the age of a bank and its small businesses lending so the more de novo entry, the more credit will be available for SMEs. Similarly, Goldberg and White (1998) state a same relationship between bank's age and small business lending. Jenkins (2000) also discovers that newly founded banks relatively have higher tendency than foreign banks in providing credit for SMEs.

De novo entrants have limited profitable lending and deposit attraction choices. As an example, Houpt (1980) shows that foreign banks that enter into the U.S. market through de novo form, have lower profitability than those U.S. banks acquired by foreigners since they rely on relatively costly purchased funds. It might seem logical for the de novo banks to concentrate on small businesses with the consideration of these limitations.

2.3.3 Branches or Subsidiary

Although there are some types of organizational forms available for foreign banks to choose, but the easiest (and the most limited) one for establishment is the representative offices which offices neither make loans nor take deposits. These representatives send payments orders to the parent offices. Generally, these offices founded to check the possibility of heavier investment in the target country.

Agencies, that are more broad form of entrance, are authorized to do industrial or commercial lending activities, however they are not allowed to make consumer loans and take deposit. They also have the permission of preservation of credit balances that are similar to deposits with the difference that payments are seldom done from these accounts. Agencies' funds rely on borrowing in interbank market, Federal Fund or come from the parent bank. As the representative offices and agencies do not have full involvement and profit opportunities, most of foreign banks prefer establishment of branches to step into the host country.

Opening of branches is the most dominant type of entry of foreign banks into the developing countries (Goldberg, 1992). In comparison to the agencies or representative offices, branches can offer a broader scope of services. According to Miller and Parkhe (1998) and Goldberg (1992), branches in the U.S. are mainly involved in the wholesale activities. Subsidiaries are authorized to delivered wider range of services in comparison to branches. In some countries, subsidiaries are behaved similar to domestic banks and are regulated in same manner.

2.3.4 Cross Border Lending

Although the majority of research about foreign bank entrance into the developing countries have focused on the lending actions of foreign banks acting inside the border lines of a host country's, cross border lending is another important source of credit (Focarelli and Pozzolo, 2000; Claessens et al., 2000; Clarke et al., 2000). In some countries including Mexico, Brazil, and Argentina cross border lending is greater than the supply of credit by subsidiaries. Peek and Rosengren (2000) observe that the amount of cross-border loans made by foreign banks to these three countries surpass the supply of credit by the foreign bank subsidiaries founded inside those countries.

Later, an important change in the constitution lending of foreign bank happened and the volume of newly acquired and existing onshore subsidiaries exceeded the extent of cross-border lending. In addition, the clues from Mexico, Argentina, and Brazil, imply that after financial crises periods the tendency of foreign banks to expand their operation into the countries with funds deficit increase.

2.4 Activities of the Foreign Banks in the Host Country

As it mentioned before, indications are that foreign banks do not solely pursue their client from their home countries; however, they also are intrigued by the profit opportunities in the host country. It seems that foreign banks operating in developing countries are more attracted by the profit opportunities rather than following their customers. However, the characteristics of the participation of foreign bank should also be considered. In the following section, we will look at the features of competition of foreign banks by domestic ones.

2.4.1 Competition with Domestic Banks

According to Goldberg (1992), it seems that international banks of the United States incline to establish a connection with retail customers, while foreign banks that operate in this country prefer wholesale businesses. Damanpour (1990) states similar result by exhibiting that foreign banks mostly focus on industrial and commercial loans. In addition, Calomiris and Carey (1994) propose that the increase in the market share of foreign banks is originated most from purchasing existing loans.

According to Goldberg (1992), foreign banks that have newly stem into a countries business environment often keep the price of their services, especially the industrial and commercial loans, below the domestic banks rates in the hope of motivate businesses. They are able to offer these cheaper services because of their lower requirement on capital and their higher ability in utilizing leverage. Zimmer and McCauley (1991) also report similar results.

Foreign banks face with a competitive disadvantage which is that the cost of operating in a foreign country is too high. They have to cover this disadvantage through either offering special services or expertise. In developed countries it is hard to overcome the situation because of the existence of powerful local banks. As a result; foreign banks compete mostly on price and in the wholesale market.

Claessens et al. (2000), studying 80 developed and developing countries, try to understand how the foreign banks entrance affect the operations of the domestic banks in the host country. They realize that foreign entries lead the overall costs, noninterest income, and profitability of the domestic banks to decrease. They explain the outcomes that the entrance of foreign banks results into a higher efficiency for the domestic banks.

Domestic banks that operate in the developing countries have more difficulties in preserving their profits. Barajas et al. (2000) offer evidences that the entrance of foreign banks into the Colombia leads to reduced non- financial costs and lower intermediation spreads. Moreover, they observe that both new domestic and foreign banks try to pertain on a lower spread than their founded competitors in order to obtain more market share.

Generally, it seems that foreign banks tend to focus on those areas in which they have a comparative advantage over the domestic banks. In particular, Barajas et al. (2000) and Clarke et al. (2000) realize that domestic banks whose loan portfolios are focused on manufacturing have lower profit and net margins than domestic banks since foreign banks tend to devote more credit to this type of lending. Moreover, according to the authors those banks that focus on consumer lending have greater profits and greater net interest margins as foreign banks are not expertise in this kind of credit lending.

2.4.2 Types of Lending

Generally, it seems that foreign banks designate a higher proportion of their lending to industrial and commercial loans, indicating that foreign banks activity is of greater significance in the financing of large corporations. For example, according to Goldberg (1992), about 29% of industrial and commercial loans in the U.S. are made by foreign banks while they hold only 22 % of all banking assets. Similarly, Cho et al. (1987) in investigation about the foreign banks operating in the U.S. observe that

31% mentioned foreign exchange trading, 44% point corporate banking, and 56% indicate trade finance as a main field of specialization all of which are services that might benefit large companies. Moreover, Clarke et al. (2000) also observe same concentration in Argentina in the late 1990s.

As it is mentioned by Focarelli and Pozzolo (2000) and Berger et al. (2000), most of internationally developed banks are relatively large. These large financial institutions find it difficult to provide relationship-lending services to small businesses while they are offering transaction lending wholesale capital services to their large corporate clients at the same time. Bigger banks have greater tendency to utilize standardized procedure in order to evaluate the creditworthiness of the small businesses according to their past loan records. However, smaller banks merely use this method of creditworthiness and they almost made loans based on the officer's opinions. Consequently, creation and maintenance of a relationship between a smaller borrower and a small bank is easier than large banks.

There are plenty of studies indicating that larger banks (not necessarily foreign) make less loans to SMEs in comparison to small banks (Berger et al., 2001). According to Berger et al. (2000), small and medium size businesses operating in Argentina have lower chance in comparison to larger firms to get credit from large banks (domestic or foreign).

Clarke et al. (2001) also realize that foreign banks operating in four country of the Latin America (Colombia, Chile, Peru, Argentina) generally made fewer loans to SMEs in comparison to domestic banks. However, in some cases they report that some large foreign banks have greater tendency to lend to SMEs than similar domestic banks.

Although there is a probability that foreign banks presence lead to reduction of availability of credit for SMEs, their existence still provide some benefits for small borrowers. In this case, the enhancing competition among major players (large foreign or domestic banks) forces some local banks to focus on novel niches of financial market like making loans to SMEs. Consistently, Jenkins (2000) by analyzing a sample of banks from various countries note that changing in the market condition and enhanced competition in making loans to large corporation is the reason of almost half of those financial institutions which supply credit for SMEs. Another study by Jenkins (2014) on the Turkish banking sector showed that all domestic and foreign commercial banks began to target SMEs as the competition in lending to large corporations increased.

As it seems, research that has concentrated on domestic versus foreign bank behavior have not given a decisive conclusion to the net impact of foreign entry on the availability of credit to small and medium-sized businesses. Clearly, separation of the impacts of the entrance of foreign banks on lending preferences of domestic banks from influential macroeconomic factors is difficult. Moreover, there is not any access to comparable source that gives detailed information about SME lending across countries. A primary reason for this lack is that different reporting requirements dominate in different countries. As illustration, in the study of four countries from Latin America by Clarke et al. (2001), associated data with Argentina and Peru was collected according to loan size, while Colombian banks had to accumulate SMEs loans' data. Moreover, data about Chile's bank were gathered by the total debt of the business.

Clarke et al. (2001) analyze 4,000 companies of different developing countries to investigate about the connection of access to long-term credit provided by foreign banks and borrowers' perceptions about interest rates. Their empirical findings indicate that foreign banks entry increase the availability of fund for corporations. Although their results indicate that presence foreign banks benefits larger firms more than smaller organizations, there are also some significant evidence that even small businesses benefits in some ways. So, although the first consensus was that foreign banks entry, diminish the SMEs' access to credit, recent evidences show contrasting results.

2.5 Impacts of the Foreign Banks on the Host Country

Some researchers have investigated about the impacts of the existence of foreign banks on domestic banking of the host country. Previously, the consensus was that the advantages of foreign banks outweigh associated costs from various perspectives (Claessens, 2006; Clarke et al, 2003). However, after the global financial crisis some doubts raised to this points of view. In the following sections reviews of literature and some new evidences about the local effects of foreign banks is presented.

2.5.1 Access to Financial Services

Generally, some studies proved that greater foreign banks presence lead to lower cost of financial intermediation as measured by spread, margins, and overheads (Berger et al, 2005; Mian, 2003; Claessens et al., 2000). Moreover, there are some evidences indicating that higher foreign banks penetration results in better quality for financial intermediation including better economic performance of borrowers and lower loanloss provisioning (Peria and Mody, 2004). Some factors are proposed to be the reasons of these impacts. First, entry of foreign bank may increase competition among banks in the host country. Moreover, foreign banks presence can result in higher diversification in products, use of advances technologies. Furthermore, foreign banks can force governments to do regulatory and supervisory tasks better, add transparency, and generally accelerate domestic corrections (Mishkin, 2007).

However, it should be noted that these outcomes are dependent on some other factors. As illustration, according to Beck et al. (2004) legal restrictions on the foreigners entrance disturb the efficiency of foreign banks. Moreover, the relative size of the foreign banks' participation seems to affect the outcomes as well: with a tighter narrow entry (in which the share of foreign banks to total host banking sector is little), fewer spillovers rouse which indicates the existence of a threshold effect (Claessens and Lee, 2003). In addition, there are some other factors such as the performance of foreign banks in the local market and distance of the home to the host country.

As of availability of financial services, higher foreign bank participation appears to be beneficial. According to Berger et al. (2004) and Beck et al. (2004), a higher foreign banks presence results in an easier availability of credit for small and medium size businesses. Also, Brown et al. (2011) realize that foreign banks operations in a host country leads to greater availability of funds for more transparent organizations in this country. In addition, Giannetti and Ongena (2012) observe that while small firms are more likely be financed by private domestic banks, large and foreign firms tend to establish a relationship with a foreign bank. Besides, they discern that higher foreign banks presence is associated with more likelihood that a business obtains bank loans.

Still the clear effects of foreign banks on the availability of credit and development of financial sector are doubted. Although many researchers have tried to clarify the connection of foreign bank presence and private credit, it has not been specified yet which factors leads to a positive relationship between foreign bank ownership and private credit and what condition leads to negative one. Some studies indicate that foreign banks "cherry pick" borrowers. If this is true, obviously the foreign banks participation diminishes access to financial services because of the deterioration of the existing credit supply available to domestic banks leading to smoothing overall growth of the financial sector. Especially, in the case of undeveloped counties in which lending is based upon relationships the cherry-picking behavior has exponential effects. Moreover, according to Detragiache et al. (2008), higher participation of foreign banks in low-income countries lessens the available credit. Interestingly, Cull and Peria (2013) find that this connection has vanished (or even reversed) since financial crisis has led to acquisition of (distressed) banks by foreigners.

Claessens and Van Horen (2013) try to find how country features affect the relationship of foreign bank participation and degree of private credit. They applied cross-country regressions including 111 countries that contain countries with all levels of development. Their results show that beside the general development of the country, some of the host country features also matter. For the whole sample of countries, they discern a negatively related connection between the presence of foreign bank and growth in private credit to GDP. Moreover, through categorization of the countries by income groups, for high-income counties and emerging market they could not extract a statistically significant relationship. However, on the other hand, for the group of developing countries, they realize a negatively related connection. In addition, through categorization of the sample according to other dimensions, they observe that foreign banks presence lessens credit when foreign banks have a narrow market share, administration of contracts is costly, and information about creditworthiness of customers is limited. These findings indicate that in specific kinds of markets, foreign banks have much more power to be niche players that cherry-pick their customers. This position benefit them, however, influence credit provision to the private sector as a whole negatively.

2.5.2 Financial Stability

After the global financial crisis, the effects of foreign banks on lending stability has become an important topic. Foreign banks can provide great diversification services and absorb shocks happening in the host market. Some researchers have stressed that foreign banks may increase financial stability when crises happen in the host country. Moreover, since foreign affiliates are supported by the parent bank financially, they do not need to restrict their supply of credit in the host country during a financial crisis, while domestic banks mostly do (De Haas and Van Lelyveld, 2010; Crystal et al., 2001).

However, recently concerns have been raised that participation of foreign banks may spread crisis and act as a contagion. Practically, when they face with capital or funding deficits at the home country, they have to decrease their supply of credit to feed lending at home. Consequently, the reduction leads to some negative impact on the demand and supply of credit in the host country. Peek and Rosengren (2000) find that financial shocks to parent banks may pass to their foreign affiliates abroad and affect their lending negatively. In addition, Schnabl (2012) finds that international financial institutions decreased their lending to both foreign and domestic banks of Peru because of existence of liquidity problems globally. However, although parent banks generally lessened their lending to Peruvian banks, they keep supporting their own Peruvian affiliates.

Recent research that concentrate on the previous global financial crisis show that internationally developed banks were transferring shocks across borders through their subsidiaries. For example, Popov and Udell (2012) imply that during financial crisis the probability of a restricted credit increased for firms.

Claessens and Van Horen (2013) utilizing a database including 3,615 banks, of which 1,198 foreign owned, across 117 countries between 2005-2009, tried to understand how loan growth of foreign banks differed from that of domestic banks. Their findings indicate that for the whole countries, foreign banks decreased credit by 6 percentage points more in comparison to domestic banks. However, through categorization of the counties regarding their income group, it is obvious that only in emerging market and developing countries a significant difference between foreign and domestic banks exist. In addition, these authors tried to find out whether there is any difference between the effects of foreign ownership on lending in countries where foreign banks are close and in those countries that are distant to the home country of foreign bank or not. They observe that the average distance of the foreign banks situated in the host country does not have any effect on lending stability during the global financial crisis. Moreover, they find that foreign banks that have a robust deposit base decrease credit significantly less in comparison to foreign banks that are funded less by deposits. This indicates that the funding shape of foreign banks is very significant with respect to the stability of credit supply when parent banks are beat by a shock.

To conclude, foreign bank presence can have a positive effect on financial stability as cross-border lending is more stable during a crisis. In addition, parents assist their affiliates in times of crisis. However, if parents are deal with funding shocks, this may have affect subsidiaries negatively. It should be remarked that these transmissions are highly dependent to local conditions and business model of affiliates.

2.6 Trends in Foreign Banks Presence

Claessens and Van Horen (2013) containing very detailed information about the changes in ownership of foreign banks among 117 countries collect the most extensive ownership database between 1995 to 2009. Figure 1 which is collected from their paper gives an overview of foreign banks penetration in 1995 and 2009 separately. Obviously, many countries experienced a sudden enhancement in the share of foreign banks. Moreover, the relative importance (in number term) increased from 20 percent in 1995 to 34 percent in 2009. Generally, there are two paradoxically related trends; firs, the number of domestic banks reduced due to consolidation originated by technological changes, deregulation, and happening of financial crises, and second, the penetration of foreign banks duplicated through foreign direct investments.

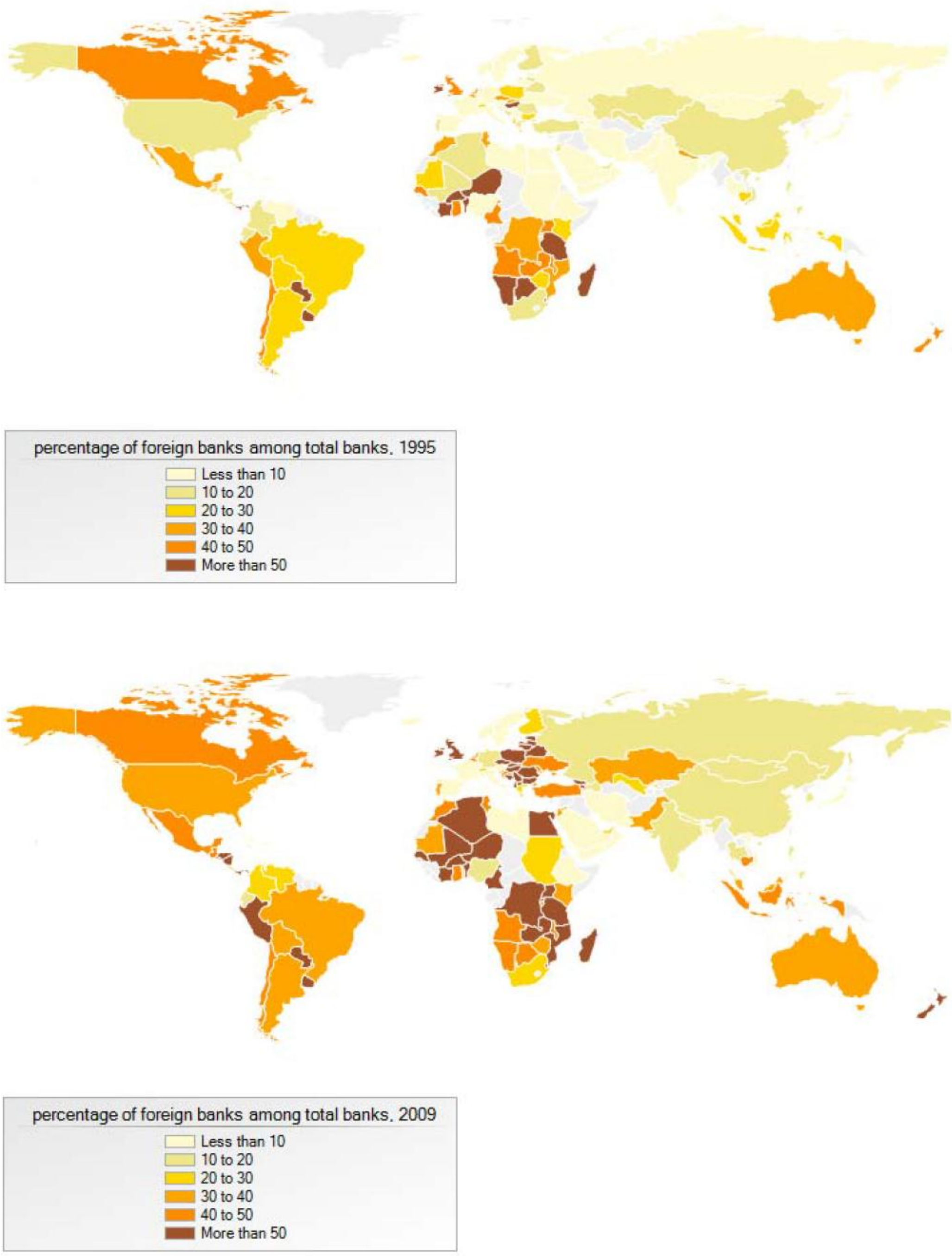

Figure 01. Foreign banks presence, 1995 and 2009 (Source: Claessens and Van Horen, 2013)

There are some differences among countries regarding foreign banks participation. The growth of foreign presence in developing countries and emerging markets is drastically greater than developed nations. While the market share of developing countries and emerging markets were 24 and 18 percent in 1995 respectively, they reached to 36 and 45 percent in 2009. Consequently, while domestic banks in OECD countries are key players in financial intermediation, foreign banks play a major role in the financial intermediation of these countries, with deposit, average loan, and profit shares between 42 and 50 percent.

However, there are some significant differences within the emerging market and developing countries as well. The expansion of the foreign ownership in Eastern Europe and Central Asia had much more higher rate in comparison to other areas. Moreover, in South Asia also the growth was strong. The growth of the presence of foreign banks in Latin America was very strong in the four years of studies period; however, after 1999 because of the Brazilian and Argentine crises it remained limited as many foreign banks quitted the area. Finally, foreign bank entry in Sub Saharan Africa, already high in 1995 because of colonial links, rose additionally over this period.

According to Claessens and Van Horen (2013), banks from OECD countries prefer to invest mostly in emerging markets or other OECD countries while emerging markets' banks incline to focus on developing countries or emerging markets. In addition, banks from developing countries prefer other developing countries or emerging markets for investment. So, it seems that banks search for those countries which have comparable income level and institutional development to their home market.

2.7 Performance of Foreign Banks

According to Claessens and Van Horen (2013), taking all countries together, foreign banks have lower loan to asset ratios in comparison to domestic banks. It indicates that foreign banks tend not to be involved in traditional forms of financial intermediation than domestic banks. However, in emerging markets foreign banks prefer to be more engaged in lending. A reason for this preference might be that in these countries foreign banks prefer to be more committed, as they often stem a market by acquiring domestic bank with a high number of retail customers.

Moreover, they study the loan to deposit ratio, which is an indicator for the degree to which banks tend to be involved in lending activities and wholesale funding relative to deposit funding. They find that the ration is greater for domestic banks on average in comparison to foreign banks. The finding is compatible with the assumption that foreign banks are less involved in lending especially in the developing countries. However, foreign banks perform with higher loan to deposit ratio in emerging markets than domestic banks indicating that in these countries foreign banks relatively are more interested in lending and are capable to pull non-deposit sources of funds.

Generally, different studies report different results about the performance of foreign banks. Those studies that concentrate on the case of the United States observe that domestic banks have significantly better performance in comparison to foreign banks (Mahajan et al., 1996; and DeYoung and Nolle 1996). However, studies about the operation of foreign banks in other developed countries observe that foreign banks have higher performance or perform almost with same performance with domestic banks. Moreover, according to Berger et al. 2009 and Grigorian and Manole 2006, in developing countries foreign banks outperform domestic banks of the host country. Contrary to their results, however, Yildirim and Philippatos (2007) report opposite findings. In addition, some studies find no significant difference between the performance of domestic and foreign banks (Mian 2003; Crystal et al., 2001).

Claessens and Van Horen (2012) investigate about these contradictory results and study the performance of domestic and foreign banks in 51 developing counties and emerging markets. They consider profitability (gauged by ROA) as an indicator for performance. They results show that foreign banks have better performance when they have a bigger market share and are relatively larger. Moreover, they find that foreign banks that are from high income counties perform better while weak regulation in the host county also leads to higher performance for foreigners.

Claessens and Van Horen (2013) extend their previous study and include 74 countries, including advanced countries, in their analysis. They consider various factors in their study including its loan to asset ratio, market share of the bank, average growth of the bank's loans and bank leverage (equity to asset ratio), ROA volatility, the ratio of deposit and short-time funding to total liabilities, the number of years it has been active in the country and etc.

Their findings indicate that for the all of the countries, foreign banks have higher performance than domestic banks. In addition, by splitting their sample they find results that are more interesting. Compatible with the findings of Claessens and Van Horen (2012), foreign banks significantly perform profitable compared to domestic banks in developing countries. The relationship is also valid for emerging markets but with less significance. However, in high-income countries foreign banks underperform domestic banks, a result that is in line with the findings of Mahajan et al. (1996) and DeYoung and Nole (1996).

They also find other results by splitting the sample between those countries that foreign banks hold less than half of the assets and countries in which they control more than half. They find that while foreign banks have greater performance in countries that they do not dominate, they have same performance as domestic banks in countries that they dominate.

Chapter 3

FOREIGN BANKS' ENTRY IN THE TURKISH BANKING SECTOR

Since 1980, Turkish banking sector has greatly embraced the financial liberalization. This process was mainly based on a structural adjustment program containing some key elements including liberalization of interest rates, liberalization of exchange rates, institutional reforms, and capital and monetary market reforms. In order to encourage competition and increase efficiency, restriction on foreign bank entry into the Turkish banking system relaxed leading to the increase of the number of foreign banks operating in this country.

In this chapter, an overview of Turkey's liberalization procedure, the entry of foreign banks into the country, and factors attracting foreign banks toward the country have been discussed.

3.1 Financial Liberalization in Turkey

Financial liberalization of Turkey which begun in the 1980, was a part of a wider program of structural adjustment and economic reforms. The principal elements of the program included liberalization of interest rate, liberalization of exchange rate, and capital and monetary market reforms. With implementation of this comprehensive program, Turkish Lira devaluated in 1980. One year later, Turkey tried to maintain an unchanged real effective exchange rate by applying a flexible exchange rate through daily balances in the nominal rate. Moreover, a drastic increase in nominal rates on bank deposits occurred because of the cancelation of the ceilings on the interest rates. Due to the lack of regulations to manage these developments, the Central Bank was empowered to decide about the deposit rates according to the fluctuation of the inflation rate and other economic indicators (Denizer, 2000).

Because of the lack of regulatory framework to manage the implementation of the reforms, a crisis started in Turkey in 1982, leading to closing Istanbul Stock Exchange (1886), while the Capital Market Board were founded to supervise institutional reforms in the securities market.

As part of the reforms, in 1984 Turkish residents were permitted to open foreign currency accounts in banks that led to an increase in product and services diversification. More importantly, this kind of permission along with the opening up of the capital account in 1989, expedite international trade of Turkey both for goods and financial service. (Degirmen, 2011).

With the consideration of the earlier restrictions on foreign trade and financial markets, these were significant changes. Until the interest rates were liberalized in 1980, there was a non-price competition among the banks in Turkey. The non-price competition such as opening of new branches originated from strict ceilings on the interest rates since the 1940s. These rigid controls had resulted in that interest rate adjusted (changed) just five or six times until 1978 (Denizer, 2000).

While on one hand the entrance of foreign banks was completely restricted, on the other hand a large number of banks quit Turkey's banking system between 1960 and 1980. Therefore, this circumstance led to a very concentrated banking market in which large private and public banks were the major players. In 1980, there were only four foreign banks (of 42 banks) operating in Turkey. Before 1980, the banking sector had a very limited number of services and it was inefficiently with no competition (Denizer, 2000).

Although there were some occasional obstacles during 1980-90, the general trend in Turkey was toward liberalization of financial prices and policies. By 1989, interest rates were determined according to the market forces that prevented the financial intermediation ratios from decreasing more as it happened prior to 1980. The market reforms and new legal laws motivated both foreign and Turkish to expand therefore the sectorial concentration declined. In addition, the Istanbul Stock Exchange started its operations again overtime and became an important part of the Turkey's financial market. Besides, government securities that was a significant part of the financial assets, commenced to be sold at auction in 1985. One year later, in 1986 interbank market, that enabled banks to borrow and lend from each other overnight, started to operate.

Banking Regulation and Supervision Agency founded in 2000 in order to unify the execution of auditing of the banking sector. Moreover, in order to lessen the problem of chronic inflation the stability of price became the primary aim of the monetary policy and the Central Bank Law was modified. The occurrence of financial crisis in the early 2000s resulted in some reforms in the Turkish banking sector leading to higher efficiency of banks. In addition, it motivated foreign banks toward takeover of Turkish banks and consequently, the number of bank branches and personnel declined because of the mergers and acquisitions (Çakar, 2003). So, the share of foreign banks increased and they increased their market share considerably.

Moreover, the crisis provided them the opportunity to increase their interest incomes by lending to the domestic banks. Specifically, these foreign banks had the highest interest margins in that period. The fact that the number of foreign banks declined in this period is just due to the change in their status and being classified as private banks thereafter.

After the crises period, Turkish banking industry expanded in size and approximately formed 75% of Turkey's financial system. Because of the existence of a general trend toward expansion of consumer banking, consumer credit and credit cards, the volume of credit enhanced among domestic banks (Aysan and Ceyhan, 2006).

3.2 Overview of the Foreign Banks Entry into the Turkey

Liberalization of Turkey motivated foreign banks to step into the country. The first two foreign banks that opened branches in Turkey in 1981 were American Express Bank and Citibank. The number of foreign banks increased sharply from 4 in 1980 to 13 in 1984, 23 in 1990, and 17 in 2014 (BDDK webpage). This foreign banks were from various countries including UK., US., Netherland, Italy, France, Luxembourg, Iran, and Saudi Arabia. It is obvious that after the liberalization in 1980, a considerable number of bank entries and exits happened. For example, because of the privatization or merger of some small banks, the number of state-owned commercial banks decreased from eight in 1980 to four in 1997.On the other hand, the number of private banks increased from 24 as of 1980 to 38 as of 1997. However, the general trend of the number of foreign banks operating in Turkey has been upward.

Out of USD 95 billion total banking sector assets in Turkey in 1997, foreign banks hold about USD4.5 billion. In comparison with all other banks operating in Turkey, foreign banks have had a narrow network of branches. While in 2000 there were 7837 branches in Turkey, only 49 branches belonged to the foreign banks. However, this small share in number of branches does not mean that foreign banks had a small impact on the banking sector. Obviously, the operation of foreign banks, which is mostly involved in corporate finance, derivatives, and trade finance, led competition to increase a lot and consequently in some area of banking fees declined. Moreover, while foreign banks initially preferred offering their services to large corporations, overtime they became interested in retail services as well, which shows that the medium businesses also benefited from the liberalization. Foreign bank entry also decreased concentration in Turkish banking sector as well (Denizer, 2000).

According to Pehlivan and Kirkpatrick (1992), the foreign banks entry in Turkey during 1980-1990 modernized the banking sector in this country through three major paths; planning, credit evaluation and marketing, and recruitment. She remarks that before 1980s Turkish banks were mostly shaped by financial repression as they did not use operational planning seriously. As they could collect cheap deposits and invest these funds in higher return investments their initial plan was to expand as much as possible. However, after removing ceilings on interest rates and the barriers to entry of foreign banks they begun to consider their development plans rationally. They adopted foreign banks' planning schemes and their other management aspects such as budgeting and management information system.

Moreover, foreign banks also changed the credit evaluation system of domestic banks in Turkey. Domestic banks assessed the credit worthiness of their customers based on knowledge of the credit officers and the information provided by borrowers. They did not apply any intelligence techniques in their evaluations. In addition, in the pre-liberalization period commercial banks had little efforts in marketing their financial services. Instead of attracting customers to their banks, they were accustomed to wait for clients seeking loans or other financial services they could offer. Citibank was the first foreign bank that started to attract clients by using a marketing department and it attracted some profitable companies. This situation obliged domestic banks to have their own marketing departments.

Furthermore, recruitment and overall qualification of staffs enhanced considerably after foreign banks entry. Foreign banks generally proposed higher salaries and better incentives to attract qualified college graduates. They also organized some training programs for their domestic recruited staff and sometimes sent them to their centers for training purposes as well. Consequently, the ratio of university graduates to total employment in Turkish banking systems enhanced. Besides these improvements, foreign banks led to technological and electronic banking developments as well. Introduction of new technologies such as ATMs, Point of Sales (POS), credit cards, and online services help domestic banks to reduce their transaction cost and operate more efficiently.

As it mentioned before, after the liberalization of Turkish financial sector foreign banks began to expand in Turkey very fast. Regarding to the cause of this fast expansion various studies state different reasons. Some of these reasons include "population, per capita income, foreign trade and growth potentials, geopolitics, EU accession process, easy take over of Turkish banks, size of Turkish banks, interest rates, inflation rates, corporate governance system, exchange rate system, Basel II agreement, and consumer credit and mortgage" (Aysan and Ceyhan, 2006).

In the case of Turkey, it seems that there is a difference between the entry of foreign banks before and after 2000. As it is appear from the Table 1 and Table 2, most of the foreign banks entries before 2000 were in the form of direct opening of branches or foundation in Turkey. However, after this year there is a tendency among foreigners to acquire domestic banks especially those with extensive network of branches. In addition, after the acquisition they would like to expand their number of branches relatively fast.

Table 1. List of foreign banks that started their operations in Turkey by opening of direct branches

No.	Name	Year of Starting Operation in Turkey
1	Bank Mellat	1982
2	Banko di Roma	Before 1980
3	Bank of Credit and Commerce International	Before 1980
4	Citibank N.A.	1980
5	Habib Bank Limited	1983
6	Holantse Bank Uni N.V.	Before 1980
7	Arap-Türk Bankası A.Ş.	Before 1980
8	Manufacturers Hanover Trust Co.	1984
9	The Chase Manhattan Bank N.A.	1984
10	The First National Bank of Boston	1984
11	Chemical Mitsui Bank A.Ş.	1985
12	Uluslararası Endüstri ve Ticaret Bankası A.Ş.	1980
13	Bank of Bahrain And Kuwait	1987
14	Banque Indosuez	1986
15	Saudi Amerikan Bank	1985
16	Standard Chartered Bank	1986
17	Birleşik Türk Körfez Bankası A.Ş.	1988
18	Bnp-Ak Dresdner Bank A.Ş.	1989
19	Midland Bank A.Ş.	1990
20	Kıbrıs Kredi Bankası Ltd.	1990
21	Credit Lyonnais	1988
22	Sociéte Générale (SA)	1990
23	Westdeutsche Landesbank (Europe) A.G.	1990
24	Türk Sakura Bank A.Ş.	1993
25	Abn Amro Bank N.V.	1994
26	Morgan Guaranty Trust Co.	1999
27	Rabobank Nederland	1998
28	HSBC Bank A.Ş.	1998
29	WestLB AG	2002
30	Deutsche Bank A.Ş.	2004
31	Credit Suisse First Boston	1999
32	Portigon AG	2012
33	The Royal Bank of Scotland Plc.	2009
34	Burgan Bank A.Ş.	2012

(Source: Extracted by author by using existing data on The Bank Association of Turkey's webpage)

Table 2. Acquired domestic banks by foreigners

No	Name	Date Founded	Date acquired	Foreign acquirer	Number of Branches				
					Number of Branches Before Acquisition	No. of Branches After 1 year of Acquisition	No. of Branches After 2 year of Acquisition	No. of Branches After 3 year of Acquisition	No. of Branches After 4 year of Acquisition
1	Eurobank Tekfen	1989	2007	Germany	31	36	42	42	54
2	Deniz Bank	1938	2006	Belgium	226	262	320	400	500
3	Finansbank A.S.	1987	2006	National bank of Greece	208	309	411	458	461
4	Fortis Bank AS	1964	2005	Belgium	171	186	225	268	300
5	ING Bank A.S.	1984	2007	Netherlands	349	366	359	323	322
6	Millennium Bank AS	1984	2002	Portugal	2	12	12	12	16

(Source: Extracted by author by using existing data on The Bank Association of Turkey's webpage)

Chapter 4

DATA AND METHODOLOGY

This chapter provides information on the type and source of data that have been used in the analysis. In addition it provides information on research methodology, and related econometric concepts. It discusses the proposed model that is a multivariable regression analysis and its variables. Moreover, it provides the results of the statistical tests that had to be done before the regression analysis.

4.1 Type and Source of Data

In this study, data regarding the total amount of lending in Turkey's banking sector and foreign banks asset size was obtained from the webpage of The Bank Association of Turkey (www.tbb.org). In addition, macroeconomic indicators such as inflation, money supply (M2), and GDP is obtained from the World Bank's database (www.worldbank.org). The data was collected for the years between 1980-2012, and they represent the end of year figures. It should be noted that the existing data in the Bank Association of Turkey webpage is recorded in different currencies before and after 1995. By using the corresponding exchange rate for every year, we converted all of the numbers into Turkish Lira. Finally, E-Views software is used for statistical test.

4.2 Methodology

In order to test the impacts of foreign bank operations on credit growth in Turkey, a multivariable regression analyses is used. Our regression model is built according to the existing empirical literature.

As it was mentioned in the second chapter, there are some empirical studies showing that higher foreign bank presence leads to increased availability of credit for borrowers (Berger et al., 2004; Beck et al., 2004; Brown et al., 2011; Giannetti and Ongena, 2012). Generally, while foreign banks tend to establish relationship with large corporation, small businesses are usually funded by local private banks.

Entry of foreign banks increase competition among banks in the host country and motivate them to attract customers. Both domestic and foreign banks offer various type of loans to fulfill customers' demand for credit. Therefore, it is expected that a positive relationship exists between the presence of foreign banks and credit availability. So, we hypothesized that there should be a positive relationship between foreign banks presence and credit growth in Turkey's banking sector as well.

In the model, the annual growth rate of the private sector lending is chosen to represent the credit availability as a dependent variable. In addition, the annual growth rate of foreign banks' total asset has been selected as an independent variable. This variable shows existence and size of foreign banks operations in a host country.

In addition, according to existing literature, some other macroeconomic factors affect the credit availability in the banking sector. Therefore, to disentangle the independent effect of foreign banks presence on access to credit our proposed model includes controls for the macroeconomic and institutional environment in which banks operate. Particularly, we control for Turkey's GDP, level of financial development (as measured by the ratio of M2), and inflation rate. Based on the considerations, the final model is as follow:

$$
\begin{aligned}
&(\text{Growth rate of the private sector lending})_t \\
&\qquad = \beta_0 + \beta_1(\text{ Growth rate of foreign banks asset' size})_t \\
&\qquad + \beta_2(\text{ Annual growth rate of M2})_t \\
&\qquad + \beta_3(\text{ Annual growth rate of inflation})_t \\
&\qquad + \beta_4(\text{Annual growth rate of GDP})_t + \epsilon_i
\end{aligned}
$$

4.2.1 Unit Root Tests for Time Series Data

Since our collected data is in the form of time series, before doing regression analysis we have to check it by unit root test to see whether our variables are stationary or not. Without checking the test, although the regression analysis may lead to significant results but they will be spurious. In this framework, we use the following unit root tests that specify whether our variables are stationary or not.

- Phillips-Perron (PP) test (Phillips and Perron, 1988)
- Augmented Dickey-Fuller (ADF) test (Dickey and Fuller, 1979)

4.2.2 Multicollinearity, Heteroscedasticity, and Autocorrelation tests

Similar to the unit root test, before running regression analysis, the related problems associated with the existence of multicollinearity, heteroscedasticity, and autocorrelation should be fixed. In this research, as the second hypothesis's model is a multiple variable regression, it has to be checked by the aforementioned tests.

In order to check for multicollinearity the correlation matrix is used. Moreover, for checking heteroscedasticity and autocorrelation this study utilizes White tests and Durbin-Watson statistic coefficient respectively.

The results of the unit root tests, multicollinearity, heteroscedasticity, and autocorrelation tests are all presented in the next chapter (chapter 5) under the empirical findings.

Chapter 5

EMPIRICAL RESEARCH FINDINGS

5.1 Result of Unit Root Tests

As explained before, first we should check to find out whether our variables are stationary or non-stationary. Each of the ADF and PP tests generate a t-statistics that help us to reject or accept the null hypothesis. Reporting t-values that are greater than the critical values mean that the null hypothesis is accepted and variables are stationary. Following tables show the results of stationary tests:

Table 3. Results of ADF and PP tests in the level form for annual growth rate of foreign banks asset

Test	Test Critical Values			t-Statistic	P-value
	1% level	5% level	10% level		
ADF	-4.273277	-3.557759	-3.212391	-3.643609	0.0417
PP	-4.271536	-3.557759	-2.212361	-3.665979	0.0397

Table 4. Results of ADF and PP tests in the level form for annual growth rate of the private sector lending

Test	Test Critical Values			t-Statistic	P-value
	1% level	5% level	10% level		
ADF	-3.670170	-2.963972	-2.621007	-3.839731	0.0066
PP	-3.670170	-2.963972	-2.621007	-3.562414	0.0130

Table 5. Results of ADF and PP tests in the level form for annual growth rate of GDP

Test	Test Critical Values			t-Statistic	P-value
	1% level	5% level	10% level		
ADF	-4.273277	-3.557759	-3.212361	-7.865623	0.0000
PP	-4.273277	-3.557759	-3.212361	-6.367624	0.0000

Table 6. Results of ADF and PP tests in the first difference for annual growth rate of inflation

Test	Test Critical Values			t-Statistic	P-value
	1% level	5% level	10% level		
ADF	-2.639210	-1.951687	-1.610579	-2.036223	0.0416
PP	-2.639210	-1.951687	-1.610579	-2.025144	0.0426

Table 7. Results of ADF and PP tests in the level form for annual growth rate of M2

Test	Test Critical Values			t-Statistic	P-value
	1% level	5% level	10% level		
ADF	-2.641672	-1.952066	-1.610400	-1.229890	0.1959
PP	-2.639210	-1.951687	-1.610579	-1.25745	0.1875

Table 8. Results of ADF and PP tests in the first difference for annual growth rate of M2

Test	Test Critical Values			t-Statistic	P-value
	1% level	5% level	10% level		
ADF	-4.284580	-3.562882	-3.215267	-7.920552	0.0000
PP	-4.785452	-3.214587	-3.117431	-5.243699	0.0000

As it is appear from the previous tables, annual growth rate of foreign banks asset, annual growth rate of private sector lending, annual growth rate of GDP, annual growth rate of inflation are stationary in the level form, I(0). In addition, annual growth rate of Money supply (M2) is stationary in the first difference, I(0). Therefore, since the results indicate that all of the variables are stationary, whether in the level form or first difference, we can do our proposed regression analysis.

5.2 Result of Multicollinearity, Heteroscedasticity, and Autocorrelation

Similar to unit root tests, tests of multicollinearity, heteroscedasticity, and autocorrelation should be done before regression analysis as well in order to prevent model from returning misleading outputs. As the proposed model of the second hypothesis of this research is a multivariable regression analysis, it should be checked by the aforementioned tests.

Table 9. Correlation matrix of independent variables

	M2	**Inflation**	**GDP**	**FB asset**
M2	1	0.654344	-0.311480	0.446334
Inflation	0.654344	1	-0.276847	0.395992
GDP	-.0311480	-0.276847	1	0.208575
FB asset	0.446334	0.395992	0.208575	1

As it is obvious from Table 9, there isn't a high correlation among independent variables which means that in our model we will not have multicollinearity problem.

As of testing heteroscedasticity, the following hypothesis is assumed:

H_0= Homosedasticity exists in data

H_1= Heteroscedasticity exists in data

The White test returns a p-value of 0.2642 meaning that we cannot reject the null hypothesis and means that there is no heteroscedasticity problem in our model provided in the chapter four. Moreover, the Durbin-Watson coefficient for checking autocorrelation problem in our proposed model was 1.863 indicating that there is no autocorrelation in the model as well as compared with critical values.

5.3 Results of regression analysis

Following is the output of the regression analysis for aforementioned hypothesis in the chapter four.

Table 10. Result of regression analysis

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.026156	0.074451	0.351321	0.7281
Inflation	0.006974	0.001285	5.428805	0.0000
D(M2)	0.002031	0.001316	1.543802	0.1343
GDP	0.028904	0.00902	3.185951	0.0036
FB Asset	0.150096	0.071781	2.091021	0.0461
Prob (F-statistic) = 0.0000 R-squared = 0.7151 Adjusted R-squared = 0.6729 Durbin-Watson stat = 1.8447 F-statistic = 16.9499				

As it is obvious from Table 10, annual growth rate of inflation, annual growth rate of GDP, and annual growth rate of foreign banks asset are statistically significant in our proposed model. Accordingly, due to positive coefficient for these variables, it seems that there is a positive relationship between the independent variables and dependent variable. Results also indicate that money supply (M2) is not statistically significant in this regression. It is important to note that M2 was included in the model by its first difference since it was integrated of order one, I(0), from Unit Root tests results.

Chapter 6

CONCLUSION

6.1 Conclusion

This research analyzed the effects of foreign banks presence in Turkey on the banking sector credit growth to the private businesses. The existing literature argues that foreign banks presence is positively related with the host country's banking sector deposits and its credit supply to the private sector. According to these theoretical arguments, we expect to see that the presence of foreign banks would increase available funds for lending and results in increased lending to the private sector.

Since foreign banks are connected to their parent companies, foreign banks presence provide the opportunity for the host country to access the home country available fund as well to some extent. Especially, during the periods of financial crisis that host countries face with severe funding deficit, presence of foreign banks could compensate this shortage (De Haas and Van Lelyveld, 2010; Crystal et al., 2001).

To test the impact of foreign banks operation in Turkey on its banking sector, a multivariable regression analysis is designed. In this regression it is aimed to find whether there is a statistical significant relationship between foreign banks presence and credit availability and what type of relationship exist. This model applied total private sector lending as an indication for credit availability in the banking sector.

Moreover, to represent foreign banks presence in this model, the annual growth rate of foreign banks asset has been considered as an independent variable.

In addition, to control for factors that affect the available credit in the banking sector, according to literature, annual growth rate of GDP, annual growth rate of inflation, and annual growth rate of money supply (M2) are added to the regression as control variables (Clark et al., 2001).

In addition, according to existing literature, some other macroeconomic factors affect the credit availability in the banking sector. Therefore, to disentangle the independent effect of foreign banks presence on access to credit our proposed model includes controls for the macroeconomic and institutional environment in which banks operate. Particularly, we control for Turkey's GDP, level of financial development (as measured by the ratio of M2), and inflation rate.

The results of the regression analysis show that there is a significant positive relationship between foreign banks existence and domestic credit growth in Turkey. This finding is in line with the findings of other research indicating that entry of foreign banks and merger and acquisition by foreigners lead to domestic credit growth (Peek and Rosengren, 2000; Berger et al., 1998; Avery and Samolyk, 2000). Moreover, results show that GDP and inflation also affect the credit growth positively.

According to the research results, we can conclude that foreign banks presence in Turkey's banking sector increase the availability of fund for borrowers. In addition, their presence during financial crisis help the banking sector to deal with fund deficit since these foreign banks are supported by their parent companies.

6.2 Policy Implications

Since foreign banks bring benefits to the Turkish banking sector, incentives should be created in order to attract them to Turkey. Foreign banks' operations lead to a highly competitive environment in which banks have to provide better services with lower costs in order to retain their existing customers and attract new customers. In terms of credit, the competitive environment also provides a better access to credit and with lower interest rates. This is particularly important for small and medium sized enterprises because without competition, banks are not forced to look for alternative markets to lend and they only focus on large enterprises. The increased competition in the banking sector helps to improve access to credit particularly to micro, small and medium sized enterprises and accelerate economic growth. Foreign banks may also bring new technology and knowhow that help to improve service quality.

On the other hand, there is a possibility that foreign banks may act as contagion agents and transmit the problems of their home country to the host country when there is a financial or economic crisis. Therefore, it is strongly recommended that Turkey should have a clear operating framework for foreign banks that can prevent the transmission of financial shocks from the home countries of foreign banks to the Turkish financial sector.

6.3 Shortcomings of the Study and Direction of Further Research

One of the shortcomings of the study could be the selection of independent variables. One can claim that there are other independent variables affecting the dependent one that should be considered in the regression analysis. However, as this study tried to be consistent with previous literature and tried to investigate about direct impact of foreign banks presence on credit availability those aforementioned variables are selected.

Another possibility for further study is to perform multiple variable regression analysis, containing a wide range of variables, in order to probe the impact of foreign banks presence on various aspects of Turkish banking sector such profitability, operating cost, interest income, fee and commission, and saving mobilization. Further research is also suggested as a cross-country study with a number of emerging market countries that has similar economic and financial characteristics with Turkey.

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