A camel-wise comparative financial and market share analysis of the Islamic banks currently operating in Turkey

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Abstract

The aim of this study is to analyze the activities of Islamic banks in Turkey, to assess their present and potential impact on the overall banking industry and compare and contrast the array of available data. Results of this research indicate that, in spite of rapid growth, interest-free banks of Turkey bear large amounts of risk. The result renders some important risk-wise implications for the regulatory authorities. Findings of this research also reveal that the growth of these banks as a group does not lay significant impact on the overall banking sector.

1. Introduction

The Turkish liberalization policies of January 24, 1980, basically sought to increase competition and capacity utilization, enhance exports, improve production in both manufacturing as well as service industries and integrate

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the economy to the global system. In order to achieve these goals, foreign banks were allowed to enter the previously closed market, interest rates were set free and bans on foreign trade were lifted. The first entry of Islamic banks into the system with Faisal Finance Institution and Al Baraka Finance Institution in 1985, coincides with a period when the banking system had already become competitive, interest rates were rising due to inflationary pressures and strategic planning was becoming difficult under unstable macroeconomic policies.

The aim of this study is to examine the course these banks have followed and to see how well they have performed on a comparative basis. In order to keep the discussions consistent, interest-based banks would be referred to as conventional banks or conventional banking system and the Islamic or interest-free banks of Turkey would be referred to as Special Finance Institutions (SFIs).

2. Banks operating in Turkey: An overview

Table 1 gives the number of banks and the number of branches over a period of 67 years. In 1924, 43% of the main offices and 22% of the total bank branches were held by foreigners. This share was rapidly overpowered by the expanding national banks; in 1979 National banks comprised 90% of total main offices and 98% of total bank branches. Following 1980, we again observe a sharp increase in the number of foreign banks. By 1990, the share of foreign banks in total main branches rose to 39%.

One of the main effects of the 1980 liberalization program was an increase in the number of banks. While there were only 44 banks in 1980, this number rose to 66 in 1991 and to 70 during 1992. This increase was mainly due to 16 foreign banks which entered the market during the 1980-91 period. Table 2 gives peer group totals, averages, market shares and two capital sufficiency ratios, which will be evaluated in Section 5.

Overall, major characteristics of the Turkish conventional banking system can be summarized as follows:

1) The number of national banks is increasing at a slow pace and there is no significant increase in the number of branches.

2) Foreign banks are constantly losing their competitive edge. There are no more new entries into the market.

3) Gap between the number of branches of national and foreign banks remained steady during the first few years of the Republican era. Later, it widened rigorously in favor of the national banks.

4) Although the banking system is exerting efforts to integrate with international markets by opening branches abroad, it has not reached a satisfactory level. By definition, globalization involves the *de facto* elimination of geographical barriers to trade and financial activity. This in itself would be expected to go parallel to the direction of legal and regulatory restrictions within the country as well as across national boundaries, stability and the level of economic mix-up, strategic preferences, management strength and innovation, competition, prospects of profitability, the degree of risk and the possibility of implementing the so-called financial engineering techniques. In this direction, Turkey is still one-armed and will have to cover further distance in order to achieve a satisfactory globalization (Ağaoğlu, 1993).

5) In spite of the fact that the number of banks have increased rapidly during 1980's, Table 2 reveals that 17 banks (about 24.5% of total number of banks) within the public and private sectors, large scale commercial banking groups have a share of labor force, branches, assets and equity, amounting to 91.4%, 93.2%, 83.3% and 80%, respectively. This brings us to the debate of concentration and the oligopolistic character of the Turkish banking system. Some recent studies have taken up the matter in brief, concluding that liberalization policies in Turkey have neither been able to achieve an efficient intermediation and competitive environment nor an optimum bank size. These studies show that in spite of an improved trend, further steps should be taken in order to bring about financial efficiency (Akyüz, 1993; Aşıkoğlu, 1993; Aydoğan, 1993; Aydoğan and Çapoğlu, 1993; Denizer, 1992; Uygur, 1993). Under a finance theory perspective, which explains this efficiency in terms of a risk-return trade-off, this would mean that funds are not being allocated rationally in the economy and that there is a waste of resources.

By the end of 1992, there were four Special Finance Institutions operating under Islamic banking principles (Akgüç, 1992; Yearly Reports of the SFIs: 1986-92).

2.1. Faisal Finance Institution

This institution was granted license on January 23, 1985. Initially, its paid-in capital was 5 billion TL which was further raised to 10, 25 and 65 billion TL in 1987, 1989 and 1991, respectively. SFIs were required to raise their capitals to 75 billion TL by December 31, 1993. Dar-Al-Maal Al Islami Trust (DMI) is the largest partner with 51% of total shares. By the end of 1991, the institution had 10 branches with its general directorate

located in İstanbul.

2.2. Al Baraka Türk Finance Institution

This institution was granted license on January 21, 1985. Initially, its paid-in capital was 5 billion TL which was raised to 10, 30 and 50 billion TLs in 1987, 1991 and 1992, respectively. The largest part of shares belong to Al Baraka Holding of Saudi Arabia. The institution had 10 branches by the end of 1991.

2.3. Kuwait Türk Evkaf Finance Institution

This institution was founded in 1989 with a capital of 15 billion TLs which was raised to 30 billion and 100 billion TLs in 1990 and 1992, respectively. It had 4 branches at the end of 1991.

2.4.   Anadolu Finance Institution

This Institution was founded on March 4, 1991, with a paid-in capital of 30 billion TLs. It began its operations in Ankara on October 3, 1991. All of its capital belongs to Turkish citizens. In this respect, it is the first Turkish Islamic bank. The largest percentage of shares belong to HES Group of Kayseri who are the manufacturers of cables.

3. The logic of Islamic banking and its entry to the Turkish banking system

Islamic banking attempts to attract savings through a non-interest banking system. In the literature of Islamic banking, it is also asserted that contemporary interest-based banking system has many features which would not comply with long term economic development policies. These reasonings can be summarized as follows (Wohlers-Scharf, 1983; Akgüç, 1992):

1) Conventional banks are inclined to give loans of short maturities rather than long term development loans. This tendency of the conventional banking system would hamper economic development.

2) Conventional banking system does not fully track the efficiency and financial performance of loan receivers. Islamic banks, however, operate on the participation principle, therefore, they will accomplish this job more effectively.

Under the momentum of its liberalization efforts, which included easier permits for the entry of foreign banks, Turkey allowed the establishment of Islamic banks. The aim was to benefit from the developing Islamic banking system through an increased inflow of foreign capital, to channel savings to the economy through Islamic banks, which would otherwise be kept idle under the conventional system and to develop close relationships with other Muslim countries.

To this end, the Turkish Council of Ministers passed a law on December 16, 1983, regarding the setting up of Islamic banks under the name of "Special Finance Institutions". The said law was followed by rules and regulations of 21st and 25th of March, 1984, set by the Undersecreteriat of Treasury and Foreign Trade (UTAFT) and the Turkish Central Bank, respectively. With these rules and regulations, Special Finance Institutions would bear a status independent of the banking law and would be allowed to render services which other conventional banks offered. However, their asset and liability management would be different from conventional banks due to the differences in the basic philosophy behind the banking practices. Neither the basic code, nor any rule or regulation uses the name "Islamic Banks", because it would violate the 7th article of the preface, and articles 5, 10, 14 and 24 of the Turkish Constitution. It was necessary to work out a well-rounded chain of rules and regulations which would stay within the limits of Turkish Constitution regarding the secular make-up of Turkey as a whole (Günal, 1984).

In general terms, Islamic banks mainly operate under the philosophy of what is called the "Profit and Loss Sharing Principle". In the Turkish context, SFIs would collect funds under two headings for which books will be kept separately. None of these funds are protected under the Deposit Insurance Scheme. A simple break-up of the asset and liability mix is given below[1,2].

Current account

These accounts can be opened in TL or foreign currency terms. They can be drawn without any obligations. Although these accounts are not protected

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[1] Although, Akgüç (1992), Keyder (1990) and Tikveş (1992) give detailed information on the laws regarding Turkish banking system, we would suffice with a simple break-up of asset and liability mix which is necessary for the interpretation of our results.

[2] Regarding the in-debth discussion of these individual items and their economic implications, refer to Akgüç (1992), Akın (1986), El-Naggar (1986), Nienhaus (1987) and Wohlers-Scharf (1983).

under deposit insurance fund scheme, SFIs can collect current accounts not more than 10 times of their equity base, which in other words is a limit to the leverage multiplier in terms of the current accounts. The aim behind this limit is to safeguard the interests of depositors. These accounts are similar to the demand deposits of the conventional banks. The account may be in the name of the depositor or may be "a bearer account".

Participative accounts

These accounts are the backbone of the system. They can be opened in TLs or foreign currency with maturities of 90, 180, 360 days or more. The deposit must be at least 100.000 TLs or its foreign currency equivalent. Profit shares are paid in the money unit of the deposit account. Both parties have to sign a contract which has a standard format (prepared by the Central Bank). Partial or full withdrawals are possible with a notice of thirty days. The institution's share of profit (or loss) cannot be more than twenty percent. No guarantee is provided to the depositors regarding profit share.

Trust financing (business participaton -mudaraba-)

"Mudaraba" consists of a transaction between the provider of the capital, "Rab-el-Mal", and the borrower "Mudarib", under the intermediation of the institution. The transaction takes place on the basis of profit and loss sharing, but no guarantees are given in this respect. "Rab-El-Mal" will, however, monitor the operations to safeguard the invested funds. Any profits or losses resulting from the investment would be reflected to the savers. This constitutes one of the main differences between SFIs and conventional banks. Conventional banks will have to pay the pre-determined interest, without having any connection to their profitability.

Cost plus financing (production support -murabaha-)

"Murabaha" consists of a transaction for physical goods and commodities. Commodities demanded by a trader or producer would first be purchased by the bank and sold to them at a profit (also known as a cost-plus-negotiated-margin transaction). The trader or producer pays this loan back as money according to the terms which were agreed upon. The level of cost plus profit would be agreed upon by the parties involved, effected by such factors as the type of goods and commodities, re-payment terms and risk level. All of the risk is born by the bank in return for a profit, contrary to the trust financing,

where all of the risk goes to the saver.

Equity participation (Musharaka)

"Musharaka" consists of a transaction where the provider of capital will participate in the capital of investor as well as the management. The two parties may or may not determine the proportion of profit distribution, but any loss will be shared in accordance with the shares. In this respect, it is an extension of "Mudaraba". "Decreasing Equity Participation", on the other hand, is an extension of "Equity Participation", in the sense that the fund receiver purchases the shares of "Rab-El-Mal" over time, until all shares get transferred to the fund receiver. In this transaction, profit and loss shares of "Rab-El-Mal" decreases proportionally over time.

Leasing (Ijara)

The bank leases machines or equipments on a rental basis. A modification of leasing is "ijara and iktina", where over time, the lessee completely owns the leased item. For this purpose, an extra amount needs to be paid, besides the rent charge, over a pre-determined period.

4. A comparative assessment of the two groups

The conventional banks are subjected to very sharp and strong rules and regulations, while the rules and regulations prepared for SFIs are much more flexible. The conventional banks have to block a large portion of their deposits as legal reserves and liquidity requirements. SFIs set aside ten percent of their current accounts as liquid cash and another ten percent is held in the form of securities or deposits at the Central Bank. One percent of participation accounts will be blocked, while the remaining are free to use. There are no provision requirements for participation accounts. The conventional banks are not allowed to be involved in any kind of commodity trading, while SFIs can be involved in almost any kind of commercial activity. The conventional banks can not process a leasing contract on a direct basis, while SFIs can. The conventional banks are subjected to reserve restrictions on foreign currency accounts, while SFIs are not.

The conventional banks are subjected to ceilings on the aggregates of their loan portfolios, and also on loans given to any single entity. These ceilings have been specified in terms of the level of their capital equity. SFIs are not subjected to these ceilings. The only ceiling for SFIs is on loans

placed from their current accounts. Loans given by SFIs from their current accounts to any single entity cannot exceed ten percent of their capital equity. No restrictions are imposed on participation accounts. The conventional banks have a restriction on loans given to their equity participants as well as to their staff. No such rules and regulations exist for SFIs. Regarding participation accounts, SFIs have to use twenty five percent of their yearly average participation accounts in foreign-exchange-earning operations.

Banking Law contains a number of penalties, none of which applies for SFIs. There are differences between the two groups regarding opening of a branch, voting procedures, credit committees, supervision, legal reserves, preparation of financial statements and membership to the banking association.

The preceding discussion indicates that SFIs are at an advantageous position in comparison to the conventional banking group. The flexible and relaxed nature of rules and regulations imposed on SFIs aims to provide an easy entry and extend support towards the development of the system. Additional differences will be mentioned below in the discussion concerning the comparative financial performance.

5. A camel-wise balance sheet approach to the financial performance analysis of banks

5.1. Financial performance: An overview

For any firm, the ultimate aim is to maximize the welfare of the share-holders which can be proxied as the maximization of the price of the stock. Price of the stock is simply the present value of future dividends which stock owners will receive. Dividends is a function of firm's earnings while returns required by the stock holders is a function of riskiness or variability in the flow of earnings. Intuitively, if the level of risk perceived is high, higher rates of returns would be expected on common stocks. Therefore, in terms of the theory of finance, performance would be a function of risk and return. Under capital market conditions, management would try to maximize returns for a given level of risk or vice versa. If the firm has untraded stocks, then what would measure the performance? A huge build-up of research is present in the literature. Jahankhani and Lynge (1980) for example, have proved with their multiple regression model that stock market measures of risks can be analogued through financial statement measures of variations in income flow and deposits, leverage, liquidity and payout ratio. Ball and Brown (1960) and Pettway and Sinkey (1980) have also reached similar

conclusions, indicating that properly handled financial statement analysis can be a good proxy to the market determined measures of performance, including the return dimension which would be proxied by the Return on Equity (ROE). This proxying procedure is also used to develop an early warning mechanism for the Turkish banking system through the dummy variabled regression approach. Results were satisfactory and indicated that under an appropriate approach to the modelling of relationships present within the financial statements, the proxying would work quite well for the Turkish banking system (Ağaoğlu, 1989). Return dimension which is simply the ratio of Net Income to Equity can further be manipulated through the multiplication of assets and revenues with both the numerator as well as the denominator. This simple manipulation would lead to the following set up:

$$ROE = (\text{ Net income/Revenues}) * (\text{Revenues/Assets}) * (\text{Assets/Equity})$$

This set up in itself is a function of risk and return that would be inherited within a financial statement. The first item which is called "Profit Margin" would imply that a firm should be able to transform the maximum percentage of its revenues to net income. This is an income statement view of the performance, emphasizing that the smaller the cost factor the larger would be the ROE. Therefore, any firm (bank) should keep costs under control and at the same time develop new margins beyond interest margin through research and innovation, because under competitive conditions interest margins can not be hard-pressed beyond a certain limit. The next item of the equation stands for the power of generating units of revenues for each unit of assets and is called "Asset Utilization". This is a balance sheet view of the performance and would be a function of rational and profitable investments and also of the units of assets left unconstrained within the balance sheet. For example, the higher the level of loan losses the smaller would be the units of assets left free for income generation, hence would result in a decreased asset utilization. "Return on Assets" (ROA) is a function of the first two items and is defined as Net income/Assets. The last item of the equation indicates that the firm will be able to gear up revenues through increased units of assets by supplementing equity with other borrowings. Due to this reason, it is called "Leverage Multiplier". Until here, we have depicted the return dimensions of the balance sheet. Any bank wanting to increase returns would have to go away from liquidity downwards on the balance sheet. In other words, going away from liquidity would mean that more loans would be given or assets would be placed in other non-liquid investments.

Any increase in the percentage of loans within the assets would bring with it a higher probability of loan defaults i.e., "Credit Risk". An increasing credit risk will increase the probability of losses i.e., "Operational Risk", hence requiring a strong capital base which is called "Capital Adequacy". Increasing capital beyond a particular limit will not be desired by owners, since their returns will be diluted. On the other hand, less and less liquidity would increase the probability that obligations of depositors will not be met when desired. This is called "Liquidity Risk". Regulators do not want banks to undertake high levels of risk, therefore, they strictly monitor banks and put ceilings on asset and liability composition of the banks. Bank managers would seek, however, large returns for their owners, which will not be possible without taking risk. Therefore, any measurement of performance should take into account risks and return, simultaneously. Under this context, it would be necessary that appropriate dimensions of risks be developed from within the financial statements. This is accomplished through the design of ratios and other appropriate items, which would then represent risks and return.

Regulatory authorities in the USA have designed a set of ratios under five headings towards the measurement of bank performance. They are called Capital Adequacy, Asset Quality, Management, Earnings and Liquidity. Their first letters will lead to what is known as "CAMEL". Though the term "management" could only be assessed through inside examinations, it can still be reflected through the variability in earnings. However, it is necessary that groups of banks with nearly similar characteristics be compared with each other, otherwise, the results will not be valid. Regulatory authorities in the USA usually use asset size, geographic areas, unit banks, branch banks, holding company banks and independent banks for peer grouping purposes. Asset size is the most frequently used criterion. The regulatory authorities analyze each item of "CAMEL" and give a composite rating on a scale of 1 to 5. Examiners look at the individual items under the following context (Johnson and Johnson, 1985; Harrison, 1985; Hempel et al., 1986; Sinkey, 1986; Putnam, 1983; Bovenzi et al., 1983).

In "Capital Adequacy", the examiners judge the bank's ability to support its current and projected level of asset risk. They use peer group comparisons of the capital ratios during their evaluations. The "Asset Quality" is judged by loan review. Examiners check all loans above a pre-determined cut-off point. Loans demonstrating some weakness or undue risk are classified as substandard, doubtful or loss. The relative amounts of classified loans and investments provide a basis for rating the "Asset Quality". The "Management Quality" is evaluated through technical competence, leadership and

administrative ability. Internal controls, operating procedures and compliance with banking laws and regulations is also taken into consideration. The "Earnings Quality" is determined through peer group comparisons in conjunction with the market information. The adequacy of the bank earnings is viewed in terms of the stockholders' returns, cash flows in relation to the normal borrowing needs and the contribution to equity capital base. Return on Assets (ROA) and Return on Equity (ROE) are the global indicators of the "Earnings Quality". "Liquidity" is rated on the basis of the bank's ability to meet customer demands for deposits and loans without undue strain. The determination of the adequacy of a bank's liquidity position is based on the maturity structure of the investment account, volatility of deposits, loan commitments, non-deposit borrowings and interest rate sensitivity.

5.2. Research methodolgy

Although, Al Baraka and Faisal Finance Institutions became operational in 1985, the first full operational year was 1986. Therefore, our data array starts with 1986. Short chain of data did not allow any multiple regression analysis, due to insufficient degrees of freedom. However, tables 2, 3, 4 and 5 provide all vital information regarding the individual dimensions of "CAMEL".

As discussed in the previous sections, SFIs and the conventional banking system operate under different philosophies, therefore, subdivision of activities within asset and liability compositions beyond a limit would make the analysis useless and hence would lead to invalid results. In this study, we have used asset sizes as a peer grouping criterion. The average asset size of SFIs is nearest to the average of small scale national banks as well as that of the foreign banks. Comparison have also been performed on the basis of the conventional banking group as well as the overall banking aggregates. Financial statement items were manipulated to generate a maximum number of comparable common points, without loosing much from the generality of the available data. Table 1 shows the distribution of banks and bank branches of national and foreign origin over the 1924-91 period. Table 2 shows totals, averages and percent shares of the individual groups. Shares have been calculated on the basis of overall banking aggregates. The last two columns of this table show the share-based equity structure. Column 5 of this table gives Equity/Assets ratio , based on market shares of equity and assets (third row for each group). Column 6 shows Equity/Assets ratio per branch for the individual groups. These two columns have been designed to supplement information given in Tables 3-5.

Anadolu Finance Institution became operational in October 1991, therefore it was excluded in calculations. Table 3 shows annual growths of liquid assets, investments (all assets except liquidity, fixed assets, subsidiaries and other assets), fixed assets, subsidiaries, other assets, total assets, contra accounts (contingencies), assets plus contra accounts, capital equity, borrowings, other liabilities, profits, personnel expenses, current accounts (of SFIs), profit and loss accounts (of SFIs), foreign exchange accounts and TL accounts, respectively. These items have also been used under the same order in Table 4, which gives market share analysis of the groups. In this table, we have tried to compare volumes of an average SFI to an average small national bank and an average foreign bank, respectively. This table tries to indicate how big or small an SFI is, in comparison to its asset based peer groups and also to an average conventional bank in terms of the above-mentioned financial statement items.

Table 5 gives some important proxies of the CAMEL performance indicators. This risk and return view of the groups tries to analyze the financial performance of an average SFI, in comparison to other groups. Ratios 1-6, show the percent composition of assets in terms of liquidity, investments, fixed assets, subsidiaries, other assets and contra accounts. While, ratio 1 is an indicator of "Liquidity Risk", ratios 7 and 14 would be the indicators of "Leverage Multiplier". Ratios 8-11 show the structure of deposits. On the other hand, ratios 12 and 13 indicate "Capital Adequacy Risk". The "Earnings Quality" is reflected through "Return on Equity" and "Return on Assets" which are depicted by ratios 15 and 16, respectively.

Table 5 covers the basic indicators which would be necessary for the performance evaluation, under the context of a risk-return mechanism. However, it has not been possible to obtain data regarding the non-performing loans of some SFI's on an individual basis. Hence "Credit Risk" or in other words, "Asset Quality" would be dealt with separately. Although, ratio 5 of Table 5 includes the non-performing loans, a further refinement of this ratio has not been possible on individual basis.

6. Discussion of results

6.1. An assessment in terms of risk and return

In spite of a rapid growth in the liquidity, the market shares of SFIs were only 29.63% of an average small national bank, 79.45% of an average foreign bank and 10.49% of an average conventional bank in 1991. The percentage of their liquidity within assets is far below the percentage of other

groups. In 1991, an average conventional bank held 2.26 times more liquidity than an average SFI. This is partially due to high reserves and liquidity requirement ratios and partially due to the increased borrowing of the governments. Hence we conclude that relaxed reserve requirements for SFIs lead to a higher liquidity risk which is 2.26 times larger than an average conventional bank. Table 5 shows that the percentage of investments within the assets of SFIs is almost 1.75 times that of the the conventional banking group, which in itself is another outcome of the relaxed reserve and liquidity requirements in SFIs. This is also partially due to the fact that they do not invest in government bonds. Column 7 of Table 5 shows that SFIs have a much higher tendency to finance their assets through borrowings in comparison to other groups, which is also indicated by column 14 which shows that their Investment/Borrowings ratio is extremely high. These findings indicate a large "Leverage Multiplier", in other words, a large "Leverage Risk" for these institutions.

The profit and loss deposit accounts amount to 94% of SFIs' total borrowings, 64% of which comes from foreign exchange accounts. Although, a decrease in TL accounts and an increase in foreign exchange (FX) accounts is common to all groups, SFIs have shown an extra-ordinary growth in their FX accounts and a rapid decrease in their TL accounts. This signifies the presence of a strong foreign exchange risk within their portfolios. This is partially due to the ease with which they can place the FX funds and partially due to the economic conditions of Turkey.

It has not been possible to calculate the credit risk (asset quality) in detail, due to the fact that some of the SFIs do not publicly declare the non-performing loans. However, it has been possible to get some aggregate loan loss data for the period of 1989-91 (Türkiye Bankalar Birliği, 1992). The following table shows information regarding the non-performing loans:

	1989	1990	1991
SFIs	1.58%	2.37%	1.80%
Conventional group (Net)	1.57%	1.30%	2.15%
Conventional group (Gross)	5.30%	4.30%	5.21%

The table indicates that the credit risk of conventional banking group is much higher than that of the SFIs on the basis of a balance sheet view. The matter, however, is controversial. SFIs generally concentrate on specific

groups which often have difficulties in mobilising funds for expansion and innovation, due to lack of collaterals and international market connections. The conventional banking groups, however, prefer other outlets. SFIs would be more attractive to enterpreuners because they have no fixed interest burden, but share the profit in accordance with the contract. Moreover, they may get help to find market outlets, which generally would not be available in the case of the conventional banking group. In these terms, the equity participation is prone to have a modest efficiency[3]. In a market, which is already dominated by the conventional group, SFIs will have smaller oppurtunities of diversifying their portfolio risk. Hence, with the inclusion of a higher diversification risk, the overall portfolio risk level would be much larger than what a balance sheet view can show.

The most important implication of this study is related to ROE (column 15 of Table 5), and ROA (column 16 of Table 5). SFIs have been increasing their profits at rates lower than all of the other groups (column 12 of Table 3). Their ROE is higher than an average small scale national bank and an average conventional bank. It is almost the same as that of an average foreign bank. However, their ROA is much lower than their peer groups' and is about the same as that of an average conventional bank. This could raise the following question: What then is the source of this high ROE? In order to answer this question, Multiple Regression would be an appropriate technique to use, if one has a longer chain of data than what we have. We would try to answer this question by having a look at columns 12 and 13 of Table 5 and column 9 of Table 3. The annual growth of capital equity as well as Equity/Assets ratio of SFIs has decelerated. At the same time, the annual growth of their capital equity is far below those of other groups. This indicates that the source of this high ROE is latent within the decreasing capital base itself, and not within an improving performance. These reasonings would imply that the capital risk of SFIs is very high. Due to the shock-proofing peculiarities of capital equity base, this decreasing capital equity should be an ultimate early warning signal for the regulatory authorities.

6.2. Implications of the research

Over the 1986-88 period, SFIs have been able to increase their market share in total assets (column 6 of Table 4). Their market shares of

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[3]   Wohler-Scharf (1983) discusses some of these issues in an international context.

investments is still increasing (column 2 of Table 4), while their profit shares as well as ROA are almost constant (columns 12 and 16 of Table 4). On the other hand, the year-wise growth pattern is indicating that SFIs have lost their dynamism in terms of investments (column 2 of Table 3), total assets (column 6 of Table 3), borrowings (column 10 of Table 3) and profits (column 12 of Table 3). There are two important implications of these statements. Firstly, any higher capital equity standards to be imposed by regulatory authorities, would worsen the ROE of SFIs, even beyond a point where they should not do any banking business at all. Secondly, it can be asserted that under the prevailing conditions, SFIs seem to have reached the so-called "Saturation Point". It would not be possible for them to improve their asset-wise efficiency using traditional instruments, which they are used to. They will have to develop new ways of improving their margins.

Analysis of the yearly financial statements show that the conventional banking groups have not been able to improve their investments over the last few years, while there has been a rapid increase in their liquidities (see columns 1 and 2 of Table 3). Their loan portfolio composition also indicate a change in favor of short term loans. Their non-interest income has shown an increasing trend. The yearly financial statements of SFIs, on the other hand, indicate that about 90% of their funds go to cost plus financing placements, which are generally of short term nature. The remaining goes to equity participation and leasing (SFI, 1986-92). In other words, SFIs have concentrated on investments which accomodate smaller degrees of variation within their profit margins, instead of taking higher stakes through placement of sharing schemes, where uncertainty for their profit margins is high. On the conventional banking front, Table 5 shows that almost all important indicators of performance for this group are exhibiting a steady state structure. Any steady state movement of a banking industry within the context of a short term outlook would mean that the system has become risk averse.

The above results imply that both SFIs as well as the conventional banking groups are not doing a banking business as they should. In spite of high levels of risks, SFIs have shown a better performance in hard-pressing their investments compared to conventional banking groups, which have been stuck to liquidity. The answer to this paradox is hidden within the theory of finance itself. Risk is defined as the probability of loss, and risk-taking would involve some kind of future forecasting. The risk function of banking being more complex than any other industry would mean that the dynamism of banking would be latent within how well they can foresee the future, before making any decision regarding the risk-return mix-up of their

investment portfolios versus their funding pattern. This would not be possible under conditions of unstable economic environment. Ultimately, banking will not be able to do banking as it should. This interesting issue may be another research topic.

7. Conclusion

In general terms, SFIs exhibit large levels of risk with a melting capital equity base and a steadily low level ROA. This would imply that efforts should be exerted towards strengthening their equities. In spite of all the privileges and rapid growth, SFIs have not been able to reap fully the existing oppurtunities. They have also not been able to improve their competitive edge against the conventional banking groups.

The research has depicted that SFIs have shown a fast growth at the initial stages, and later they started to contract. In spite of an enormous volume-wise expansion, an average SFI has reached only about 24% and about 15% of an average conventional bank in terms of its assets and equity, respectively. Therefore, with this smaller market share, no one should expect an effect on the conventional banking system. As far as the financial performance of SFIs is concerned, they will have to develop new instruments without sacrificing from their basic philosophies, so as to improve their performance as well as their competitive edge and attract potential customers.

Table 1
Number of Banks in Turkey

	National Banks		Foreign Banks		Total			Branches Per Bank			Percentage of Banks		Percentage of Branches	
	No.	Branches	No.	Branches	No.	Branches	National	Foreign	Sector	National	Foreign	National	Foreign
1924	20	344	15	95	35	439	17.2	6.3	12.5	57.1	42.8	78.4	21.6
1929	43	344	16	102	59	446	8.0	6.4	7.6	72.9	27.1	77.1	22.9
1934	44	385	10	78	54	463	8.7	7.8	8.6	81.5	18.5	83.1	16.8
1939	37	364	9	72	46	436	9.8	8.0	9.5	80.4	19.6	83.5	16.5
1944	34	363	9	42	43	405	10.7	4.7	9.4	79.1	20.9	89.6	10.4
1949	36	550	7	44	43	594	15.3	6.3	13.8	83.7	16.3	92.6	7.4
1954	46	1028	6	51	52	1079	22.3	8.5	20.7	88.5	11.5	95.3	4.7
1959	54	1662	6	58	60	1720	30.8	9.7	28.7	90.0	10.0	96.6	3.4
1964	44	1841	5	68	49	1909	41.8	13.6	38.9	89.8	10.2	96.4	3.6
1969	43	2846	5	102	48	2948	66.2	20.4	61.4	89.7	10.4	96.5	3.5
1974	39	4311	5	114	44	4425	110.5	22.8	100.6	88.6	11.4	97.4	2.6
1979	40	5665	4	104	44	5769	141.6	26.0	131.1	90.9	9.1	98.2	1.8
1984	35	6109	13	117	48	6226	174.5	9.0	129.7	72.9	27.1	98.1	1.9
1985	36	6172	15	120	51	6292	171.4	8.0	123.4	70.6	29.4	98.1	1.9
1986	39	6244	17	128	56	6372	160.1	7.5	113.8	69.6	30.4	98.0	2.0
1987	40	6337	17	104	57	6441	158.4	6.1	113.0	70.2	29.8	98.4	1.6
1988	39	6443	22	109	61	6552	165.2	4.9	107.4	63.9	36.1	98.3	1.7
1989	39	6617	24	109	63	6726	169.7	4.5	103.3	61.9	38.1	98.4	1.6
1990	41	6584	26	116	67	6700	160.6	4.7	96.5	61.2	38.8	98.3	1.7
1991	42	6501	24	116	66	6617	154.8	4.8	96.7	63.6	36.4	98.2	1.7

Source: Akgüç, 1992: 95-97.

Table 2
Peer Group Analysis

	No.of Personnel	No.of Branches	Total Assets	Capital Equity	Equity/ Assets (%)	Equity/ Assets Per Branch. (%)
Foreign Commercial Banks						
Total	3.706	122	12.804	1.819		14.21
Average	143	5	492	70		
% of Sector	2.44	1.90	4.13	6.29	152.4	
Private Large Commercial Banks						
Total	57.274	3.006	103.41	11.443		11.07
Average	8.182	429	14.773	1.634		
% of Sector	37.77	46.77	33.33	39.56	118.7	
Private Small Commercial Banks						
Total	9.281	319	34.281	3.683		10.74
Average	488	17	1.804	193		
% of Sector	6.12	4.96	11.05	12.73	115.2	
Public Commercial Banks						
Total	74.298	2.714	112.093	8.005		7.14
Average	18.575	679	28.023	2.001		
% of Sector	49.00	42.23	36.13	27.68	76.6	
Public Development Banks						
Total	6.353	231	37.591	3.225		8.58
Average	1.059	39	6.265	537		
% of Sector	4.19	3.59	12.12	11.15	92.0	
Private Development Banks						
Total	715	10	6.765	571		8.45
Average	102	1	966	81		
% of Sector Totals	0.47	0.16	2.18	1.98	90.6	
Private Commercial Banks						
Total	70.261	3.447	150.501	16.946		11.26
Average	1.351	66	2.894	325		
% of Sector	46.34	53.63	48.50	58.59	120.7	
All Commercial Banks						
Total	144.559	6.161	262.594	24.951		9.50
Average	2.581	110	4.689	445		
% of Sector	95.34	95.86	84.63	86.26	102.0	
All Development Banks						
Total	7.068	241	44.357	3.797		8.56
Average	544	19	3.412	292		
% of Sector	4.66	3.75	14.30	13.13	91.9	
All Conventional Banks						
Total	151.627	6.402	306.951	28.749		9.37
Average	2.197	93	4.448	416		
% of Sector	100.00*	99.61	98.93	99.39	100.4	
All Special Financial Institutions						
Total	*	25	3.330	176		5.30
Average	*	6.25	832	44		
% of Sector	*	0.39	1.07	0.61	56.9	
*Sectoral Total***	151.627	6.427	310.281	28.925		9.32
*Sectoral Average***	2.197	88	4.250	396		

Sources: Turkish Banking Association, *Yearly Reports;* Special Financial Institutions, *Yearly Reports.*
* : Since data for some SFIs are not available, these calculations remain inexhaustive.
**: Sectoral totals include SFIs.

Table 3
Year-Wise Growth Patterns (%)

	1 Liquid Assets	2 Invest-Ments	3 Fixed Assets	4 Subsidia-Ries	5 Other Assets	6 Total Assets	7 Contra Acc.	8 Assets+ Contra Acc.
Special Financial Institutions								
1987	143.80	82.52	82.56	63.05	329.53	94.44	124.24	106.25
1988	109.05	94.74	97.13	54.61	14.93	92.69	63.48	80.10
1989	39.55	46.86	239.85	300.24	76.68	54.95	81.00	65.14
1990	44.50	75.68	221.34	13.78	127.27	83.42	8.22	51.17
1991	118.59	53.99	-71.15	-23.98	80.65	44.23	29.00	39.56
National Small Scale								
1987	94.71	62.73	42.58	45.36	76.90	74.12	84.35	81.70
1988	55.49	40.63	90.56	161.28	136.38	62.62	75.26	72.13
1989	56.39	106.18	87.26	73.82	35.62	73.19	40.70	48.31
1990	51.48	73.94	45.91	45.68	36.46	59.17	65.71	63.92
1991	141.72	74.80	62.67	54.31	98.13	97.30	80.76	85.15
Foreign Banks								
1987	57.68	57.40	29.83	30.60	-47.50	34.61	93.15	65.98
1988	75.48	55.01	69.95	42.47	86.16	68.77	89.01	81.39
1989	7.03	63.38	42.93	427.18	0.73	26.49	38.13	34.05
1990	44.47	75.29	50.07	6.58	38.91	57.28	38.91	44.98
1991	98.84	72.23	72.77	44.56	70.04	83.47	93.56	89.94
Conventional Banking Sector								
1987	63.32	59.55	67.27	64.69	55.18	60.59	115.46	92.61
1988	74.42	38.44	147.77	55.26	36.13	54.26	63.53	60.31
1989	43.75	60.58	82.65	84.81	53.33	54.39	33.83	40.70
1990	28.68	63.28	30.42	43.82	52.38	46.68	60.58	55.49
1991	93.76	67.47	106.76	57.08	80.62	79.17	72.22	74.62

Source: Turkish Banking Association, *Yearly Reports*; Special Finance Institutions; *Yearly Reports*.

Table 3 Continued

	9 Capital Equity	10 Borrowings	11 Other Liabilities	12 Profits	13 Personel Expenses	14 Current Acc.	15 P&L Sh. Acc.	16 Foreign Exc. Acc.	17 TL Acc.
Special Financial Institutions									
1987	40.27	112.08	72.13	36.50	93.46	92.23	113.33	163.96	111.58
1988	68.40	102.97	79.07	−2.66	110.74	156.13	99.96	111.28	94.27
1989	57.23	40.47	162.90	59.15	111.41	45.35	40.11	−1.83	99.03
1990	51.30	73.86	132.38	96.79	123.16	56.12	75.19	104.96	52.67
1991	39.82	66.93	−22.43	32.48	42.02	60.31	67.37	125.19	5.20
National Small Scale									
1987	67.98	66.95	106.30	65.92	61.82	−	−	114.09	42.45
1988	70.28	57.89	66.59	141.43	72.68	−	−	25.43	44.80
1989	91.33	76.34	63.96	33.17	86.95	−	−	60.46	112.12
1990	69.73	63.15	38.42	86.05	78.70	−	−	68.40	51.50
1991	65.31	100.51	100.03	97.26	75.16	−	−	198.33	81.73
Foreign Banks									
1987	38.79	63.68	−31.68	72.10	54.35	−	−	93.29	48.08
1988	33.19	64.36	91.51	133.36	66.35	−	−	76.85	40.24
1989	60.97	26.94	23.99	−8.71	73.86	−	−	11.78	13.50
1990	61.74	50.77	90.83	29.84	73.13	−	−	28.30	6.24
1991	114.46	89.96	31.30	185.73	101.04		−	72.82	57.91
Conventional Banking Sector									
1987	59.74	60.23	59.68	84.88	55.23	−	−	112.08	37.76
1988	67.14	49.56	68.17	83.62	79.71	−	−	56.91	45.65
1989	80.47	54.09	53.37	5.68	82.34	−	−	45.70	61.12
1990	50.91	46.91	39.11	89.25	88.03	−	−	49.42	41.74
1991	64.84	78.03	90.86	83.41	76.25	−	−	144.69	59.99

Table 4
Market Share Analysis (%)

	1 Liquid Assets	2 Invest- ments	3 Fixed Assets	4 Subsidia- Ries	5 Other Assets	6 Total Assets	7 Contra Acc.	8 Assets+ Contra Acc.
Average of SFIs / Average of National Banks								
1986	17.62	90.94	54.80	21.99	8.68	52.98	12.13	22.69
1987	22.06	102.00	70.17	24.66	21.08	59.17	14.76	25.76
1988	29.65	141.25	72.59	14.59	10.25	70.11	13.77	26.95
1989	26.46	100.61	131.73	33.60	13.35	62.73	17.71	30.01
1990	25.24	101.61	290.11	26.24	22.24	72.29	11.57	27.68
1991	29.63	118.36	67.91	17.24	26.73	69.66	10.90	27.52
Average of SFIs / Average of Foreign Banks								
1986	23.17	252.60	199.20	526.23	9.69	95.72	54.47	73.61
1987	35.83	292.92	280.10	656.99	79.27	138.26	63.23	91.48
1988	42.69	368.00	324.90	712.99	48.94	157.86	54.69	90.83
1989	55.66	330.78	772.50	541.31	85.84	193.39	71.67	111.89
1990	55.67	331.52	1654.12	577.85	140.44	225.53	55.83	116.67
1991	79.45	391.92	364.58	405.15	196.66	233.71	49.14	113.06
Average of SFIs / Average of All Conventional Banks								
1986	3.67	21.29	18.03	4.10	1.81	11.79	5.53	8.13
1987	5.48	24.35	19.68	4.06	5.01	14.27	5.75	8.71
1988	6.57	34.25	15.66	4.05	4.23	17.83	5.75	9.78
1989	6.38	31.33	29.14	8.76	4.88	17.89	7.78	11.48
1990	7.16	33.71	71.79	6.93	7.28	22.37	5.24	11.17
1991	10.49	40.98	13.22	4.47	9.59	23.74	5.18	11.77

Source: Turkish Banking Association, *Yearly Reports*; Special Finance Institutions; *Yearly Reports*.

Table 4 Continued

	9 Capital Equity	10 Borrowings	11 Other Liabilities	12 Profits	13 Personnel Expenses	14 Current Acc.	15 Profit & Loss Share Acc.'s	16 Foreign Exc.	17 TL . Acc.
Average of SFIs / Average of National Banks									
1986	76.01	51.43	37.67	141.69	19.56	–	–	116.17	62.29
1987	63.47	65.33	31.43	116.57	23.39	–	–	143.23	92.51
1988	62.77	83.98	33.79	47.00	28.54	–	–	241.27	124.12
1989	51.58	66.90	54.18	56.16	32.27	–	–	147.62	116.46
1990	45.98	71.29	90.95	59.41	40.30	–	–	179.67	117.36
1991	43.03	79.06	46.48	52.58	43.02	–	–	180.67	90.51
Average of SFIs / Average of Foreign Banks									
1986	135.25	110.59	42.65	202.96	44.83	–	–	259.03	62.76
1987	136.70	143.29	107.47	160.98	56.19	–	–	353.72	89.67
1988	172.84	176.95	100.48	67.14	71.19	–	–	422.59	124.21
1989	168.82	195.81	213.06	117.05	86.56	–	–	371.16	217.81
1990	157.92	225.80	259.45	177.40	111.57	–	–	592.94	313.00
1991	113.94	264.34	201.96	108.41	103.76	–	–	1029.29	277.80
Average of SFIs / Average of All Conventional Banks									
1986	20.30	10.81	9.71	40.67	4.97	–	–	36.06	6.94
1987	17.83	14.30	10.47	30.03	6.19	–	–	44.88	10.66
1988	17.96	19.41	11.15	15.92	7.26	–	–	60.44	14.22
1989	15.65	17.69	19.12	23.97	8.42	–	–	40.72	17.56
1990	15.69	20.94	31.93	24.92	9.99	–	–	55.86	18.92
1991	14.73	26.15	17.10	23.73	10.60	–	–	68.48	16.57

Table 5
Ratio Analysis (%)

	1 Liq. assets/ Assets	2 Invest./ Assets	3 Fixed assets/ Assets	4 Subsid./ Assets	5 Oth.assets/ Assets	6 Contra/ Assets	7 Borrow./ Assets	8 Current acc./ Assets
Special Financial Institutions								
1986	11.03	82.23	3.66	0.90	2.16	39.64	70.08	5.91
1987	13.83	77.19	3.44	0.75	4.77	43.10	76.43	5.35
1988	15.00	78.01	3.52	0.60	2.84	39.12	80.51	6.76
1989	13.51	73.93	7.73	1.57	3.24	42.88	72.98	6.99
1990	10.64	70.81	13.54	0.97	4.02	30.69	69.18	6.28
1991	15.89	75.83	2.71	0.52	5.03	28.41	80.92	6.00
National Small Scale								
1986	33.18	47.90	3.54	2.18	13.18	74.14	72.19	–
1987	37.11	44.77	2.90	1.82	13.39	75.22	69.22	–
1988	35.48	38.72	3.40	2.92	19.46	76.59	67.21	–
1989	32.04	46.09	3.68	2.93	15.24	72.67	68.43	–
1990	30.49	50.37	3.37	2.68	13.06	73.46	70.15	–
1991	37.36	44.63	2.78	2.10	13.12	71.72	71.29	–
Foreign Banks								
1986	45.57	31.16	1.76	0.16	21.34	53.58	60.65	–
1987	53.38	36.43	1.70	0.16	8.32	62.35	73.75	–
1988	55.51	33.46	1.71	0.13	9.18	64.97	71.82	–
1989	46.97	43.22	1.93	0.56	7.31	66.95	72.08	–
1990	43.14	48.17	1.84	0.38	6.45	64.14	69.10	–
1991	46.75	45.22	1.73	0.30	5.98	65.37	71.54	–
Conventional Banking Sector								
1986	35.41	45.53	2.39	2.60	14.05	58.35	76.44	–
1987	36.02	45.24	2.49	2.66	13.57	65.27	76.27	–
1988	40.72	40.59	4.01	2.68	11.98	66.58	73.94	–
1989	37.91	42.22	4.74	3.21	11.90	63.33	73.80	–
1990	33.26	47.00	4.22	3.15	12.36	65.41	73.92	–
1991	35.97	43.93	4.87	2.76	12.46	64.51	73.45	–

Source: Turkish Banking Association, *Yearly Reports*; Special Finance Institutions; *Yearly Reports*.

Table 5 Continued

	9	10	11	12	13	14	15	16
	P&L Share./	Foreign acc./	TL acc./	Equity/	Equity/	Invest./	Net income/	Net income/
	Borrow.	Borrow.	Borrow.	Borrow.	Assets	Borrow.	Equity (ROE)	Assets (ROA)
Special Financial Institutions								
1986	94.09	44.74	43.96	14.78	10.36	117.34	64.71	6.70
1987	94.64	55.69	43.86	9.77	7.47	100.98	62.97	4.70
1988	93.24	57.97	41.98	8.11	6.53	96.89	36.40	2.37
1989	93.00	40.51	59.48	9.08	6.62	101.29	36.84	2.44
1990	93.71	47.76	52.23	7.90	5.46	102.35	47.92	2.62
1991	93.99	64.43	32.91	5.49	4.44	93.71	54.08	2.40
National Small Scale								
1986	–	19.81	36.30	10.00	7.22	66.35	34.71	2.50
1987	–	25.40	30.97	10.06	6.96	64.67	34.28	2.38
1988	–	20.17	28.40	10.85	7.29	57.60	48.61	3.54
1989	–	18.36	34.16	11.77	8.06	67.35	33.83	2.72
1990	–	18.95	31.72	12.25	8.59	71.80	37.09	3.18
1991	–	28.19	28.75	10.10	7.20	62.60	44.25	3.18
Foreign Banks								
1986	–	19.10	77.47	12.08	7.33	51.37	43.12	3.16
1987	–	22.56	70.08	10.24	7.55	49.40	53.47	4.04
1988	–	24.27	59.80	8.30	5.96	46.59	93.70	5.59
1989	–	21.37	53.47	10.53	7.59	59.96	53.14	4.03
1990	–	18.19	37.68	11.29	7.80	69.71	42.66	3.33
1991	–	16.54	31.32	12.75	9.12	63.20	56.83	5.18
Conventional Banking Sector								
1986	–	13.40	68.45	7.86	6.01	59.56	32.30	1.94
1987	–	17.74	58.85	7.84	5.98	59.31	37.38	2.23
1988	–	18.61	57.31	8.76	6.48	54.90	41.07	2.66
1989	–	17.60	59.93	10.26	7.57	57.21	24.05	1.82
1990	–	17.90	57.82	10.54	7.79	63.58	30.16	2.35
1991	–	24.61	51.96	9.76	7.17	59.81	33.56	2.40

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Özet

Türkiye'de İslami bankaların mali analizi

Bu araştırmada, faizsiz bankacılık işlemleri uygulayan Özel Finans Kurumları ile faize dayalı bankacılık sistemi arasında performans ve pazar payları açısında bir karşılaştırma yapılmıştır. Araştırma, Özel Finans Kurumlarına ilişkin risklilik derecelerinin yüksek düzeylerde seyrettiğini göstermiş ve önlemlerin alınması gerektiğini vurgulamıştır. Bu kurumların pazar payları ilk yıllarda artışlar kaydetmiş ise de, küçülme eğilimine girmiş oldukları tespit edilmiştir.