

FOREIGN BANK PARTICIPATION IN EMERGING MARKETS:
LESSONS FROM CITIBANK CASE IN TURKEY

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ABSTRACT

FOREIGN BANK PARTICIPATION IN EMERGING MARKETS: LESSONS FROM CITIBANK CASE IN TURKEY

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An extensive literature has examined many of the consequences of foreign bank participation in emerging markets. However, research to date has largely focused on the effects of foreign bank participation in domestic banks and yet revealed little about the situation for foreign banks. The thesis, examines Citibank in Turkey as a particular case in order to address this gap. The results show that Citibank's growth and presence in the Turkish banking sector depends significantly on: ownership advantages related to the bank's dimensional scale; the need to follow its clients who have already expanded their activities into the Turkish market in order to save their pre-existing relationships; and the access to positive externalities offered by the Turkish market.

Keywords: Foreign banks, Turkey, Citibank, emerging markets, ratio analysis

ÖZ

GELİŞMEKTE OLAN PİYASALARA YABANCI BANKA KATILIMI: TÜRKİYE'DE CİTİBANK VAKA ÇALIŞMASI

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Bu alandaki akademik çalışmaların çoğu, gelişmekte olan pazarlara yabancı banka girişlerinin sonuçlarını incelemiştir. Ancak, bugüne kadar yapılan araştırmalarda özellikle yabancı banka girişlerinin yerel bankalara olan etkilerinin üzerinde yoğunlaşmış ve yabancı bankalar açısından bu durum çok az ele alınmıştır. Söz konusu açığa yönelik olarak bu tez çalışmasında Citibank Türkiye bir vaka çalışması olarak incelenmektedir. Araştırmanın sonuçlarına göre Citibank'ın Türk bankacılık sektöründe varlığı ve büyümesi önemli ölçüde: sahip olduğu mülkiyet avantajına, Türkiye pazarında aktivitelerini daha önce genişleten müşterileri ile olan ilişkilerini korumak amaçlı onları takip etmesine ve Türkiye pazarının sunduğu pozitif dışsallıklara erişimine dayanmaktadır.

Anahtar Kelimeler: Yabancı bankalar, Türkiye, Citibank, gelişmekte olan piyasalar, rasyo analizi

*to my beloved parents
Fatma & Osman*

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CHAPTER 1

1 INTRODUCTION

Over the years, global banking sector has undergone changes. One of the biggest changes has been the rise in foreign banking, when a large number of countries in emerging markets open their banking sectors to foreign equity participation. A decision to open up domestic markets to foreign entry has been generally taken after banking sector reforms such as transparency improvement and regulatory oversight efforts, related to domestic economic problems. On the other hand, for developed financial markets, new investment, and growth opportunities as well as maintaining established relations with global clients in emerging markets have been main reasons of entries in emerging markets' economies.

The average level of foreign bank participation as the share of assets held in emerging market economies has increased from 20 to 32 percent between 1995 and 2002 (Micco, Panizza, and Yañez, 2007). In 2008, in 40 percent of all developing countries, beyond 50 percent of banks are foreign owned (Claessens, Gurcanlar, Mercado, and Van Horen, 2008). Such a growth has attracted the attention of researchers. Most studies have examined the effect of foreign bank entry in Eastern and Central European, and Latin American countries by employing cross-country or single country based bank level data. These researches include Levine (1996), Bhattacharya, Lovell, and Sahay (1997), Denizer (2000), Barajas,

Steiner, and Salazar (2000), Claessens, Demirguc-Kunt, and Huizinga (2001), Clarke G., Cull, Peria, and Sanchez (2003).

Although there is considerable literature on the effects of foreign banks in the home and host countries, the literature on the foreign banks profitability and risk of being foreign is limited. This research aims to look at the foreign bank entrances to developing countries from a different perspective. It examines whether the entrance to a new host country is a good idea for foreign banks. Do they really realize their aims? In order to find answers to such questions, Citibank in Turkey is studied in depth as a case study.

The number of foreign banks increased at an increasing rate at the beginning of the 2000s in Turkey, especially after the financial crises in 2000-2001. The huge potential in the country with the stabilizing economy increased the attractiveness of the market for foreign investors. Foreign banks either merged with domestic banks or opened new branches in Turkey. The important question is why they are coming. Is Turkey really as profitable as it looks?

Citibank is interesting to study, since the bank may enter a host country via opening a representative office, branch establishment, or development of corporate banking activities. These entry choices for the bank generally related with the host countries' economic development (Table A1). Accordingly, Citibank prefers representative office or branch openings for emerging and developing countries, however, corporate banking activities for developed economies. For instance, the bank enters Bulgaria, India, Tunisia, and Ukraine by founding representative offices; on the other hand, France, Finland, Italy, Netherlands, and Switzerland are the countries that become the host countries for Citibank by establishment of corporate banking activities (Table A1). It is significant to note that the bank prefers to enter the Arabian Peninsula by corporate banking although the countries are classified as emerging or developing ones. Moreover, there are only three countries, in which the bank prefers to enter by representative office opening

followed by corporate and consumer banking openings, Egypt, Kazakhstan, and Turkey (Table A1). Among these three countries, Turkey has the longest Citibank presence.

Citibank is in Turkey since the beginning of 1950s, especially becoming active after the 1980s. It has changed its status over the sixty years, but did not leave the country even during the major domestic and global financial crises. Despite the decrease in its profits and problems in the US, Citibank managed to stay profitable in Turkey at the end of 2007 and 2008. The research investigates and explores the historical development and related performance of Citibank in Turkey to find answers to the following questions: (1) Why did Citibank choose to invest in Turkey? (2) How did Citibank survive in Turkey for 64 years? (3) What did cause the bank's strategic changes? (4) How do Citibank's strategies relate with its performances over the years? Answers to such questions will help us understand similar undertakings in the same country or in other emerging markets.

In order to analyze the performance of the Citibank, ratio analysis is employed and financial ratios mentioned in the literature to examine the liquidity risk, credit risk, profitability and the capital adequacy of the bank is calculated. The research also examines the documents and speeches that mentions why Citibank enters different countries and especially in Turkey. Specifically, we try to determine whether Citibank achieved its aim or not.

By applying accounting tools for analyzing financial performance of Citibank in Turkey, the research will contribute to the limited number of studies that attempt to identify the situation for foreign banks. Thus, the study would provide a strategic outlook for bank managers of both domestic and foreign banks as a tool for long-term planning, and provide feedback to bank regulators and investors in the country. The term foreign bank will be used throughout the research as defined by Detragiache and Gupta (2006) "fully owned subsidiaries of foreign

institutions or domestic banks in which a foreign institution holds a controlling share...”(p. 223).

The thesis is organized as follows: First section reviews the literature on foreign banks’ entry strategies in general and analyzes the motives behind foreign bank entry into a country. Second section shifts to specific overview of the foreign banks in developing countries. Next, an historical introduction of Citibank for becoming a global institution is made, and the bank’s historical presence in Turkish market is studied as well. Following to that the experience of Citibank in Turkey is examined by using ratio analysis tools with the goal of analyzing some patterns related with liquidity, credit quality, profitability, and capital adequacy levels. At the same time, a performance comparison among Citibank in Turkey and other banks in the country is assessed in that section. The final section offers discussion on not only the research findings, but also the bank’s announced global performance, and their managerial and theoretical implications with concluding remarks.

CHAPTER 2

2 LITERATURE REVIEW

In this chapter, the literature related to the foreign bank entry is reviewed. The theories related to the multinational banking, the effects of foreign bank entry on the economy of the host country and the performance of the foreign bank in the new country are examined. The study especially focuses on the foreign banks in developing countries.

2.1 Multinational Banking

2.1.1 Theoretical Approaches of Multinational Banking

In order to capture the different patterns of the development in multinational banking, the sources of advantages for a bank have to be adequately explained. These advantages enable the foreign bank to compete against the local ones, as well as the reason for choosing overseas market instead of or in addition to domestic one. Therefore, the following section would try to answer the question why banks become multinational.

Despite the growth of multinational activities of banks in the last decades, the issue why banks become multinational has received surprisingly little theoretical attention in the literature (Lehner and Schnitzer, 2008). It is the general belief that the theories of multinational banking are extensions or simple applications of varied theoretical approaches of foreign direct investment (FDI) (Kim, 1989). Following theories, which are suggested to explain the reasons behind FDI, are also adopted by multinational banking framework (Kim 1989, p.20-21):

1. Comparative advantage hypotheses based on the traditional trade theories
2. Portfolio diversification hypotheses
3. Market imperfections hypotheses
4. Market failure hypotheses
5. The eclectic theory of multinational banking

Comparative advantage hypotheses

Aliber (1976) argues that some countries' banks have comparative advantages in specific banking products (as cited in Kim, 1989). Then, those advantageous banks serve countries in which those specific banking products needed. Therefore, Aliber, (1976) confers differences in loan-deposit spreads across countries would be eliminated by free trade in banking activities. This reveals also that according to Aliber (1976), spread on margins between borrowing and lending rates among countries is one of the main sources of multinational banking. However, the theory does not provide the sources of these comparative advantages of banks (Cho, 1985).

Portfolio diversification theory

In explaining FDI, Rugman (1979) hypothesizes the risk diversification for a firm that earnings are an increasing function of foreign operations, and the variance of the earnings is inversely related to foreign operations (as cited in Kim,1989). For instance, the stability of a firm's earnings increases in response to an increase in asset diversification on an international scale. On the other hand, Fieleke, (1977) tested multinational diversification role in U.S. banks' earning performances variability. However, the findings did not provide evidence for multinationalization motive based on risk diversification. Hence, Kim's (1989), statement that there is no necessity of transferring physical presence of the bank to foreign countries in order to diversify portfolio risk of a bank also supports Fieleke (1977) findings.

Market imperfection hypothesis

Market imperfection hypothesis assumes that due to different forms of imperfections, which might be government imposed distortions or market structure imperfections, bank-specific or location-specific advantages is provided for foreign banks in order to outcompete their domestic counterparts in their own markets (Kim, 1989). Moreover, Giddy (1983) assumes that the market imperfections and government interventions have effect in determining the extent of the multinational banking. On the other hand, Kim (1989) argues that an attempt to describe multinational banking based on typical market imperfection assumptions would be a limited one, since all facets of multinational banking and its advantages combined with other resources could not be covered.

Market failure hypothesis

Rugman (1979) applies theory of market failure approach to multinational banking. According to the study, both the scope and degree of market failures are often more in the international financial markets. Therefore, ownership advantages of multinational banks like technology, knowledge management, and managerial expertise might be useful for handling market imperfections. As a result, multinational banks could hope to gain more advantage with respect to the domestic ones, "...since internalization benefits in international financial markets are likely to be larger than those of domestic markets." (Kim 1989, p.27). Although Rugman (1979) contributed to explain why a bank decides to maintain physical presence in foreign countries, it fails to specify the nature of ownership specific advantages (as cited in Kim, 1989).

Moreover, Williams (1997) draws attention to the uniqueness of the bank customer relationships. He states that for internalization market imperfection is a necessary condition, so knowledge advantage becomes a *public good*. Thus, he suggests that banks could enjoy benefits by using market knowledge about clients at a low marginal cost in the internal markets. Consequently, the application of market failure hypothesis to banking could be classified as the defensive approach of banks.

Eclectic theory

Dunning's eclectic theory, which relies on the belief that ownership, location, and internalization advantages are the three conditions required by multinationality, is one of the most general theoretical frameworks of firms' internationalization (Uiboupin and Sorg, 2006).

The theory, based on the given required conditions, attempts to answer the questions: (1) Why firms decide to start investing abroad, (2) What the preconditions or firm-specific advantages are, and (3) Where they invest. At that point, it is important to point that ownership and location advantages alone are not sufficient for FDI, so internalization should be there (Uiboupin and Sorg, 2006). On the other hand, Williams (1997) suggests that ownership advantages in eclectic framework are vital for multinational banks in order to cope with domestic banks' historical advantages.

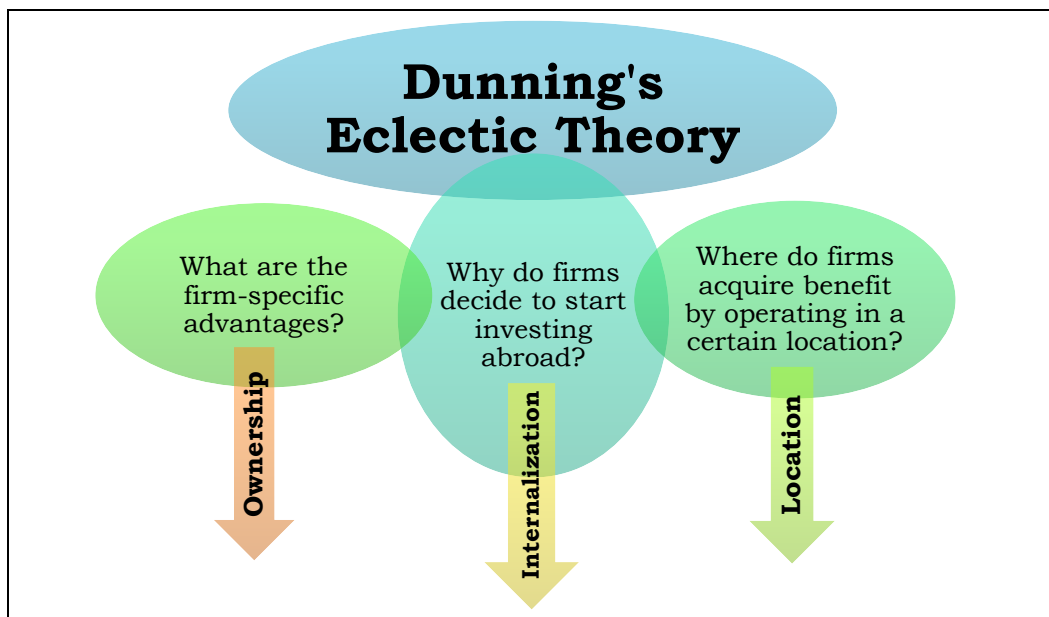


Figure 1: Structure of Dunning' Eclectic Theory

The eclectic theory of FDI as applied to multinational banking offers a useful analytical structure to explain diverse patterns of multinational banking activities (Cho, 1985).

Applying Dunning's eclectic theory of foreign direct investment to multinational banking, Gray and Gray (1981) note that imperfections in product markets in banking sector create barriers to entry. However, multinational banks can benefit from those by applying product differentiation and serving in segmented markets, like non-financial firms. Nevertheless, it is important to note that creating differentiated products are enormously challenging in the banking sector because of easiness of imitation. Moreover, their work suggests that multinational banks have cost advantage since the banks use their own global network rather than correspondent relationships¹. Another significant point that they stress is multinational banks operating in a number of different markets can also use improved networks of market information and commercial intelligence.

Building upon the initial attempt by Gray and Gray (1981) to apply the eclectic theory of FDI to multinational banking, Yannopoulos (1983) further specifies the advantages in details; for instance, following the client, both home and host country's regulations, and restrictions are identified as location specific advantages. Moreover, ownership advantages could be easy access to *vehicle currency* and internalization advantages could be informational advantages and access to local deposit bases (Uiboupin and Sorg, 2006).

There are also some critiques to Dunning's eclectic theory. First, Itaki (1991) debates that there is no need to state ownership advantages in order to explain international activities of multinational firms as they are already captured in internalization theory. Another criticism to eclectic theory comes from Williams (1997), who stresses inadequate

¹ A correspondent banking relationship involves a correspondent bank, which performs as a point of contact for another in a country or state where a second bank [respondent bank] does not have a branch or agency (Osterberg and Thomson, 1991).

connection between variables described in the theory. Besides, Williams (1997) declares that internalization alone is enough to cover ownership advantages.

After explaining the theories of multinational banking, the review comes to host country effects of the entry.

2.1.2 Entry of Multinational Banks and Their Impact on Host Countries

The literature is ample with country specific studies on financial liberalization and foreign bank entry experience to support or refute these multinational banking theories. Bhattacharya (1993) looks at the topic by providing specific cases in Turkey as well as Pakistan, and Korea. According to his findings for funding of domestic projects, foreign banks have been influential to attract external capital. In addition, McFadden (1994) suggests domestic bank operations have been improved by foreign bank entry in Australia. He and Gray (2001) contribute the literature by adducing some evidence from China. According to their research, allowing foreign multinational banks to establish subsidiaries in a developing country improves the country's economic growth and development. In a broader perspective, they found evidence that the host country becomes more attractive for FDI, since multinational banks contribute to the range and the quality of financial services available to non-financial multinational firms.

Besides, Claessens, Demirguc-Kunt, and Huizinga (1998), investigate how foreign bank presence affected the domestic banking markets in 80 developed and developing countries by using bank level accounting and macroeconomic data for the 1988-1995 period. Their findings support beneficial effects of foreign bank entry and provide that foreign bank

entry improves the functioning of domestic banking sector. For instance, foreign banks entry leads domestic banks to cut costs as they gain knowledge of new banking practices. However, the findings also provide empirical evidence that in developing countries foreign banks have higher interest rate margins, profitability, and tax payments than local banks. On the other hand, in developed countries, the findings imply opposite. Moreover, they find that a large foreign bank presence leads to decrease in domestic bank profitability, and a high provisioning for bad loans by domestic banks.

Apart from quantitative effects of the foreign bank entry, several authors have addressed the potential qualitative benefits for the domestic sector (Levine, 1996; Walter and Gray, 1983; and Gelb and Sagari, 1990). Levine, (1996) draws attention to that foreign bank entry is likely to offer more sophisticated services for customers in specific market niches. He adds that foreign entry would be beneficial for host country since it leads to improve competition, financial skills, and technology. Furthermore, he argues that the supervisory and legal infrastructure in the host country will strengthen with the foreign bank entry. Besides, he explains high foreign bank presence as a consequence of low banking costs and low non-interest income of domestic banks. This view is also supported by Pehlivan and Kirkpatrick (1992). Thus, they emphasize that foreign bank entry during the 1980-1990 period, contributes to the quality of domestic bank management in planning, recruitment, credit evaluation, and marketing.

To date, the evidence on advantages and disadvantages of the foreign bank entries for the host country is still inconclusive (Bonin, Mizsei, Székely, and Wachtel, 1998; and Dages, Goldberg, and Kinney, 2000). According to Anderson and Chantal (1998), fear of foreign control over credits, and regulatory supervision are two of the main arguments against foreign bank entries. Besides, they present that foreign banks may have different objectives rather than serving host countries consumers; for instance, promoting export from home country. Hellman,

Murdock, and Stiglitz (2000) state that foreign bank entry leads to decrease franchise value of the domestic banks due to having more incentive to take risks. The World Bank report on global development finance (2002) specifies another drawback of foreign bank entry. Foreign banks attract the most profitable portion of domestic market, so riskier or opaque sectors would be served by domestic counterparts. Further, changing lending patterns in the host country because of different focus and leading increase of financial instability by drawing out of host countries are other costs of foreign bank entry specified by The World Bank report (2002). At point in mind, it would be beneficial to focus on studies that deal with lending patterns of multinational banks.

Lending by multinational bank subsidiaries

The literature of multinational banking broadly focuses on lending behavior of foreign banks in a host country. Dages, Goldberg, and Kinney (2000) notice that lending growth of foreign banks is stronger and less volatile than domestic ones. Furthermore, their findings suggest that during the crises periods the foreign ownership increases the stability of the system in the host country. Mathieson and Roldos (2001) provide support for Dages, Goldberg, and Kinney (2000) by presenting evidence that due to large international parent banks which have diversified portfolios, foreign banks not only are able to provide more stable source of credit, but also have better access to global financial markets. Moreover, Ashcraft (2004) improves on this work and reveals that during a local financial turmoil, due to capital injections by the parent company, multinational bank subsidiaries are less likely to experience a financial distress and recover more quickly.

de Haas and van Lelyveld (2009, p.20) describe characteristics of financially strong parent banks as having "...high net interest margins

or low loan loss provisioning to net interest revenue...”. More to the point, they state that because of financially strong parent banks’ support, multinational bank subsidiaries are not only able to expand their lending faster, but also they do not need to restrict their credit supply during a financial crisis, while domestic banks need to do so. According to the research, keeping less liquid assets on the balance sheet helps to subsidiaries of parent banks to grow faster as well. Lastly, their findings indicate a positive influence of subsidiary lending when other subsidiaries within a same banking group are relatively profitable. Hence, with the help of internal allocation of capital, the subsidiaries are better at managing their lending growth compared to domestic banks. As a result, de Haas and van Lelyveld, (2009) state that on the contrary to *cut and run* act during a financial crisis, multi-bank holding company subsidiaries provide a stable source of credit.

Weller (2000) provides another interesting research which shows that as the number of foreign banks increases in the Polish banking sector, credit supply of the domestic banks decreases. According to the research, increased competition may lead to less access to capital and if the domestic banks do not decrease lending then they may face a high possibility of bank failure. Therefore, in order to decrease the risk of failure, domestic banks reduce their credit exposure when foreign banks enter in Polish banking sector during the early transition period. Furthermore, as cited by de Haas and van Lelyveld (2009), loans provided by multinational banks tends to transmit home country financial turmoil (Peek and Rosengren, 1997, 2000a; van Rijckeghem and Weder, 2000) but to dampen host country financial turmoil (Peek and Rosengren, 2000b; de Haas and van Lelyveld, 2006). In addition, home country business cycle has also influence on multinational bank lending (Peria, Powell, and Hollar, 2002).

FDI and 'follow the customer'

The literature on multinational banking points the significance of the *follow the customer* strategy. One of the main advantages enjoyed by multinational banks is information about their customers (Esperanca and Gulamhussen, 2001). Banks internationally expand their operations by following their home country customers to provide banking services to them in a foreign country. As described by Magri, Mori and Rossi (2005), the classical hypothesis (Aliber, 1984) is that “banks follow their customers abroad (follower relationship), being afraid of losing them once they have established relationships with banks operating in foreign countries, defensive expansion” (Grubel, 1977, p.1296). In other words, following corporate customers to the foreign country and opening a branch to service these home country corporate customers (Grubel, 1977; Gray and Gray, 1981; Kindleberger, 1983) makes possible a bank to retain information on its customers. By this way, multinational banks preserve customer relations by holding special knowledge of their customers' needs. Previous empirical studies have extensively tested the 'follow the corporate customer' hypothesis (Fieleke, 1977; Khoury, 1979; Goldberg and Saunders, 1981; Ball and Tschoegl, 1982; Nigh, Cho, and Krishan, 1986; Sabi, 1988; Goldberg and Johnson, 1990; Grosse and Goldberg, 1991; Sagari, 1992; Brealey and Kaplanis, 1996; Yamori, 1998; Miller and Arvind, 1998). In general, the results of these studies suggest that the hypothesis holds. Moreover, Esperanca and Gulamhussen (2001) in their research states monopolistic advantages of multinational expansion that provides banks a privileged opportunity to follow their customers abroad. Besides, the reputation of the bank among the domestic customers enhances these monopolistic advantages (Esperanca and Gulamhussen, 2001) of multinational banks as well. While most of the studies on multinational banking confirm the follower relationship hypothesis, Williams (1996) found no evidence of following clients, affecting Japanese bank profits in

Australia. Therefore, other factors like local market opportunities besides economic integration among countries needs deeper investigation for bank internalization (Focarelli and Pozzolo, 2001).

CHAPTER 3

3 FOREIGN BANKS IN DEVELOPING COUNTRIES

Foreign bank entry is described as setting up operations in a host country by either opening up a branch or a subsidiary by Clarke, Cull, D' Amato, and Molinari, (1999). Although between 1920 and 1980 several countries restricted foreign bank entry, today the movements toward the globalization and in an extent removal of trade barriers, since the early 1990s (Eichengreen and Mussa, 1998) have increased the foreign bank entry, especially in developing countries.

According to The World Bank report on global development finance (2008), the evolution of today's international banking industry is characterized by three distinct waves in the post-World War II era. The first wave was initiated in the late 1950s and early 1960s when the Eurocurrency market established and motivated by restrictions and capital controls on international transactions in the United States and Western Europe. As a result, because of tight control on capital flows, national banks preferred to set up offices abroad to serve for the overseas businesses of their clients.

In the 1980s, Japanese government initiated the second phase with the aim of increasing international role of *Yen*, along with opening its markets to international players. Moreover, the expansion of currency

and interest rate derivatives markets as well as growth of syndicated bank lending corresponded with the second phase. Thus, these developments facilitated banks' geographical expansion in order to reach both funding and lending activities.

The World Bank report (2008) describes the third wave securitization of credit. It was facilitated by growth in credit derivatives market and developments in the market for asset-backed structured financial products like collateralized debt obligations, which resulted in shift in oversight responsibility from official agencies to the private marketplace. Accordingly, cross-border mergers and acquisitions over the past decade resulted in a sizeable consolidation of the international banking industry. As Figure 2 below demonstrates, as of 2007 the 19 percent of the industry's assets were held by top 10 banks, and 75 percent accounted for the top 100 banks. These rates are higher than the corresponding values in 1996 13 and 59 percent respectively.

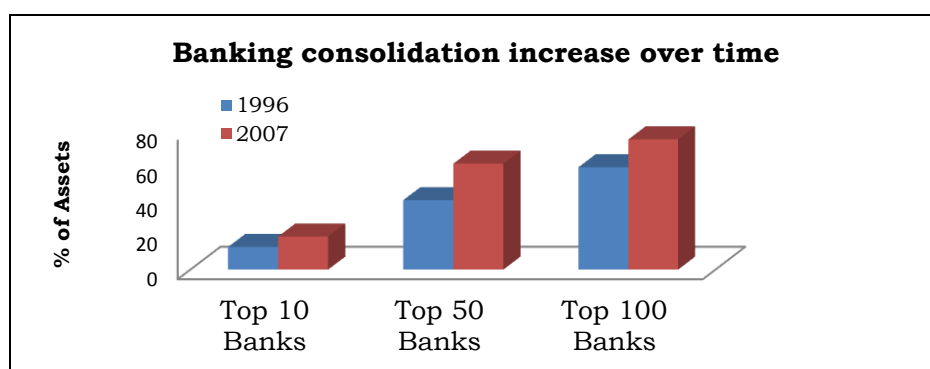


Figure 2: Banking consolidation around the world

Source: The World Bank staff calculations based on The Banker database- (The World Bank, 2008, p.85)

In accordance with the report of Bank for International Settlements (BIS) (2004), consolidation has led to facilitate international banking activities at a very fast rate over the past decade. That also represents an enlargement in world trade; thus, the rise of multinational firms, financial innovation, and technological change and the integration of transition economies into global banking system.

Today, foreign banks play a significant role for shaping the economic renovation and banking level competition in many developing countries. The World Bank (2008) explains the importance of foreign banks through the interaction of three sets of structural factors:

1. *Integration of developing countries into the world economy* raises demand for international banking services as a result of increase in trade and foreign direct investment (FDI) flows
2. *Technological advances* allows to better decision making, control operations, and standardize processes across the globe in an integrated way
3. *Regulatory reforms* in both developed and developing countries allow banks based in one country to invest and operate in the banking sectors of other countries

Foreign banks have operated in developing countries for decades. However, foreign ownership in banking industries of emerging markets have expanded rapidly since the second half of the 1990s driven by technological advances, easing regulatory constraints, and global economic integration (Mathieson and Roldos, 2001; and The World Bank, 2008). The transition countries of Central Europe and Latin America have been quickest to allow foreign entry in banking sector. For example, in Argentina, Chile, the Czech Republic, Hungary, and Poland, foreign controlled banks hold over fifty percent of total banking assets (Clarke, Cull, D'Amato, and Molinari, 1999). In Asia, Africa, the Middle

East, and the Former Soviet Union, progress has been much more modest. Table 1 below explains share of banking assets held by foreign banks with majority ownership. As Table 1 shows, Nigeria, and South Africa have minimal or no foreign bank participation with majority foreign ownership stake in Africa. On the other hand, in Latin America, Peru, and Mexico which are large economies that have foreign presence of 95 and 82 percent of the banking sector, whereas in small economies such as Guatemala and Ecuador, foreign share is 8 and 5 percent, respectively. Within Europe and Asia, foreign banking presence is low in the two largest regional economies-Russia and Turkey- but extensive in most other countries such as Croatia, Bosnia-Herzegovina and Poland.

Table 1: Share of banking assets held by foreign banks with majority ownership

Country	0 %– 10 %	Country	10 % – 30 %	Country	30 % – 50 %	Country	50 % – 70 %	Country	70% – 100 %
Algeria	9	Moldova	30	Senegal	48	Rwanda	70	Madagascar	100
Nepal	9	Honduras	29	Congo, Dem. Rep. of	47	Côte d'Ivoire	66	Mozambique	100
Guatemala	8	Ukraine	28	Uruguay	44	Tanzania	66	Swaziland	100
Thailand	5	Indonesia	28	Panama	42	Ghana	65	Peru	95
India	5	Cambodia	27	Kenya	41	Burkina Faso	65	Hungary	94
Ecuador	5	Argentina	25	Benin	40	Serbia and Montenegro	65	Albania	93
Azerbaijan	5	Brazil	25	Bolivia	38	Cameroon	63	Lithuania	92
Mauritania	5	Kazakhstan	24	Mauritius	37	Romania	60	Croatia	91
Nigeria	5	Pakistan	23	Burundi	36	Niger	59	Bosnia- Herzegovina	90
Turkey	4	Costa Rica	22	Seychelles	36	Mali	57	Mexico	82
Uzbekistan	1	Malawi	22	Lebanon	34	Angola	53	Macedonia	80
Philippines	1	Tunisia	22	Nicaragua	34	Latvia	52	Uganda	80
South Africa	0	Mongolia	22	Chile	32	Jamaica	51	El Salvador	78
China	0	Sudan	20	Venezuela, R. B. de	32	Zimbabwe	51	Zambia	77
Vietnam	0	Morocco	18	Georgia	32	Namibia	50	Botswana	77
Iran, Islamic Rep. Of	0	Colombia	18	Armenia	31			Kyrgyzstan	75
Yemen, Rep. Of	0	Malaysia	16					Poland	73
Bangladesh	0	Jordan	14					Paraguay	72
Sri Lanka	0	Russian Federation	13					Bulgaria	71
Ethiopia	0	Egypt, Arab Rep. of	12						
Togo	0								

Source: The World Bank staff estimates based on data from Bankscope, The World Bank Report (2008, p.87).

Note: A bank is defined as foreign owned only if 50 percent or more of its shares in a given year are held directly by foreign nationals. Once foreign ownership is determined, the source country is identified as the country of nationality of the largest foreign shareholder(s). The table does not capture the assets of the foreign banks with minority foreign ownership (The World Bank Report, 2008, p.87).

3.1 Economic Liberalization and Foreign Banks in Turkey

Turkish financial market has been highly regulated until the 1980s. In the early 1980s, with the launch of the financial liberalization program the Turkish financial system experienced legal and structural changes. The main objectives of the domestic market liberalization were elimination of governmental control on interest rates by increasing the role of market forces as well as increasing competition and efficiency in the sector by decreasing entry barriers to draw new banks into the domestic market (Bayraktar and Yan, 2004). In this context, government debt instruments started to be auctioned in 1985.

Following, in order to provide liquidity in the financial system, Istanbul Stock Exchange (ISE) was established in 1986. In the same year, with the purpose of allowing the banks in the market to lend and borrow from each other, Interbank Money Market was established. Another financial reform was introduced in 1987 with the start of auditing of banks by independent external auditors as well as adaptation of unified accounting principles and standard reporting system by the banks.

Following the liberalization of the financial system, bank's portfolios started to include mutual funds, interest and currency rate forwards and swaps, trading in government and private securities, repurchase transactions and consumer credits (Isik and Hassan, 2003). Due to the liberalization process and changes in the regulations, today Turkish financial system is more liberal than before the 1980s (Atiyas and Ersel, 1994; Zaim, 1995; Denizer, 1997).

Domestic market liberalization was followed by entry of foreign banks in the Turkish banking sector. In 1980, there were 42 banks in the sector and only four of them were foreign (Denizer, 2000). During 1980-1997 period, as a result of embraced financial globalization, there was a

significant number of entries into the sector, 19 foreign banks as well as a number of new domestic banks entered the Turkish banking system (Denizer, 2000). Thus, by 1990 there were 23 foreign banks. However, due to the foreign banks merging with the Turkish banks the number then declined to 17 in 1996 (Denizer, 2000).

Despite the remarkable number of entries by foreign banks, banking sector was in turmoil during 1990s. The most notable crises, including bank insolvencies, in the Turkish financial market, occurred in the following order: the Turkish financial depression in 1994, the Asian financial crisis 1997, the Turkish liquidity crises in November 2000 and later currency crisis in February 2001 (Algüner, Çabukel, and Oğuz, 2007). Despite the consequences of the financial liberalization activities, all these crises forced unstable macroeconomic situation in Turkey. Interestingly, however, the entry of foreign banks into the sector increased over the years.

According to statistics of the Banks Association of Turkey (BAT), the total number of banks in the sector reached to 46 in 2007. By the end of 2007, there were 18 foreign banks in Turkey. The presence of foreign banks has not increased only by numbers, but also by foreign banks' asset shares in the sector (Bumin, 2007). Even though literature extensively analyzing the foreign participation effects on bank efficiency, stability, and access to small business finance in developed countries, a few studies conducted for developing markets. Studies that thoroughly examine the effects by concentrating on Turkey with selected bank cases are scarce.

CHAPTER 4

4 THE CASE OF CITIBANK

Over the past decades, numerous U.S. banks entered different financial markets around the world. That is why literature of multinational banking intensely deals with the issue and its effects to home and host countries. Since the research is interested in the case of Citibank's entry to Turkish financial sector, this section reviews the Citibank in Turkey. However, for the state of coherence first Citibank Global Inc. would be assessed with a literature review of U.S. banks participation into multinational markets participate.

According to Brimmer and Dahl (1975), one of the main reasons behind the increasing number of U.S. banks expansion into different markets is the banks' desire to finance their customers, especially U.S. multinational companies. Besides, the study suggests ratification and remove of restriction on U.S. capital flows in 1965 and 1974, respectively as an explanation of growing figure of U.S. banks in abroad.

In a same manner, Fieleke (1977) also examines the reason of U.S. overseas banking expansion. Interestingly, his findings suggest no conclusive results for local GNP volume of trade, and the rate of return on branch assets; however, the cross-section regression analysis reveals that U.S. foreign direct investments have a major influence on U.S. banks' entry into different countries.

Banking plays a central role in an economy, and Citibank² has played a leading role in banking since it was founded in 1812 with 22 employees. Then, it emerged in the 1890s as the largest bank in the United States (Cleveland and Huertas, 1985). By effectively responding to the constantly changing external environment, the bank is one of the few institutions that have survived since 1812, while steadily building and maintaining a leadership position at global banking sector. To remain successful, the bank had to establish such a strategy that supports responding to both problems and opportunities experienced. Hence, Citibank's strategy is described as follows:

...[focusing on] to gain market share in selected priority emerging market countries and to establish Citibank as a local bank as well as a leading international bank. Citibank typically enters a country to serve global customers, providing them with cash management, trade services, short-term loans and foreign-exchange services. Then, Citibank offers project finance, fixed-income issuance and trading and, later, introduces securities custody, loan syndications and derivatives services. Finally, as a brand image is established and services for locally headquartered companies become significant, consumer banking services may be offered.(Citigroup Inc., 2002, p.31)

As parallel to its strategy, the bank has a long-standing presence in North America, Western Europe, and Japan in addition to emerging markets (Appendix Table A1). Its *Emerging Markets Corporate Banking* and *Global Transaction Services* business offers a wide array of banking

² "The original name at the time of the 1812 incorporation was the *Citi Bank of New York*. It became *The National City Bank of New York* when the bank joining the national banking system in 1865. *First* was added to the name in 1955 [...] the bank took over [and the name became] *The First National Bank of the City of New York*. In 1962 the name was changed to *First National City Bank*, the words *The* and *of New York* being dropped. In 1968, the bank became a subsidiary of the newly formed one-bank holding company *First National City Corporation*, and in 1974, the holding company's name was changed to Citicorp. Two years later the bank's name was changed to Citibank N.A." (Cleveland and Huertas, 1985, p. x). In the following pages, we have (mostly) referred to the bank by the name *Citibank*.

and financial services products and services that help multinational and local companies to fulfill their financial goals or needs (Citigroup Inc., 2002, 2003, 2004, 2005, 2006, 2007, 2008).

Today, Citibank is a subsidiary of a global diversified financial services holding company, Citigroup Inc., (hereafter CITIGROUP), whose businesses provide a broad range of financial services to consumer and corporate customers. According to financial information provided by CITIGROUP's 2007 annual report on form 10-K format, it has more than 200 million customer accounts and does business in more than 100 countries (Citigroup Inc., 2008).

4.1 History of Being Global

During the first seventy years, the bank has mainly provided commercial banking services, such as short-term loans and demand deposits to a small group of New York City merchants. However, its executives over the years respond changes in a way that cause the Citibank to be global. Significantly, Frank Vanderlip and James Stillman radically changed Citibank's orientation. The bank global presence is first stepped by Frank Vanderlip. He believed that international branch banking, which would provide corporate customers with banking services abroad, would be a success (Cleveland and Huertas, 1985). Indeed, Cleveland and Huertas (1985) explains Vanderlip's belief about international branch banking by stating that

...Citibank's customers doing business around the world and that large corporations, wanted the bank to finance their foreign inventories and receivables and to provide the money transfer and disbursement services they had

been getting from British overseas banks or from local banks abroad. (Cleveland and Huertas, 1985,. p.77)

Moreover, there were persuasive requests and encouragements coming from customers such as Du Pont and U.S. Steel. For instance, James A. Farrell, president of U.S. Steel offers that the bank expands its international service to include foreign branches. In return, Farrell promises that U.S. Steel would give the bank access to its credit files on foreign customers and make a substantial deposit (Cleveland and Huertas, 1985). Further, growing trade between the United States and South America would eventually provide the basis for profitable branch banking there and Buenos Aires branch is opened in 1914 (Cleveland and Huertas, 1985). Although the immediate aim is to strengthen the bank's relations with corporate customers, Vanderlip reveals to a friend:

I do not expect much profit out of it. Indeed, I shall not be surprised if there is something less than any profit, but I hope to get very considerable return by offering facilities that other banks cannot offer to exporters, and thus attach their accounts to the City Bank. ... (Despite these expectations, the Buenos Aires branch began to earn a profit almost immediately) (Cleveland and Huertas, 1985, p.78-9).

Apart from international branch banking, Vanderlip also sets up a *Foreign Trade Department* in order to supply information to American businesspersons about foreign markets and foreign firms. This attempt is also consistent with Citibank's long-term strategy, which is "...offer[ing] a broad range of financial services to institutions and individuals around the world." (Cleveland and Huertas, 1985, p.302). Cleveland and Huertas, (1985) state that by forming a foreign trade unit, Citibank starts to collect data from its branches concerning the demand

for American products and the credit-worthiness of the American firm's prospective trade partners.

Cleveland and Huertas, (1985) also describes Citibank as an *engine of war finance* during the 1940s or the years of the *Second World War* because the bank helped Treasury to sell bills and bonds at this time. It is important to note that even though Citibank is a private company; its actions are parallel to its home country trade figures. Therefore, with increasing foreign trade volume American direct foreign investment and deployment of the U.S. multinationals, the branching explosion has increased as well in the 1960s (Table 2 and Table 3).

Table 2: U.S. export volume

<i>Millions of dollars</i>	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969
Exports of goods and services and income receipts	30,556	31,402	33,340	35,776	40,165	42,722	46,454	49,353	54,911	60,132
<i>Exports of goods and services</i>	25,940	26,403	27,722	29,620	33,341	35,285	38,926	41,333	45,543	49,220
	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979
	68,387	72,384	81,986	113,050	148,484	157,936	172,090	184,655	220,516	287,965
	56,640	59,677	67,222	91,242	120,897	132,585	142,716	152,301	178,428	224,131
	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
	344,440	380,928	366,983	356,106	399,913	387,612	407,098	457,053	567,862	648,290
	271,834	294,398	275,236	266,106	291,094	289,070	310,033	348,869	431,149	487,003
	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
	706,975	727,557	750,648	778,921	869,775	1,004,631	1,077,731	1,191,257	1,194,993	1,259,809
	535,233	578,343	616,883	642,863	703,254	794,387	851,602	934,453	933,174	965,884
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009/p*
	1,421,515	1,295,692	1,258,411	1,340,647	1,572,971	1,816,723	2,133,905	2,462,099	2,591,233	2,115,929
	1,070,597	1,004,895	977,469	1,020,191	1,159,233	1,281,460	1,451,684	1,643,168	1,826,596	1,554,718

Source: Bureau of Economic Analysis, U.S. International Transactions Accounts Data

(*: Data creation date: March 16, 2010)

Table 3: U.S.-owned assets abroad

<i>Millions of dollars</i>	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969
Direct investment	-2,940	-2,653	-2,851	-3,483	-3,760	-5,011	-5,418	-4,805	-5,295	-5,960
	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979
	-7,590	-7,618	-7,747	-11,353	-9,052	-14,244	-11,949	-11,890	-16,056	-25,222
	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
	-19,222	-9,624	18/-4556	-12,528	-16,407	-18,927	-23,995	-35,034	-22,528	-43,447
	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
	-37,183	-37,889	-48,266	-83,951	-80,167	-98,750	-91,885	-104,803	-142,644	-224,934
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009/p*
	-159,212	-142,349	-154,460	-149,564	-316,223	-36,235	-244,922	-398,597	-332,012	-220,972

Source: Bureau of Economic Analysis, U.S. International Transactions Accounts Data

(*: Data creation date: March 16, 2010)

Note: excluding financial derivatives (increase/financial outflow (-))

Moreover, Cleveland and Huertas (1985) indicate that between 1960 and 1970, the value of American direct foreign investment increased from \$21 billion to \$55 billion. In addition, Citibank could strengthen corporate relationships by serving those multinational firms abroad. Walter Wriston, who took command of the Overseas Division in 1959, describes overseas expansion plan as:

The plan in the Overseas Division was first to put a Citibank branch in every commercially important country in the world. The second phase was to begin to tap the local deposit market by putting satellite branches or mini-branches in a country. The third phase was to export retail services and know-how from New York. All of these phases ran concurrently and sometimes overlapped. (Cleveland and Huertas, 1985, p.260)

With this vision in mind, between 1960 and 1967, the bank establishes 85 foreign branches: 54 in Latin America and the Caribbean, 14 in the

Far East, 15 in Europe, and 2 in the Middle East. By the end of 1967, Citibank had 148 direct foreign branches in forty-two countries. In addition, there are 93 offices of bank subsidiaries or affiliates in twenty-one countries (Cleveland and Huertas, 1985). According to financials as cited in Cleveland and Huertas (1985), the Overseas Division's loans, deposits, and profits grow more rapidly than those in the bank's domestic divisions do. From \$970 million in 1960, international loans booked in the bank's foreign branches and affiliates and in New York rose to \$2.7 billion in 1967, which was an annual increase of 16 percent, and the Overseas Division's share of the bank's total loan portfolio rose from 22 percent to 30 percent.

As of the end of 2009, the bank exists in 103 countries with its offices of subsidiaries (Citibank A.S., 2009). The global presence with its competitive advantages such as broad distribution, brand value, and product range combine and generate net income figured below (Figure 3).

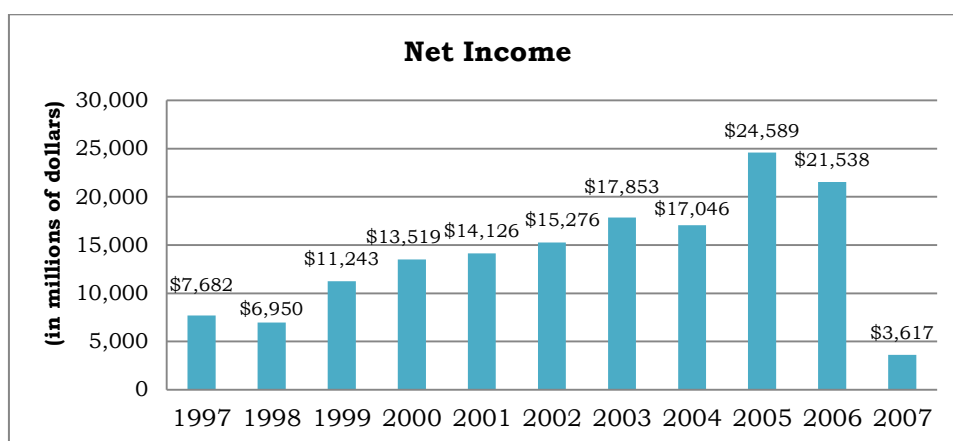


Figure 3: Citigroup Net Income

Source: (Citigroup's 2001-2007 annual reports on form 10-K format, <http://www.citigroup.com/citi/fin/sec.htm>)

Moreover, international banking revenues has vital portion of the total portfolio revenues. For example, 40% of the bank's revenues in 2005 come from outside of the U.S. In addition, the international market for goods and services is more than twice the size of, and is growing at a faster rate than the U.S. market (Citigroup Inc., 2006).

4.2 Citibank in Turkey

Citibank has had correspondent banking relations with Turkey since 1946 by involving in several development projects like motorway financings, power plants, and dams (Citibank A.Ş., 2009). Although the company was interested in Turkey since the World War II, until the opening of a representative office³ in 1975 there was no substantial business (Euromoney Magazine, 1998).

Between the years 1975 and 1977, the high interest rate policy for foreign currency-deposits in Turkey causes Citibank to focus on convertible Turkish Lira deposits (CTLDs). Thus, loans grow rapidly for providing trade finance, which allows Turkey to maintain international trade (Euromoney Magazine, 1998). Just after the start of the liberalization process in financial markets in Turkey, Citibank opens a branch in Istanbul in 1981 with the name Citibank N.A. Besides. Citibank's first General Manager in Turkey, John Bernson, saw the big opportunity that the bank seized: *"I believe that this was the first-foreign-bank license to be approved since 1923."* (Euromoney Magazine, 1998).

³ A representative office is the simplest organizational form of overseas banking, which is designed for helping the parent bank and its customers in their financial and commercial activities.

Following the opening for business in May 1981, the bank especially focuses on the activities, which are underexploited by Turkish banks, such as trade finance and treasury activities. The bank's presence in Turkey is strengthened by launching *Consumer Banking* business in 1996. Thus, the bank benefits from having experience in different markets in terms of technology and management; apparently, until the entry of Citibank, none of the local banks has marketing department in Turkey (Isik, 2007).

As the Turkish financial market grows, Citibank expands its banking services for small and medium sized enterprises and begins to provide *Commercial Banking* business in 1998.

In 2004, the bank, which had presence in Turkey for nearly 30 years, changes its status from Branch to A.Ş. in order to serve the financial needs of the government and corporations. After changing the status, the bank's services expands to include cash management, custody, loans, corporate finance, structured trade, capital markets, and asset-based finance (Citibank A.Ş., 2006). In 2005, EU membership negotiations gained momentum and EU screening process started for Turkey. Additionally, positive economic environment and expectations caused an increase in foreign investments in Turkey. As a result of increased foreign interest in Turkey, a boost in foreign capital inflow to Turkey is observed. In those years, Citibank started to implement a growth strategy in Turkey with the aim of gaining from the opportunities served by positive outlook for the future (Citibank A.Ş., 2006). In 2005 Annual Report, Citibank's regional General Manager Steve Bideshi explains the bank's growth plan in Turkey as:

...increase our market share by growing our branch network and product range. We will enhance current relationships with corporate and SMEs and launch innovative products for treasury, investment banking, commercial and corporate finance. (Citibank A.Ş., 2006, p.9)

The strategy of the bank encompasses opening new branches, hiring new employees, and introducing new products and services. At the beginning of the 2005, the first year of new strategy, Citibank A.Ş. (from now on CITI-TR) doubled its branch network by opening 30 new branches, and increased the number of employees by more than 45%. Parallel to growths in employee and branch numbers, increase in *Consumer Banking* growth in 2005 confirms that the bank was well positioned to benefit from the changes in the market. The 2005 Annual Report shows that CITI-TR acquired 170,000 new customers; and customer assets grew by 115% for personal loans and 31% for cards while the customer liabilities grew by 100%. Citibank's Consumer Business Manager Michael Miebach enlightened the banks growth strategy in his 2005 Annual Report assessment by the words: "...expansion of our distribution network in terms of branches as well as remote channel" (Citibank A.Ş., 2006, p.10).

By 2006, Citibank's global strategy, entering many different markets across the world with the help of acquisitions displayed itself in Turkey. The bank's parent CITIGROUP announced its planned purchase of a 20% equity interest of a local bank (Akbank) in order to form strategic partnership with a strong local bank. Akbank, the second-largest privately owned bank by assets in Turkey, is a premier, full-service retail, commercial, corporate and private bank whose approximately worth is \$3.1 billion (Citigroup Inc., 2007). CITIGROUP completed its purchase in 2007. In order to begin offering equities services in Turkey, *Opus Menkul Değerler A.Ş.*, which became *Citi Menkul Değerler A.Ş.*, was also acquired in the same year of strategic partnership with Akbank (Citibank A.Ş., 2009).

CHAPTER 5

5 DATA AND METHODOLOGY

5.1 Case Study Analysis

Although foreign banks' participations in emerging markets have been extensively studied, the research on the application of corporate performance and practices in the host country that a foreign bank operates is limited. Hence, a single detailed case employing a viable methodology can play a significant role in confirming or challenging theories in this area (Yin, 1994, Bryman, 1988). Furthermore, case studies not only emphasize detailed analysis of events or conditions, but also the relations among them. In more detail, Soy (1997, para. 1) states, "*case study research excels at bringing us to an understanding of a complex issue or object and can extend experience or add strength to what is already known through previous research.*" Therefore, we combine Yin's (1994) case study methodology that is used to contribute to the development of theories and generate practice-oriented implications for managers with ratio analysis (see Table 4).

Table 4: Processes of case study and its application into this study

Steps of Yin's case study methodology	Related process of the case
Research questions determination	The research questions formed in relation to general field of the study: foreign bank entry into emerging markets and the implication of this action to those banks while contributing the science addressing a gap. In addition, <i>why</i> and <i>how</i> question forms used in order to determine the study's inquires.
Case selection and decision on data gathering and analyzing techniques	Specifically, a single Citibank case in Turkey is selected in order to study foreign bank behaviors in an emerging market. Later, we decided to use ratio analysis tools that help to study a case in a more quantitative manner. Nevertheless, establishing external and internal validity is significant, so multiple pieces of sources and evidences comprehensively presented through the study.
Prepare to collect the data	Data gathering techniques largely include documentation reviews such as newspaper, literature works, financial reports, governmental reports, and non-profit organization reports. The data are categorized with respect to its expected contribution to study such as qualitative or quantitative.
Collect data in the field	Data employed are publicly available in the form of annual reports, financial statements, 10K reports, and other news items.
Analyzing and evaluating the data	Many interpretations are examined to find linkages between research questions. We use ratio analysis findings to corroborate and extend the empirical field experience.
Report preparation	This research composes the findings and represents them to the audience group.

Source: Our illustration

As a result, this study provides descriptive and exploratory analysis of a bank's performance by focusing on entry into the Turkish banking sector with a specific case analysis. Therefore, the changes in the strategies of Citibank during the period of 1981-2007 will be examined.

5.2 Ratio Analysis

Financial performance of banks is usually assessed via two approaches: production approach and intermediation approach. The production approach mostly focuses on variables like number of branches, personnel, deposits accounts, transactions, which can be utilized to assess operational efficiency. On the other hand, the intermediation approach looks at deposits, loans, interest income or expenses, and securities portfolio, which reflect financial intermediation function of a bank. Nevertheless, there is no globally accepted methodology for measuring bank performance (Mercan, Reisman, Yolalan, and Emel, 2003). Several studies utilized financial ratios to determine the efficiency and performance of banks. Among these ratios are: the net interest margin, the ratio of non-interest income to total assets, the share of before tax profit in total assets, the ratio of overhead costs to total assets, net interest margin, deposit growth and loan growth and the ratio of loan loss reserves to total assets (Ross, 1977; Aydoğan, 1990; Aydoğan and Booth, 1996; Claessens, Demirguc-Kunt, and Huizinga, 1998; Denizer, 2000; Bayraktar and Yan, 2004; Detragiache and Gupta, 2006; Micco, Panizza, and Yanez, 2007; Brissimis, Delis, and Papanikolaou, 2008; Altunbaş and Marques, 2008 among others).

Hence, in order to measure the financial performance of CITI-TR we follow the financial intermediation approach and utilize widely used bank-performance measures. Moreover, additional financial ratios are derived in order to assess different compositions for the intermediation function of the bank. Table 5 presents the ratios used in the study.

Furthermore, some of the key elements of production approach such as number of branches and personnel are also used for our discussion in order to create linkages between the real life case and the findings of ratio analysis.

Table 5: Ratios Utilized

Liquidity Related Ratios	
Liquid Assets to Total Assets	$(\text{Cash and Balances with The Central Bank of Turkey} + \text{Banks and Other Financial Institutions} + \text{Money Market Securities} + \text{Reserve Deposits} + \text{Investment Securities Available for Sale (Net)} + \text{Trading Securities (Net)}) / \text{Assets}$
Banks to Total Assets	$\text{Banks and Other Financial Institutions} / \text{Assets}$
Total Loans to Total Assets	$\text{Loans} / \text{Assets}$
Securities to Total Assets	$(\text{Investment Securities Available for Sale (Net)} + \text{Trading Securities (Net)}) / \text{Assets}$
Credit Quality Ratios	
Total Loans to Total Deposits	$\text{Loans} / \text{Deposits}$
Loan Loss Provisions to Total Assets	$\text{Specific Provisions} / \text{Assets}$
Non-performing Loans to Total Assets	$\text{Loans under close watch} / \text{Assets}$
Loan Loss Provisions to Total Loans	$\text{Specific Provisions} / \text{Loans}$
Non-performing Loans to Total Loans	$\text{Loans under close watch} / \text{Loans}$
Contingencies and Commitments to Total Assets	$(\text{Contingencies} + \text{Commitments}) / \text{Total Assets}$
Loan Loss Provisions to Net Interest Income	$\text{Loan Loss Provisions} / \text{Net Interest Income}$
Profitability Ratios	
Net Income to Total Assets	$\text{Net Profits or Losses} / \text{Assets}$
Efficiency: Non-interest Expense to Net Interest Income plus Non-interest Income	$(\text{Fees and Commissions Paid} + \text{Provision for Loan Losses or Other Receivables} + \text{Other Operating Expenses} + \text{Provision for Taxes on Income}) / (\text{Net Interest Income} + \text{Fees and Commissions Received} + \text{Net Trading Income} + \text{Dividend Income} + \text{Other Operating Income})$
Net Interest Income to Total Loans	$\text{Net Interest Income} / (\text{Short-term Loans} + \text{Medium and Long-term Loans})$
Spread: Interest Income to Earning Assets minus-Interest Expense to Interest Bearing Liabilities	$(\text{Interest Income} / (\text{Cash and Balances with The Central Bank of Turkey} + \text{Banks and Other Financial Institutions} + \text{Money Market Securities} + \text{Trading Securities (Net)})) - (\text{Interest Expense} / (\text{Deposits} + \text{Derivative Financial Liabilities Held For Trading} + \text{Funds Borrowed} + \text{Interbank Money Market} + \text{Marketable Securities Issued (Net)}))$
Burden: Non-interest Expense minus Non-interest Income to Total Assets	$((\text{Fees and Commissions Paid} + \text{Provision for Loan Losses or Other Receivables} + \text{Other Operating Expenses} + \text{Provision for Taxes on Income}) - (\text{Fees and Commissions Received} + \text{Net Trading Income} + \text{Dividend Income} + \text{Other Operating Income})) / \text{Assets}$
Capital Ratios	
Total Equity to Total Assets	$\text{Shareholders' Equity} / \text{Assets}$
Net Income to Total Equity	$\text{Net Profits or Losses} / \text{Shareholders' Equity}$

Source: (Ross, 1977; Aydođan, 1990; Aydođan and Booth, 1996; Claessens, Demircukunt, and Huizinga, 1998; Denizler, 2000; Koch and MacDonald, 2000; Bayraktar and Yan, 2004; Detragiache and Gupta, 2006; Micco, Panizza, and Yanez, 2007; Őimga-Muđan and HoŐal-Akman, 2007; Brissimis, Delis, and Papanikolaou, 2008; AltunbaŐ and Marques, 2008)

In order to maintain coherence, some financial statement account balances for the period 2002 to 2007 were adjusted by deducting inflation adjustments to capital account value from both total assets and total equity accounts in order to have comparable data. All bank related data in this study are obtained from the data bank of the Banks Association of Turkey (BAT) and, Banking Regulation and Supervision Agency (BRSA). We used annual unconsolidated balance sheets, income statements, and off-balance sheet items for the period of 1981-2007 for the ratio calculations. Moreover, archive documents that are available to public are downloaded from Citibank web page. Lastly, magazine and newspaper releases related with the study are also collected.

CHAPTER 6

6 BANK PERFORMANCE AND RATIO ANALYSIS

In order to analyze the performance of CITI-TR, commonly used financial ratios are utilized to examine the liquidity risk, credit risk, profitability and the capital adequacy of the bank. Specifically, the purpose of the analysis is to determine how Citibank survived in Turkey by enhancing its presence, and how do Citibank's strategies relate with its performances over the years in the Turkish market.

6.1 Liquidity

Credit and Finance Risk Analysis Company describes liquidity as:

...reserves of cash, securities, [a bank's]... ability to convert a bank's asset into cash, and unused bank lines of credit [and] ...liquidity must be sufficient to meet all maturing unsecured debt obligations due within a one year time horizon without incremental access to unsecured markets. (Credit and Finance Analysis Company, 2009, para.10)

Corresponding to the above definition, one of the most essential issues to investigate for a bank is the ability to meet its obligations. The bank's lending policy is conservative when a high proportion of deposits is invested in low yielding liquid assets; thus, earnings are usually lower and liquidity is high. On the other hand, earnings and liquidity might be low, and then the bank might have an aggressive lending policy attached with heavy borrowing. Liquidity ratios are worthwhile to examine a bank's ability in order to cover deposit withdrawals and to meet the credit needs of its borrowers. In order to analyze the liquidity risk of the CITI-TR, the *changes in total loans to total assets, liquid assets to total assets, banks to total assets, and securities to total assets ratios* that are displayed in Figure 4 are calculated⁴.

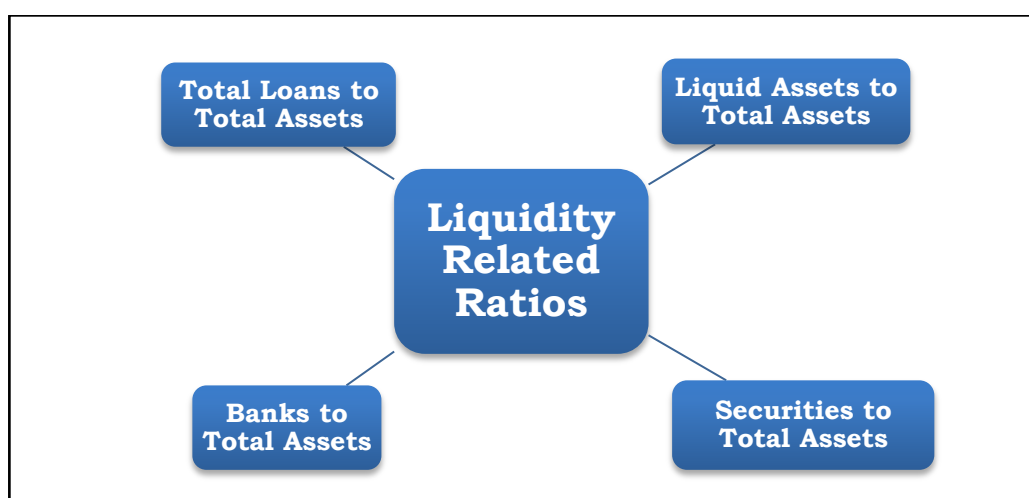


Figure 4: Liquidity Ratios

⁴ In order to maintain coherence, data dated from 2002 to 2007 adjusted to previous years by deducting *inflation adjustments to capital account* value from both *total assets* and *total equity accounts*.

The ratio of *total loans to total assets* (TL/TA) indicates the percentage of bank assets that are tied up in loans. In order to avoid insolvency problems banks often hold liquid assets that can be easily converted into cash. Higher the loans in a bank's portfolio, it becomes less liquid and more risky.

The second ratio used in the analysis is *liquid assets to total assets ratio* (LQ/TA). It is expected as the LQ/TA increases, the liquid assets in a portfolio increase and liquidity risk decreases. The same expectation also holds for the third ratio, *banks to total assets ratio* (BK/TA) as well.

Finally, *securities to total assets ratio* (TS/TA) is employed for liquidity analysis of CITI-TR. This ratio would specially be useful for discussing assets allocation decision of the bank. Once more as this ratio increases the liquidity risk will decrease.

After a brief introduction about the ratios for liquidity analysis, discussion begins with TL/TA ratio of CITI-TR in order to have an idea about the liquidity risk of the bank. For the period of 1982-2007, this ratio fluctuates between 15.8% and 61.5% with an average of 34.5% (Figure 5). Due to enormous 685.2% growth rate⁵ in loans side of the balance sheet, the ratio leaps first in 1990 just before the Gulf War from 17.7% to 52%.

During mid-1990s TL/TA ratio changes between 15.8% and 38.7%. However, the ratio has an increasing trend between years 2002 and 2007 excluding 2006. In 2003, when the bank changed status, and started its operations as a foreign established bank in Turkey, this ratio reached its highest point at 61.5%. In particular, that increase in TL/TA ratio suggests increasing loans while decreasing assets in the balance sheet of the bank, just before changing its status. Besides, due to diminishing of *bank accounts*⁶ occurring at that time, a huge decrease in

⁵ The growth rates are presented in the appendix (Table B1).

⁶ The funds deposited in other banks by Citibank.

assets is also observed. Hence, further research shows that CITI-TR preferred to decrease the investments in other banks' accounts just before the structural change.

As Figure 5 indicates, CITI-TR holds ample liquid assets and *bank accounts* play a trivial role of asset portfolio of the bank. Therefore, it is also significant to study BK/TA and TS/TA ratios when the liquidity level of the bank deviates. The up-downward moves of LQ/TA, BK/TA and TS/TA ratios have similar slopes (Figure 5). The most interesting year for deviations of ratios seems in year 1991; two years before that time BK/TA ratio started to decrease and in 1991, the ratio reaches its deepest percentage at 11.3%. In addition, TS/TA assets ratio peaks at 32.0% during the same period. Another decrease appears in 2003 when the structure of the bank has changed, and BK/TA ratio drops dramatically from 52.4% to 21.2%. Meanwhile the bank has managed to preserve its liquidity position with the help of an increase in TS/TA ratio.

In general, the results indicate that the asset portfolio of the bank contains high amount of liquid assets particularly as *banks account* and *securities account* (Figure 5). CITI-TR held approximately 9.9% of its assets as liquid securities. Between 1991 and 1992 as well as from 2003 to 2005, the bank held the highest amount of trading securities. CITI-TR invested more in trading securities especially when its bank account decreases except for 2007. There may be three different reasons of this digression. The first reason might be the decreased appeal of trading securities during 2007; the second one might be increasing attractiveness of being a lender with better competition in the sector; and the last one might be the effect of acquiring 20% of Akbank's shares.

On average, CITI-TR has very high investment in liquid assets as depicted by the ratio of LQ/TA, which is always above 40%. Figure 5 shows that the lowest value for LQ/TA ratio is in 1993 (43.5%); and the highest ratios are in 1989, 1999 and 2002, about 60% in all these

years. In 1989 just before the Gulf War, it reaches its peak at 76.8%, and during the war years, the ratio falls to 44.7%. Interestingly, the ratio has an upward slope during the crises periods. As if an *invisible hand* warns the bank before the crises, the bank takes position beforehand. Of course, future predictions of the bank's analysts may hit the target and predict the situation of not only the country but also the world before the crises. For instance, CITI-TR starts to increase its LQ/TA rate in 1996 right before Asian and Russian Crises as well. Also in 1999, it reaches 74.7%. Thus, the bank has a good liquidity position when Turkey encounters *2000 liquidity crises*. From a liquidity risk perspective, it looks like it has very low liquidity risk, but it also shows that CITI-TR is channeling funds to other banks instead of fulfilling its economic mandate.

Finally, CITI-TR's assets portfolio contains more the *banks account* related items than the *trading securities account* related items in general. Therefore, different from other banks in Turkey, CITI-TR does not channel the funds to the government by investing in government debt instruments even during the periods when the return on these instruments are very high. Instead, the bank prefers to keep its current assets as deposits in other banks. This is also interesting because headquarters in the US support the governments (Cleveland and Huertas, 1985).

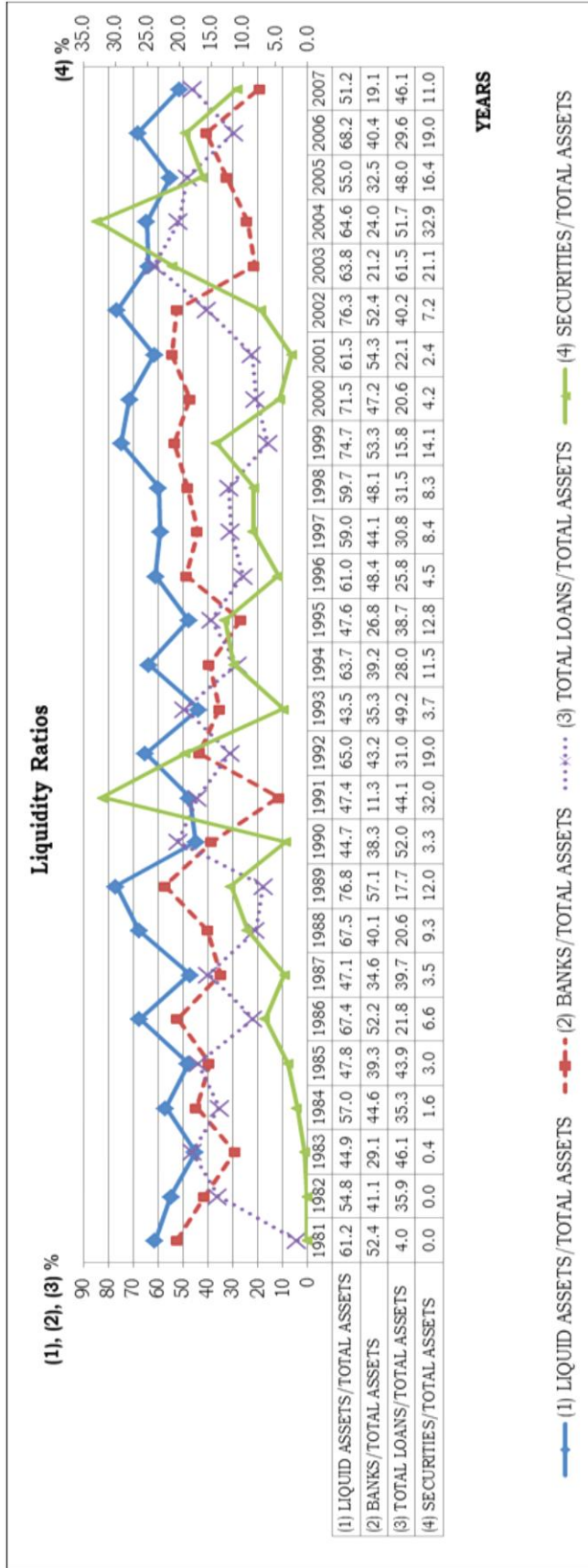


Figure 5: Liquidity Related Ratios (1981-2007)
 Note: All ratios are our calculations and based on the Banks Association of Turkey data base
http://www.tbb.org.tr/tr/Banka_ve_Sektor_Bilgileri/Veri_Sorgulama_Sistemi.aspx

6.2 Credit Quality

Throughout this research, the intention is to concentrate on several aspects of performance and risk structure of a foreign bank, CITI-TR. Because as Ford (1989) mentioned, a bank action could be described as a *vehicle* for moving funding from those who have surplus money to those who have a deficit, it is significant to rehearse both lending motives and quality of credits of the bank. With the purpose of accessing credit quality and financing motivation of a bank, several ratios are employed in the literature. For our purposes we, selected the ratios that are displayed in Figure 6⁷.

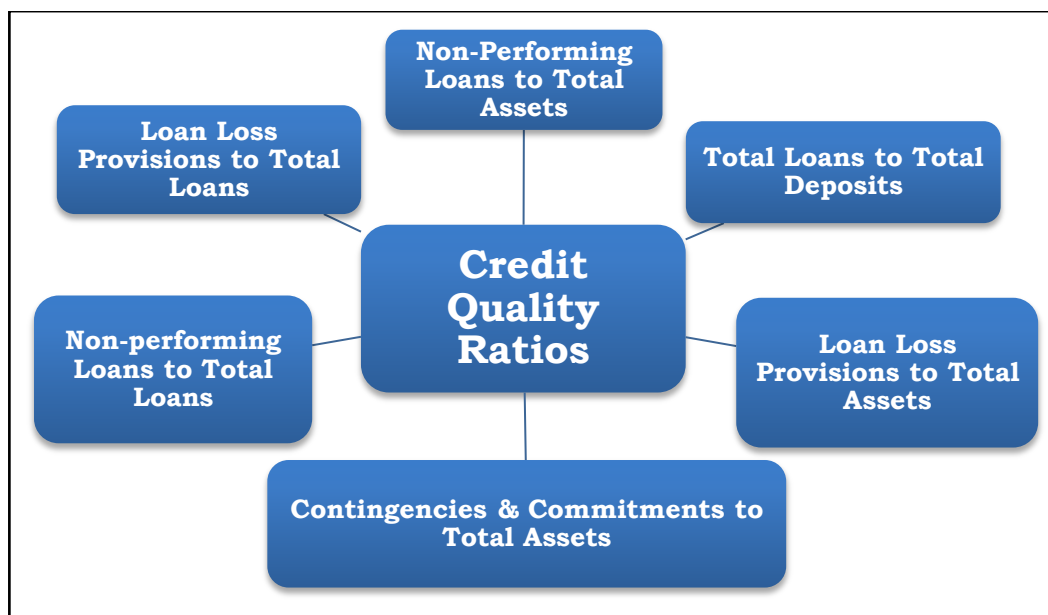


Figure 6: Credit Quality Ratios

⁷ In order to maintain coherence, data dated from 2002 to 2007 adjusted to previous years by deducting *inflation adjustments to capital account* value from both *total assets* and *total equity accounts*.

By using these ratios we get some insights related to the CITI-TR's credit screening and monitoring policies as well as investigating *cherry-peek*⁸ related actions.

We first study *total loans to total deposits* ratio (TL/TD), which implies a bank's deposits convergence capacity. Moreover, *contingencies & commitments to total assets* ratio (CC/TA) which gives clues about the lending channels is examined. Higher these ratios mean that the bank prefers corporate customers, and plays an important role in trading activities of its customers.

Moreover, *loan loss provisions to total loans* (LLP/TL) ratio delivers not only useful insight into the bank's loan portfolio and bad debts coverage, but also gives idea about the sufficiency of loan provisions. In a similar manner, a *loan loss provisions to total assets* (LLP/TA) ratio indicates the health of a bank. The higher this ratio, the higher the probability of problematic loans and the less healthy the bank is.

Meanwhile, loans are a substantial portion of total assets; therefore, an increase in *non-performing loans to total assets* (NPL/TA) percentage could lead to a decrease in the earning capacity of a bank and degrade its credit quality.

Correspondingly, the higher the non-performing loans to total loan (NPL/TL) percentages, the provision for loan losses probably is higher. Consequently, this would reduce the net income of a bank.

When we examine TL/TD ratio of Citibank, we see that on average 78.2% of the deposits of CITI-TR are extended as loans during the 1982-2007 period. During the first years of the bank, its TL/TD ratio has an increasing trend. The bank gives loans more than it could cover with its deposits (Figure 7), especially between 1990 and 1993. Therefore, the situation of TL/TD ratio during 1990-1993 makes one wonder why a

⁸ The term *cherry* is used for the most profitable domestic customers in the literature; and by *cherry picking*, foreign financial institutions leave the less profitable domestic institutions to serve others.

bank would take such risks for financing. Moreover, we can conclude from the results that high volume of credit extension may lead to high credit risk exposure during these times.

TL/TD ratio value reaches relatively low 61.4% level in 1995 when deposit growth hikes⁹. Interestingly in 1999, the bank has lower TL/TD ratio than in 2001 when the currency crises occurs in the country. CITI-TR gives more loans in 2000 than in 1999. The growth rate of loans is 106.9% from 1999 to 2000 while the deposit growth is only 27.4%. On the other hand, the bank has relatively stable TL/TD ratios in 2001 and following years. Finally, TL/TD ratio reduced to its minimum at 32.3% in 2006. Therefore, it could be concluded for CITI-TR that lowering TL/TD ratios designates strict credit policies that begin in 2001.

At that point, it is essential to question LLP/TL ratio, Figure 8 below demonstrates LLP/TL amount of CITI-TR for 1996-2007 periods. The ratio has a minimum of 0.1 percent in 1996 and 1997. From 1996 to 1997 loan growth rate is 564.9%, but there is no change in LLP/TL ratio. Although the ratio has an increasing trend beginning from 1998 to 2007, loan growth rates of the bank does not have increasing trend. In order to have more in debt analysis we also examined the changes in the LLP/TA ratio related to the credit risk structure of the CITI-TR.

According to the findings, LLP/TA ratio has lower values between 1996 and 2000 when compared with the period of 2001-2007 (Figure 8). It has an increasing trend beginning from 2001. The reason behind these two different moves could be explained by two possibilities. On the one hand, between 1996 and 2000 the ratio displays comparatively low rates since the bank starts issuing loans more carefully to avoid losses due to increased competition in the sector, as well as world economic turmoil during those years. This explanation supports the findings of Denizer (2000). He shows that foreign bank entry has a strong competitive effect in Turkey although their asset share is not large. Therefore, increasing

⁹ The growth rates are presented in the appendix (Table B1).

number of banks in Turkey may play a role in LLP/TA ratio decreases. Further, if a high asset increase accompanies low growth of loans; LLP/TA rate is forced to decline.

On the other hand, there is an increasing trend in LLP/TA ratio between 2001-2007. This may due to the rise in foreign bank shares in Turkey. Since the bank takes higher risks by leaving *cherry picking* and financing small borrowers to compete with the others, on the contrary to Denizer's (2000) views, it has to allocate higher provisions for the default probability. Thus, LLP/TA rate increases with the probability of default in bank credits.

In discussions of credit quality analysis, provision for loan losses account is the main concern. Therefore, it is important to understand why provision for loan losses account stand for. It is noticeably a reserve account to cover unexpected defaults on loans by borrowers, which are also denoted as non-performing loans.

It is also noteworthy to emphasize that NPL/TA percentage indicates the percentage of loans, which have been deterred and have been adversely categorized as a percentage of the banks' total assets portfolio. Since loans are a significant portion of total assets, an increase in NPL/TA ratio could decrease the earning capacity and increase the credit risk of CITI-TR. The NPL/TA has an increasing trend after 2000. Remarkably, NPL/TA reaches its maximum value in 2003, when the bank decides to change its structure (Figure 8).

Furthermore, the Turkish economy is not a stable one; therefore, a bank in this country should be well positioned against fluctuations in a financial turmoil. For instance, changing interest rates might have effects on interest income and interest expense of a bank. Thus, it is expected that a bank's management would attempt to balance their incomes above their expenses. One way of increasing income rather than using balance sheet items is increasing off-balance sheet undertakings. Henceforth, it is significant to analyze behavior of

contingencies and commitments accounts for gathering more about Citibank's credit quality in Turkey. The bank's CC/TA ratio is 64.3 % on average and highest in 1996 (Figure 7). As Figure 7 suggests CITI-TR's customers prefer off-balance sheet credits, which means increase in non-interest income due to commissions, or fee based gains.

As a conclusion when we examine the credit risk of the CITI-TR by looking at the trends in loan loss provisions and non-performing loans we can say that the credit risk of the bank increased after 2002. CITI-TR increased the weight of loans portfolio in its assets after 2002 when the economic conditions in the country became stable with high economic growth and low inflation. Unfortunately, their loan loss provisions and non-performing loans increased during this period as well. The results indicate that in line with its general policy, the bank preferred to extend loans and enlarge its customer base. However, leaving the *cherry picking* strategy increased its credit risk. With this point in mind, the attention now shifts to *profitability analysis*.

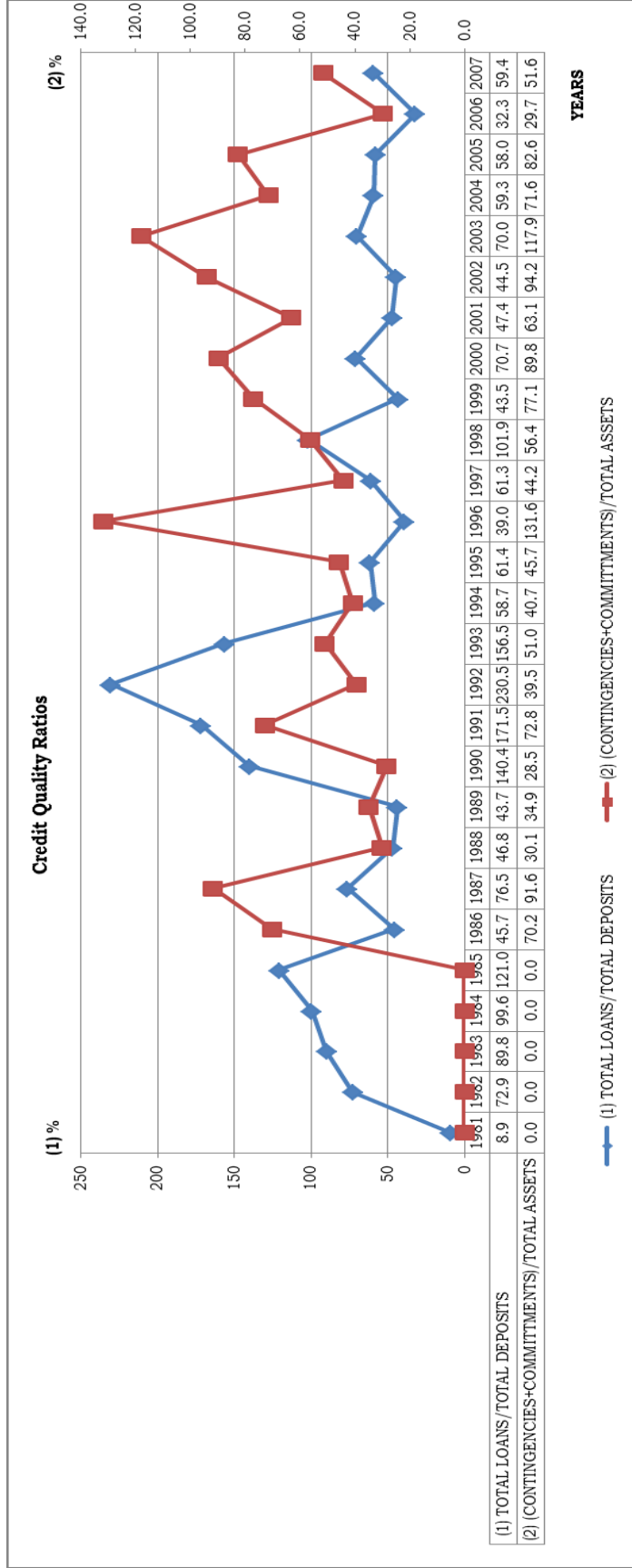


Figure 7 : Total Loans to Total Deposits, and Contingencies and Commitments to Total Assets Ratios
 Note: All ratios are our calculations and based on the Banks Association of Turkey (BAT) database,
http://www.tbb.org.tr/Banka_ve_Sektor_Bilgileri/Veri_Sorgulama_Sistemi.aspx

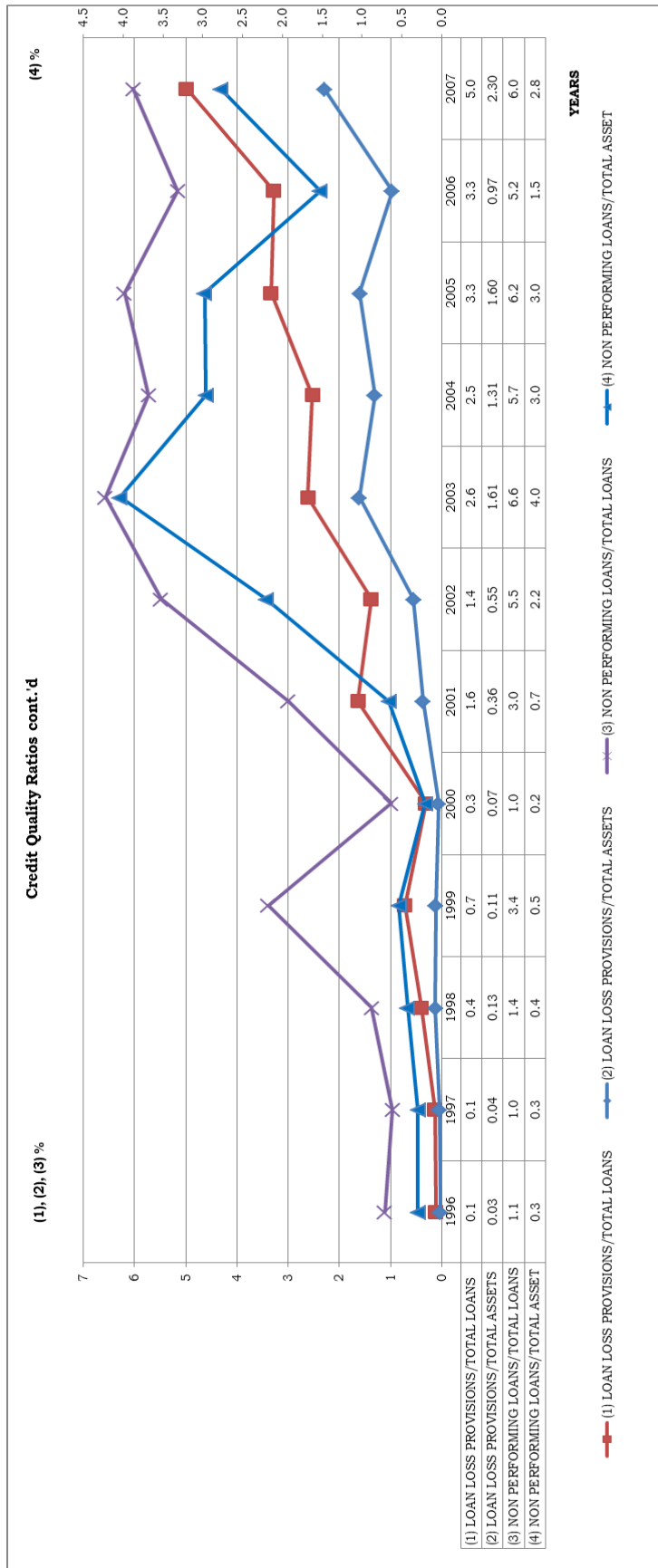


Figure 8: Loan Loss Provisions to Total Loans, Loan Loss Provisions to Total Assets, Non-Performing Loans to Total Loans, and Non-Performing Loans to Total Assets Ratios

Note: All ratios are our calculations and based on the Banks Association of Turkey (BAT) database, http://www.tbb.org.tr/Banka_ve_Sektor_Bilgileri/Veri_Sorgulama_Sistemi.aspx

6.3 Profitability

Profitability is earning creation ability of a bank, and it determines four basic milestones for a bank:

- 1) Increasing capital
- 2) Absorbing loan losses
- 3) Providing chance for growth of bank assets
- 4) Enhancing investor returns

According to U.S. Department of Treasury, the main sources of income for a bank could be classified as three different groups: net interest revenue, investing activities, and commissions - transactions fees with respect to their impact on earning creation (Credit and Risk Analysis, 2009). In order to access the profit generation ability along the lines of previous research, we examine *return on asset*, *efficiency*, *net interest income to total loans*, spread and burden ratios that are displayed in Figure 9.

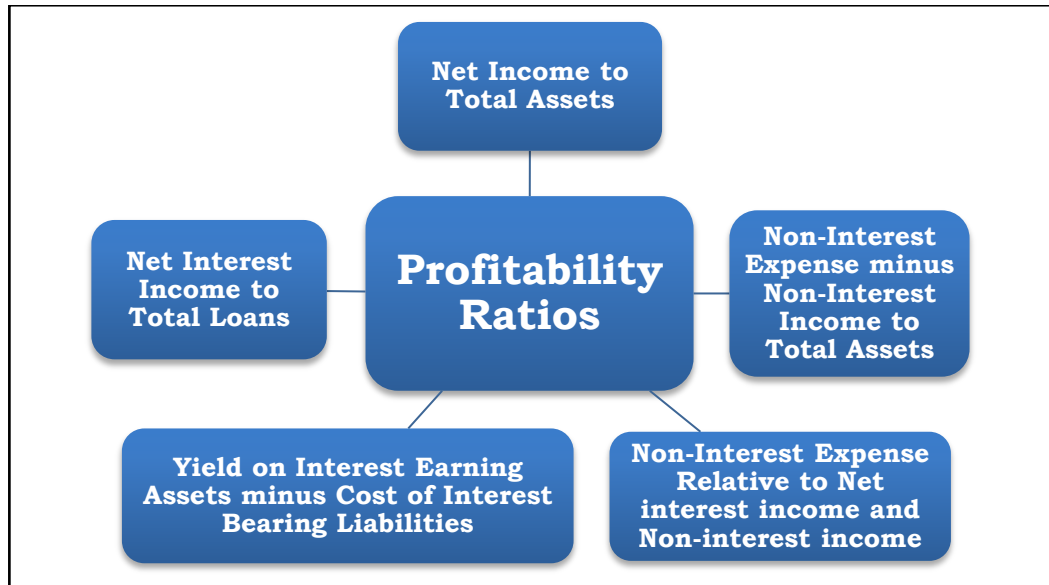


Figure 9: Profitability Ratios

Net income to total assets (ROA) ratio measures the value of net income created from the total assets of a bank. In other words, ROA indicates profitability of the assets of a bank with respect to assets utilization.

Besides, determination of the ability of a bank in controlling its non-interest expense with respect to its net operating income would be beneficial for profitability analysis purposes. Therefore, *non-interest expense relative to total of net interest income and non-interest income* (EFFICIENCY) ratio is employed. EFFICIENCY ratio also indicates the cost of non-interest expense for one unit increase in operating income of a bank, so the lower the ratio the more efficient a bank is.

Furthermore, *net interest income to total loans* (NII/TL) that is net interest margin in percent of total loans is used for accessing operational performance. In other words, NII/TL ratio articulates whether a bank is profitable.

Moreover, net interest income to interest earning assets, minus interest expense to interest bearing liabilities reveals yield on earning assets minus the cost of interest bearing liabilities. This is also defined as *spread* (SPREAD) ratio, since it is a measure of the rate spread of funding differential (Koch and MacDonald, 2000).

At the same time, the measure of the amount of non-interest expense covered by income generated by non-interest items like fees, service charges as a fraction of total assets is also useful for deciding whether a bank is able to manage its non-interest expenses well enough. Thus, we employ BURDEN ratio to measure this (Koch and MacDonald, 2000). It is important to note that higher SPREAD and lower BURDEN rates increase a bank's profit generation ability.

For the period of 1982-2007, ROA ratio fluctuates between -3.9% and 17.1% with an average of 4.4% (Figure 10). CITI-TR's ROA ratio is quite high during the 1980s and 1990s. In 1994, the ratio is at its maximum value of, 17.1%. The reason behind that success during a crises period might be the foreign exchange position of the bank. In other words, CITI-TR changes its policy and increases liabilities in foreign currency in 1990 (Table 6). Thus, an open foreign exchange position might lead to increase FX risk.

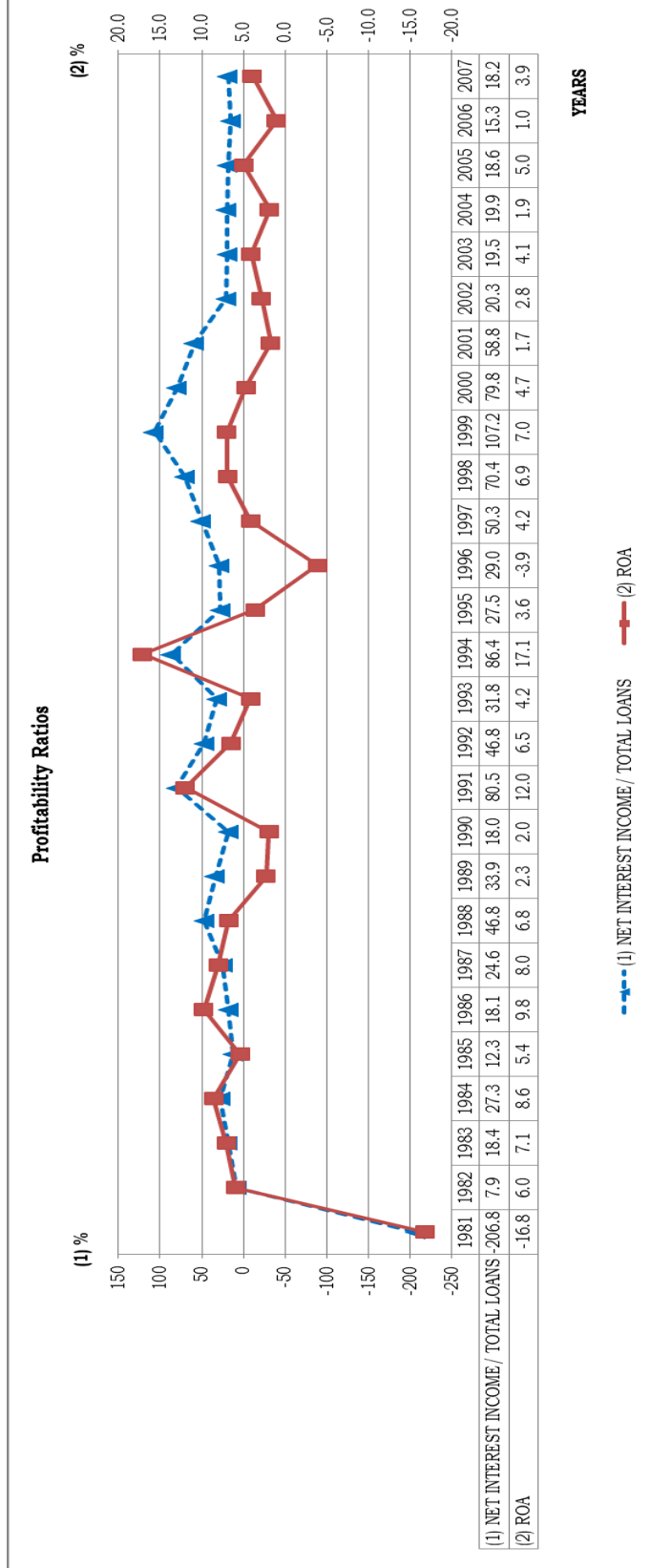


Figure 10: Net Interest Income to Total Assets and ROA Ratios
 Note: All ratios are our calculations and based on the Banks Association of Turkey data base
http://www.tbb.org.tr/tr/Banka_ve_Sektor_Bilgileri/Veri_Sorgulama_Sistemi.aspx

Table 6: CITI-TR's Liabilities allocation between Turkish Lira and foreign currency

<i>1,000 TL</i>	2000	1999	1998	1997	1996	1995	1994
Total Liabilities	587,789	360,514	189,236	121,079	20,282	12,411	4,609
Total Liabilities in Turkish Lira	155,583	123,287	59,129	33,032	6,465	4,457	2,509
Total Liabilities in Foreign Currency	432,206	237,227	130,107	88,047	13,817	7,954	2,100
	1993	1992	1991	1990	1989	1988	
	2,688	2,220	528	471	192	155	
	643	408	231	144	146	90	
	2,045	1,812	297	328	46	65	

Source: Our calculations, based on the data obtained from Banks Association of Turkey (BAT), http://www.tbb.org.tr/tr/Banka_ve_Sektor_Bilgileri/Veri_Sorgulama_Sistemi.aspx

Subsequently, there is a decrease in ROA in 1996 (Figure 10). The reason of such a decrease is the net interest margin of the bank, which is interest income minus interest expense. In 1996, interest expense exceeds interest income (Figure 11). This finding is not only significant because it indicates management's ability to control interest risks, but it also designates a turning point for the bank. In the following years, the management overcame this problem and improved ROA.

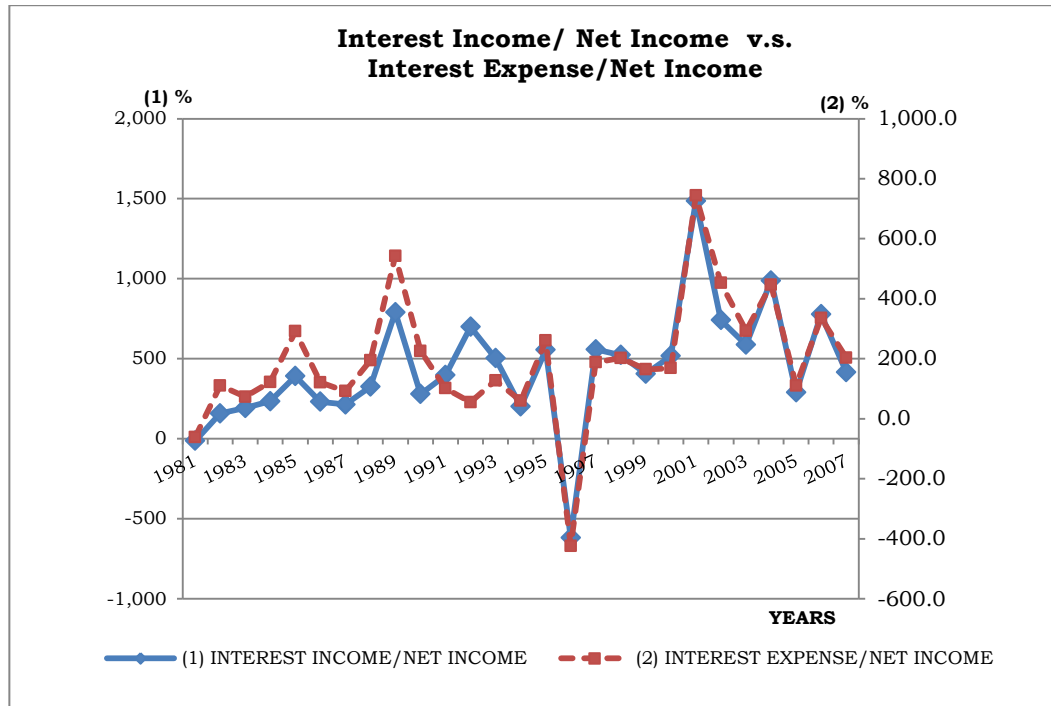


Figure 11: Interest Income to Net Income, Interest Expense to Net Income Ratios

Note: All ratios are our calculations and based on the Banks Association of Turkey database, http://www.tbb.org.tr/tr/Banka_ve_Sektor_Bilgileri/Veri_Sorgulama_Sistemi.aspx

From 1997 to 2007 ROA changes between 7.0% and 1.0% with a decreasing trend (Figure 10). It is significant to note that these figures may show the response to increases in loan loss provisions and non-performing loans rates in its balance sheet. Increase in non-performing loans signals the problems in the credit portfolio and this will be reflected as a decrease in net income.

Furthermore, Bonin, Hasan, and Wachtel (2004) note that foreign banks in transition economies of Central and Eastern Europe tend to have ROA ratios greater than 2.2%. Therefore, as for return of assets, with the exception of year 1996 that has been suffering from a negative ROA ratio, the bank has acceptable ratios. Nevertheless, as Koch and

MacDonald (2000) indicate most banks today, face shrinking net interest income. Therefore, one possibility in order to support profit growth of CITI-TR might be to cut expenses, since its fee-income is also decreasing according to our findings. Because the results show that CITI-TR has negative net non-interest income, we analyzed it further (Figure 12).

EFFICIENCY ratio of the bank would be valuable to measure CITI-TR's ability to manage its non-interest expenses. For the period of 1982-2007, average of EFFICIENCY ratios is 73.7% with a minimum of 46.5% (Figure 13). Even though the ratio fluctuates year by year, the bank's efficiency gain cannot be classified as a successful one, since a smaller the ratio shows how cost-effective a bank is.

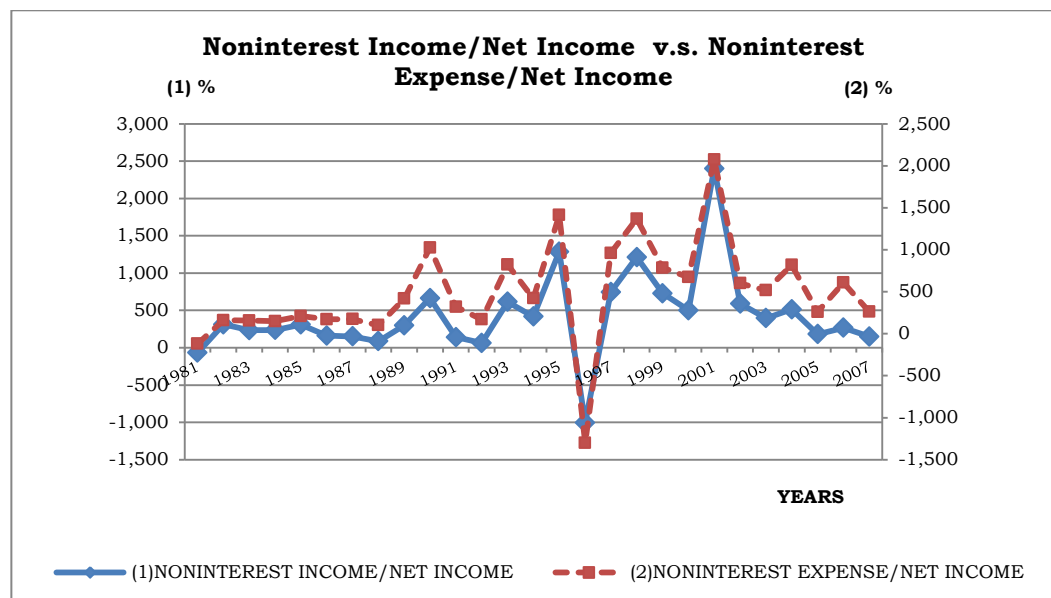


Figure 12: Noninterest Income to Net Income and Noninterest Expense to Net Income Ratios

Note: All ratios are our calculations and based on the Banks Association of Turkey database,
http://www.tbb.org.tr/tr/Banka_ve_Sektor_Bilgileri/Veri_Sorgulama_Sistemi.aspx

We also analyze the changes in *net interest income to total loans* ratio (NII/TL) to understand the operational performance of the bank, since a higher ratio means a high amount of funding is available for a lower cost. It is also significant to note that except the three years 1986, 1994, and 1999 the total loans growth has an increasing trend¹⁰. Especially in turmoil times the gains increases for the bank. Beginning from the first years in the sector, the bank always has high returns on its loans. Interestingly, apart from financial crises that happened in Turkey in 2000 and 2001, during 1997 Asian and 1998 Russian crises the ratio increases as well. On the other hand, starting from year 2002 it takes a stable move with an average of 18.6% although total loans growth rate decreases with respect to 1990s. This situation might be explained by decreasing interest rates in the country during that period (Table 7).

Table 7: Average Monthly Interest Rates in Turkey (1996-2004)

<i>Average Monthly Interest Rates (%)</i>	
1996	77.6
1997	73.6
1998	76.2
1999	75.7
2000	43.7
2001	94.3
2002	50.2
2003	37.5
2004	23.1

Note: Yearly averages are our calculations based on Central Bank of Republic of Turkey database, <http://evds.tcmb.gov.tr>

¹⁰ The growth rates are presented in the appendix (Table B1).

Lastly, it is important to reveal the bank's ability to manage interest rate risk. Therefore, this study examines the bank's ability to manage interest rate risk by looking at the SPREAD and BURDEN ratios. SPREAD ratio would be suitable to access whether CITI-TR is actually profitable or not when interest rates change. The findings related with this ratio show that in general the bank is able to manage funding differential. The ratio peaks at 346.8% in 1991 (Figure 13). The reason behind that might be the decrease in growth rate of *banks account*, which is a component of that ratio¹¹. Furthermore, BURDEN ratio would demonstrate the size of non-interest expenses that exceed non-interest income for the bank. Thus, CITI-TR would be better off with a low BURDEN ratio or a BURDEN ratio that would be covered by the SPREAD. There are only two exceptions when SPREAD ratio is not able to cover BURDEN. In 1981 and 1989, BURDEN ratios are 9.0% and 2.7% respectively (Figure 13). We can conclude that in those years the bank is not able to manage its non-interest expenses well enough. Then, interestingly equity growth of the bank increases enormously after the bank suffers from high burden ratios. Although the equity support is needed sometimes, we can say that the bank is profitable since its SPREAD ratio is large enough to cover its BURDEN except in 1981 and 1989.

¹¹ Apart from year 1991, SPREAD ratio has another unexpected figure in 1981. However, we eliminated this, since that year points the bank's branch-opening and physical entry year in the Turkish market.

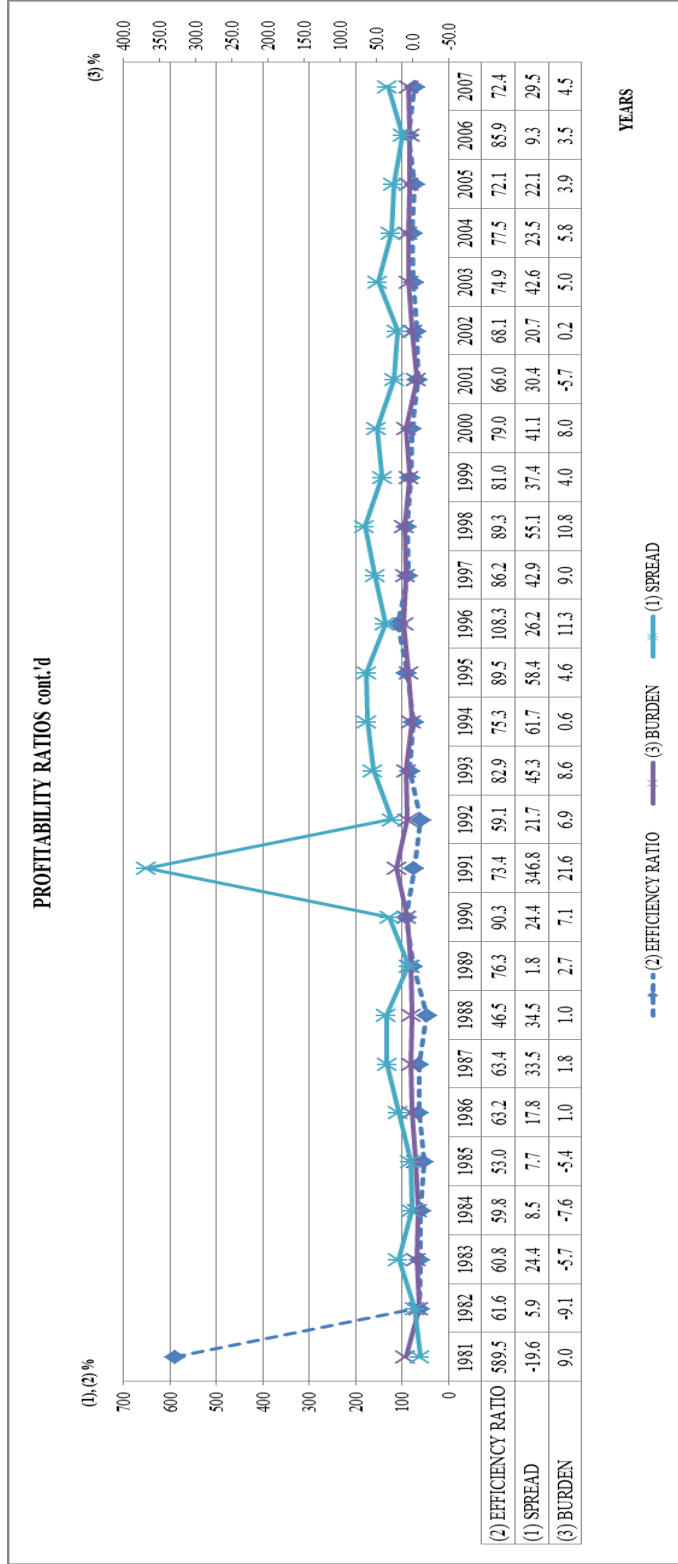


Figure 13: Spread, Efficiency, and Burden Ratios
 Note: All ratios are our calculations and based on the Banks Association of Turkey data base,
http://www.tbb.org.tr/tr/Banka_ve_Sektor_Bilgileri/Veri_Sorgulama_Sistemi.aspx

6.4 Capital Adequacy

Credit and Finance Analysis Company states:

Capital allows a [financial institution] ... to grow, establish and maintain both public and regulatory confidence, and provide a cushion (reserves) to be able to absorb potential loan losses above and beyond identified problems (Credit and Finance Analysis Company, 2009, para.7).

Moreover, generating capital internally confirms that the institution has capital strength. Therefore, capital adequacy level for a bank is used as a measure of capacity to cope with risks, which are incurred in the course of business, in order to maintain soundness.

Although restatements due to accounting standard changes might lead to an increase in capital, this is not a capital increase in the sense of investing new capital. In order to compare capital adequacy level of CITI-TR the data should be consistent; however, due to inflation adjustments it is not consistent during the study period. Therefore, CITI-TR equity data is adjusted by eliminating the inflation effects and the resulting ratios displayed in Figure 14 are used for the analysis¹².

¹²In order to maintain consistency, data dated from 2002 to 2007 are adjusted to previous years by deducting *inflation adjustments to capital account* value from both *total assets* and *total equity accounts*.

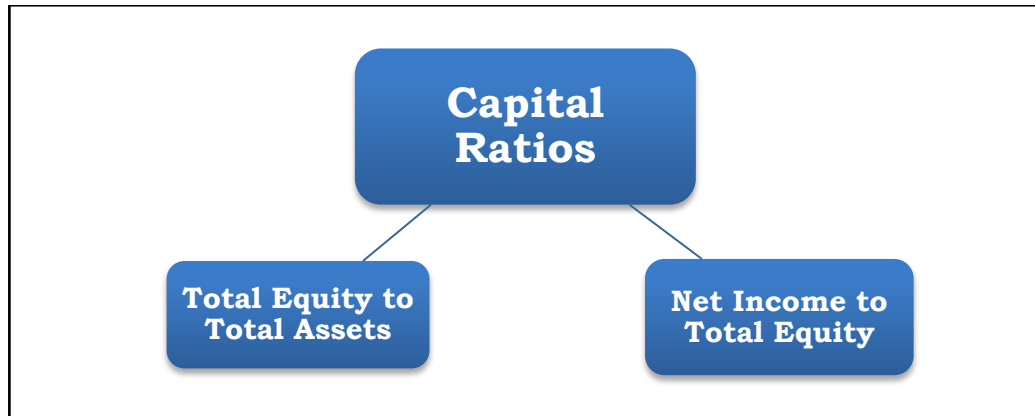


Figure 14: Capital Ratios

One of the tools that are beneficial to measure the capital adequacy level of a bank is the ratio of *total equity to total assets* (TE/TA). This ratio is used to measure the capital strength of a bank. A bank with higher equity is more capable to manage its dues, and meet the creditors' demands (Golin, 2001; Cyree, Wansley, and Black, 2000; Wheelock and Wilson, 2000). Thus, a higher rate of *total equity to total assets* ratio is expected for a strong bank.

According to Bayraktar and Yan (2004) *total equity to total assets ratio* (TE/TA), which measures the amount of protection afforded to the bank by equity invested in, could be classified as a cushion against asset malfunction. Hence, the higher the ratio, the more protected a bank is. Furthermore, Aydogan and Booth (1996) analyze individual banks in Turkey, and find that for foreign banks equity is a significant source of funding. In view of that, we expect TE/TA ratio measurement to give clues about the bank's relation with its parent bank.

Another measurement that would be useful for judging capital strength of a bank is *return on equity* (ROE) ratio. That ratio is determined by dividing net income by equity to get the return on equity. As its name

suggests, ROE ratio relates to the return on the stockholder's investment. Since the ratio is affected by the level of capitalization, the ratio beneficial for capital strength measurements of a bank; the higher the ROE, the better the capital strength of a bank, so lower the risk.

The following figure shows that the ratio has jumps in 1982, 1991, 1996, 2001, and 2007 (20.5%, 20.2%, 14.8%, and 12.6% respectively) (Figure 15). Growth of equity¹³ in these years provides an explanation for the source of funds of credit growth in respective years. Moreover, during the 1990s and the beginning of 2000s when Turkey and the world as a whole were coping with crises, there were equity growths in CITI-TR's balance sheet again. Since, the ratio is a measure of the extent to which a bank's total assets are financed by the shareholder equity; we can say that the problem in the sector might be solved out by increasing equity. Besides, the period of 2002-2004 could be classified as a relief period after the currency crisis in 2001, as the bank gets stronger as indicated by higher total equity to total assets ratio with 12.6%. The only exceptions are in 2002, 2003, and 2004. In those years, the data are adjusted for the inflation and the TE/TA becomes negative (-7.5%, -6.3%, and -2.7%).

Moreover, the results indicate that mostly CITI-TR provides high gains to its stakeholders. The average ROE is 64.7% with a maximum value at 221.9% in 1994 and a minimum at -37.7% in 2002 (Figure 15). Except in 1996 and 2002 CITI-TR always provided a nice return for its shareholders due to the financial leverage, *ROE-ROA*, effect. The average financial leverage effect 59.4%. (Table 8) It shows that management borrowed smartly and used these funds efficiently.

¹³ The growth rates are presented in the appendix (Table B1).

Table 8: Financial Leverage Effect (1981-2007)

CITI-TR					
<i>(ROE-ROA) (%)</i>					
1981	-173.0*	1990	27.0	1999	62.0
1982	102.0	1991	47.4	2000	58.6
1983	66.6	1992	83.9	2001	12.1
1984	79.2	1993	39.5	2002	-40.5
1985	54.9	1994	204.8	2003	46.6
1986	107.7	1995	44.0	2004	48.7
1987	101.4	1996	-22.2	2005	45.7
1988	142.9	1997	44.1	2006	22.5
1989	54.6	1998	90.1	2007	20.3
<i>Average</i>		59.4			
<i>(%)</i>					

Source: Our calculations based on the Banks Association of Turkey (BAT) database, http://www.tbb.org.tr/tr/Banka_ve_Sektor_Bilgileri/Veri_Sorgulama_Sistemi.aspx,

Note: *We eliminated this, since that year points the bank's branch-opening and physical entry year in the Turkish market.

Moreover, during Gulf War period (1990-92) the bank tripled its ROE percentage from 28.9% to 90.4%. Although 1994 financial turmoil and 2000 liquidity crisis could be classified as the periods when level of capitalization for CITI-TR is strong, in 2000, when *Turkish currency crises* happens the bank's ROE ratio decreases from 63.3% to 13.8%, but 2003 to 2007 could be noted as a stable period for the bank.

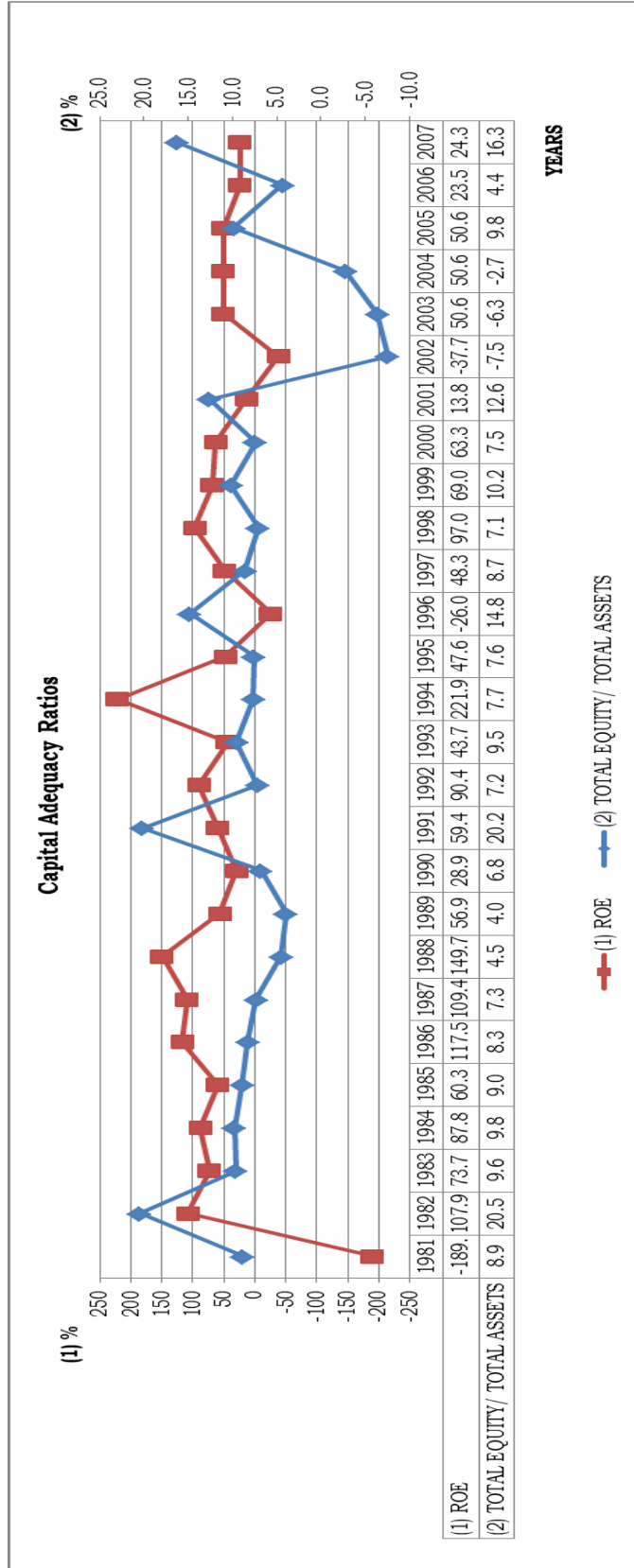


Figure 15: ROE and Total Equity to Total Assets
 Note: All ratios are our calculations and based on the Banks Association of Turkey (BAT) database, http://www.tbb.org.tr/tr/Banka_ve_Sektor_Bilgileri/Veri_Sorgulama_Sistemi.aspx

6.5 Performance Comparison of Bank Groups in Turkey

It is essential to assess other banks' performances in the country and to compare them with CITI-TR's performance in order to complete the ratio analysis chapter. The comparison would be among following banking groups and CITI-TR: *state banks*, *private banks*, and *foreign banks without CITI-TR*. We calculate BK/TA, TL/TA, TL/TD, NPL/TA, ROA, and TE/TA ratios for the bank groups for the period of 1988-2009.

First, BK/TA ratio fluctuates between 8.01% and 29.17 % on average in the country (Table 9). Accordingly, as Table 9 presents *foreign banks* prefer to keep a high amount of their assets in *banks accounts*. On the other hand, *state banks* and *private banks* always have lower rates than their foreign counterparts do. The liquidity analysis for CITI-TR reveals that the bank also prefers high amount of liquidity as keeping its assets more in other banks or securities. Although CITI-TR's BK/TA ratio is 35.70% on average for the studied period, the ratio reaches its minimum rate at 0.77% in 2008 (Table 9).

When we analyze TL/TA ratio for 1988-2009 period in the country, it is interesting to note that all banking groups have approximately matching rates in terms of total loans as a portion of their total assets. Even though *private banks* group with an average 41.04% TL/TA ratio has leadership position among others, in some years *state banks* group holds the leading position (Table 9). For instance, in 1988, 1989, 1990, 1991, and 1995 *state banks* group has higher rates than the other banking groups. On the other hand, in 2001 and respective years *foreign banks'* loan level with respect to their assets are higher than other banks in the country (Table 9). Furthermore, CITI-TR also keeps a high amount of loans in its assets portfolio. Especially, in 2003 and 2004 with 61.48% and 51.73%, its TL/TA ratios are higher relative to all banking groups in the country (Table 9).

Moreover, deposit convergence to loans is high for *foreign banks* group compared to *private banks* and *state banks groups*. CITI-TR's TL/TD ratio has also a parallel manner with its foreign counterparts (Table 9).

Such a huge deposit convergence to loans and high loans share in assets portfolio motivate us to study NPL/TA ratio for banking groups in the country. Although *foreign banks*' TL/TD ratios are higher compared to *private banks* and *state banks groups*, it is interesting to note that *foreign banks non-performing loans* have a lower rate in their asset portfolio (Table 9). This might due to their strict credit analysis techniques or to *cherry picking* effect. Moreover, CITI-TR could not be classified as successful as its foreign counterparts could. However, it could be said that CITI-TR does better job than *private banks* and *state owned banks* in many years.

Having high liquidity positions and high NPL/TA ratios might lead lower ROA rates for *state owned banks* compared to other banking groups in the country. Even though *private banks* could be classified better performers than *state banks* group, *foreign banks* group's ROA ratio is 3.60% on average during 1988 and 2009 period (Table 9). The findings also support that during currency crisis in 2001, *foreign banks* are better performed than both *private banks* and *state banks* groups although *private banks* more successfully managed liquidity crisis in 2000 and hold 0.81% ROA (Table 9). Moreover, CITI-TR is better performer than its counterparts with an average 4.40% ROA ratio during the studied period (Table 9).

Finally, TE/TA ratio is interesting to give signs related to equity injections. *Foreign banks* group's TE/TA ratio is 9.08% on average, and it is the highest rate among other banking groups (Table 9). It is also important to note that during crises periods TE/TA ratios increase for the banking groups in general. For instance, *foreign banks*' TE/TA ratio is 7.31% in 2000, and it becomes 21.93% at the end of 2001.

These analyses show that in the country *foreign banks* have higher liquidity position than *private banks* and *state banks* groups. Although both three banking groups' lending rates are close each other, *foreign banks* are better performers in terms of deposit convergence to loans. Furthermore, they manage to keep *non-performing loans* rate lower than both *private banks* and *state owned* banks. Thus, a lower *non-performing loans* rate might help to lead *foreign banks* to gain more than their counterparts do in the country in terms of ROA.

Table 9: Ratio Comparison among Banking Groups in Turkey

Banks/Total Assets (%)	State Banks	Private Banks	Foreign Banks without Citibank	CITI-TR	<i>Average</i>
1988/12	10.88	21.76	30.49	40.07	25.80
1989/12	10.48	15.10	20.43	57.10	25.78
1990/12	8.09	13.80	22.62	38.33	20.71
1991/12	8.92	17.01	23.08	11.33	15.09
1992/12	12.60	19.69	33.85	43.25	27.34
1993/12	12.48	25.98	42.89	35.34	29.17
1994/12	14.49	19.80	34.37	39.15	26.95
1995/12	12.60	16.72	35.26	26.77	22.84
1996/12	9.52	15.49	29.62	48.45	25.77
1997/12	9.29	13.87	35.95	44.09	25.80
1998/12	6.17	13.78	29.21	48.08	24.31
1999/12	5.92	14.95	26.78	53.29	25.24
2000/12	6.29	18.68	37.17	47.16	27.33
2001/12	9.58	10.95	8.89	54.26	20.92
2002/12	5.54	6.13	7.33	52.38	17.85
2003/12	6.65	4.43	11.45	21.18	10.93
2004/12	5.88	5.45	12.77	23.96	12.01
2005/12	4.69	5.76	12.81	32.48	13.93
2006/12	5.77	5.77	13.10	40.43	16.27
2007/12	4.23	4.77	3.98	19.06	8.01
2008/12	4.07	5.31	4.37	0.77	3.63
2009/12	3.75	5.82	4.03	8.42	5.50
<i>Average</i>	8.09	12.77	21.84	35.70	

Table 9: cont'd.

Total Loans/Total Assets (%)	State Banks	Private Banks	Foreign Banks without Citibank	CITI-TR	<u>Average</u>
1988/12	44.08	33.30	30.49	20.64	32.13
1989/12	43.79	33.98	20.43	17.66	28.97
1990/12	47.61	41.87	22.62	51.95	41.01
1991/12	44.81	36.21	23.08	44.12	37.05
1992/12	41.11	41.95	33.85	31.04	36.99
1993/12	39.89	45.58	42.89	49.21	44.39
1994/12	37.61	42.97	34.37	28.01	35.74
1995/12	44.23	37.30	35.26	38.68	38.87
1996/12	39.47	44.53	29.62	25.77	34.85
1997/12	45.60	39.83	35.95	30.78	38.04
1998/12	31.93	38.68	29.21	31.50	32.83
1999/12	24.32	41.36	26.78	15.79	27.06
2000/12	32.11	39.78	37.17	20.64	32.43
2001/12	14.82	22.81	27.27	22.10	21.75
2002/12	13.17	32.84	41.02	40.21	31.81
2003/12	17.37	35.33	44.87	61.48	39.76
2004/12	21.04	42.39	50.14	51.73	41.32
2005/12	25.77	45.35	54.14	48.01	43.32
2006/12	33.32	49.53	60.03	29.61	43.12
2007/12	39.14	52.84	63.76	46.07	50.45
2008/12	42.13	54.45	62.39	45.13	51.03
2009/12	41.55	50.00	59.74	42.15	48.36
<u>Average</u>	34.77	41.04	39.32	36.01	

Total Loans/Total Deposits (%)	State Banks	Private Banks	Foreign Banks without Citibank	CITI-TR	<u>Average</u>
1988/12	77.96	49.26	55.85	46.83	57.47
1989/12	73.67	53.66	81.78	43.69	63.20
1990/12	78.12	67.60	123.38	140.37	102.37
1991/12	72.84	62.78	129.94	171.54	109.27
1992/12	64.65	68.27	126.77	230.50	122.55
1993/12	64.90	74.22	139.41	156.48	108.75
1994/12	53.81	54.61	59.35	58.67	56.61
1995/12	59.33	58.00	43.65	61.45	55.61
1996/12	49.99	62.67	43.80	38.98	48.86
1997/12	61.05	67.40	55.05	61.33	61.21
1998/12	41.75	64.19	59.56	101.88	66.85
1999/12	31.89	53.44	47.77	43.55	44.16
2000/12	41.54	62.55	41.12	70.72	53.98
2001/12	21.16	30.70	58.87	47.37	39.52

Table 9: cont'd.

Total Loans/Total Deposits (%)	State Banks	Private Banks	Foreign Banks without Citibank	CITI-TR	<u>Average</u>
2002/12	16.72	42.31	72.91	44.46	44.10
2003/12	20.92	50.30	79.70	70.03	55.24
2004/12	26.00	63.57	81.33	59.30	57.55
2005/12	32.92	70.51	89.92	57.99	62.83
2006/12	42.07	77.67	98.48	32.33	62.64
2007/12	49.32	85.80	104.84	59.43	74.84
2008/12	53.80	85.64	110.03	58.18	76.91
2009/12	55.12	76.65	98.72	56.87	71.84
<u>Average</u>	49.52	62.81	81.92	77.82	
Non-Performing Loans/Total Asset (%)	State Banks	Private Banks	Foreign Banks without Citibank	CITI-TR	<u>Average</u>
1988/12	0.84	0.54	1.36	n/a	0.91
1989/12	0.73	0.32	0.71	n/a	0.59
1990/12	0.81	0.23	0.34	n/a	0.46
1991/12	1.27	0.26	0.49	n/a	0.67
1992/12	0.54	0.32	0.50	n/a	0.45
1993/12	0.65	0.23	0.39	n/a	0.42
1994/12	0.49	0.34	1.37	n/a	0.73
1995/12	0.57	0.16	0.18	0.28	0.30
1996/12	0.42	0.17	0.10	0.29	0.24
1997/12	0.71	0.27	0.10	0.30	0.34
1998/12	1.24	0.43	0.07	0.43	0.54
1999/12	1.57	0.47	0.07	0.54	0.66
2000/12	2.25	0.64	0.09	0.20	0.79
2001/12	3.08	5.73	0.26	0.66	2.43
2002/12	7.32	3.11	2.01	2.21	3.66
2003/12	5.91	2.44	1.76	4.04	3.54
2004/12	2.35	2.15	1.35	2.96	2.21
2005/12	2.06	1.91	1.97	2.98	2.23
2006/12	1.71	1.79	1.56	1.53	1.65
2007/12	1.59	1.91	1.75	2.78	2.01
2008/12	1.61	1.91	2.41	4.78	2.68
2009/12	1.87	2.71	4.55	8.24	4.34
<u>Average</u>	1.80	1.27	1.06	2.15	
Net Income / Total Assets (%)	State Banks	Private Banks	Foreign Banks without Citibank	CITI-TR	<u>Average</u>
1988/12	1.98	2.96	4.57	6.79	4.07
1989/12	1.39	2.23	3.39	2.27	2.32
1990/12	1.79	2.87	2.82	1.96	2.36

Table 9: cont'd.

Net Income / Total Assets (%)	State Banks	Private Banks	Foreign Banks without Citibank	CITI-TR	<i>Average</i>
1991/12	0.55	3.02	4.59	12.01	5.04
1992/12	1.62	2.41	5.70	6.48	4.05
1993/12	2.48	2.87	3.95	4.16	3.37
1994/12	-0.05	2.97	9.33	17.09	7.33
1995/12	0.14	4.21	5.97	3.60	3.48
1996/12	0.66	4.20	5.83	-3.86	1.71
1997/12	0.64	3.47	4.44	4.18	3.18
1998/12	0.60	4.33	5.41	6.89	4.31
1999/12	1.13	4.32	5.74	7.01	4.55
2000/12	-0.52	0.81	0.08	4.72	1.27
2001/12	-2.96	-7.68	0.26	1.75	-2.16
2002/12	1.70	2.27	1.15	2.83	1.99
2003/12	2.46	2.22	3.07	4.06	2.95
2004/12	2.63	1.73	2.76	1.90	2.26
2005/12	2.35	0.61	2.32	4.99	2.57
2006/12	2.65	1.81	2.66	1.03	2.04
2007/12	2.80	2.48	1.93	3.95	2.79
2008/12	1.90	1.78	1.32	1.49	1.62
2009/12	2.58	2.55	1.95	1.56	2.16
<i>Average</i>	1.30	2.20	3.60	4.40	

Total Equity/ Total Assets (%)	State Banks	Private Banks	Foreign Banks without Citibank	CITI-TR	<i>Average</i>
1988/12	5.30	7.16	0.32	4.53	4.33
1989/12	6.77	8.09	0.25	4.00	4.78
1990/12	6.30	8.59	6.51	6.78	7.04
1991/12	5.33	8.12	8.92	20.21	10.65
1992/12	3.69	7.57	0.28	7.17	4.68
1993/12	6.29	6.66	5.26	9.52	6.93
1994/12	5.21	7.37	7.28	7.70	6.89
1995/12	4.31	7.45	8.58	7.57	6.98
1996/12	4.02	7.14	9.09	14.82	8.77
1997/12	5.09	6.83	7.31	8.65	6.97
1998/12	3.37	8.49	7.49	7.11	6.61
1999/12	2.97	8.58	7.27	10.16	7.24
2000/12	2.73	10.70	7.31	7.45	7.05
2001/12	8.82	7.40	21.93	12.64	12.70
2002/12	1.57	2.81	6.83	-7.50	0.93
2003/12	-1.16	7.47	11.45	-6.30	2.86
2004/12	4.93	8.81	15.26	-2.75	6.56
2005/12	8.91	8.31	10.68	9.85	9.44

Table 9: cont'd.

Total Equity/ Total Assets (%)	State Banks	Private Banks	Foreign Banks without Citibank	CITI-TR	<i>Average</i>
2006/12	8.85	7.26	11.37	4.36	7.96
2007/12	8.97	10.62	12.11	16.26	11.99
2008/12	7.55	9.90	15.37	14.61	11.86
2009/12	8.75	12.59	18.82	17.47	14.41
<i>Average</i>	5.39	8.09	9.08	7.92	

Source: Data acquired from Banking Association of Turkey (BAT)
http://www.tbb.org.tr/tr/Banka_ve_Sektor_Bilgileri/Veri_Sorgulama_Sistemi.aspx
Note: All ratios are our calculations and based on the Banks Association of Turkey (BAT) data base,

CHAPTER 7

7 DISCUSSION AND CONCLUSION

CITI-GROUP is diversified across number of geographies (Appendix Table A1), which presents both opportunities and risks for the company. Therefore, its financial performance is closely tied to external environment. For instance, in global economies: movements in interest rates, inflation, exchange rates, and geopolitical uncertainties have impact on the earnings. The company is able to create income around the world, with a combination of its strategic, financial and risk management abilities (Figure 16).

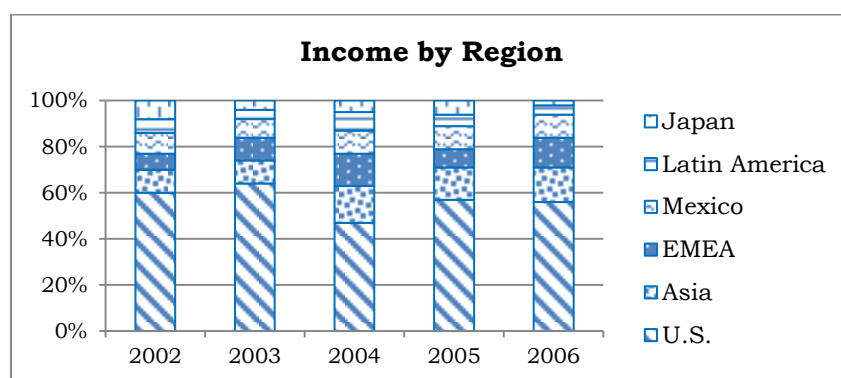


Figure 16: CITI-GROUP's income by region

Source: (Citigroup Inc., 2007)

Moreover, the research findings indicate that Dunning's eclectic theory can be used to explain the presence of Citibank in Turkey. Citibank possesses ownership, location, and internationalization advantages in order to be profitable in Turkey as well. The amount of deposits after the bank is incorporated in Turkey is shown in Figure 17. The figure shows that CITI-TR can attract deposits, and the growth in deposits is usually the same with the total for banks' deposit growth with exception of hike in 2006 and decrease in 2009, following Citibank's failure.

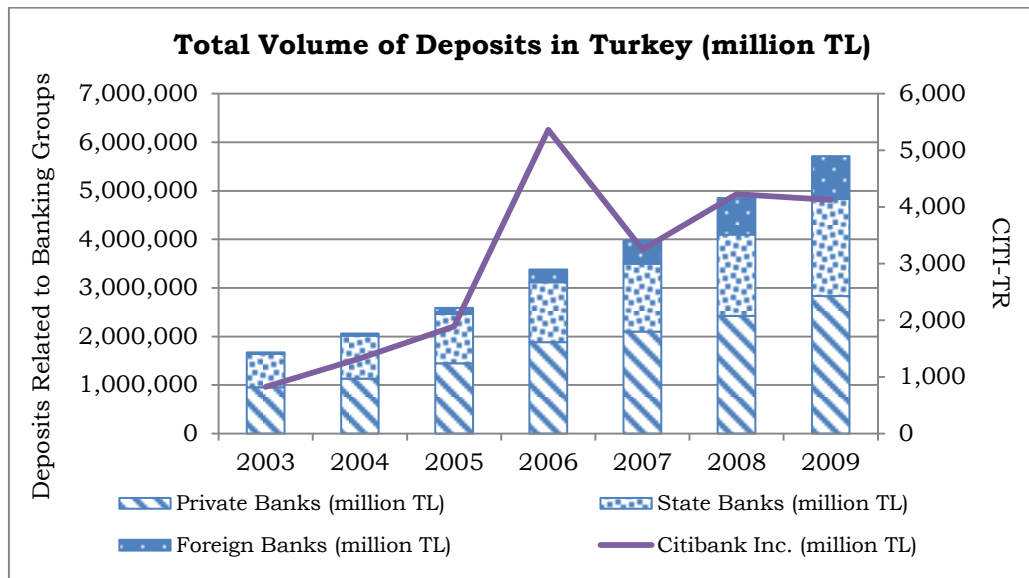


Figure 17: Total Volume of Deposits in Turkey

Source: Banking groups related data obtained from Banking Regulation and Supervision Agency, Turkey, (BRSA)

<http://ebulten.bddk.org.tr/AylikBulten/Gelismis.aspx>;

Citibank data acquired from Banking Association of Turkey (BAT),

http://www.tbb.org.tr/tr/Banka_ve_Sektor_Bilgileri/Veri_Sorgulama_Sistemi.aspx

In addition, the increase in the CITI-TR's number of employees (Figure 18) leads to the conclusion that the bank had no difficulty to attract human resources. Lastly, due to its extensive banking experience Citibank also has knowledge about unique banking techniques. With the help of these factors, we may conclude that it has an ownership advantage as required by the eclectic theory. Since a foreign investment has greater risk than a domestic one, all of the above factors allow Citibank to overcome the advantages possessed by the domestic banks due to incumbency and to compete effectively with them over 64 years.

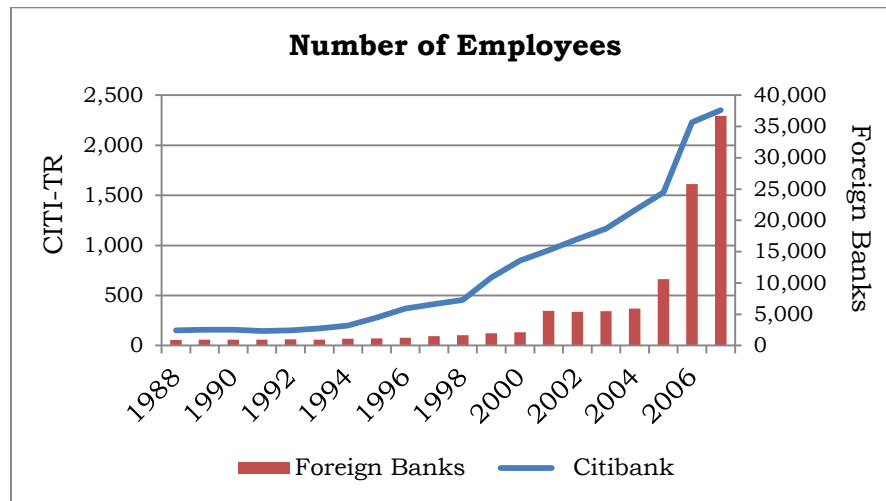


Figure 18: Number of Employees work in Foreign Banks in Turkey

Source: Data acquired from Banking Association of Turkey (BAT)

http://www.tbb.org.tr/eng/Banka_ve_Sektor_Bilgileri/Istatistiki_Raporlar.aspx

When we compare the performance of CITI-TR and CITI-GROUP in terms of ROA and ROE, we find that CITI-TR has higher (2.92%) ROA and ROE (25.10%) than CITI-GROUP (1.24% and 16.81% respectively)

for the period of 2001-2007. Thus, CITI-GROUP's shareholders enjoyed the benefit of going abroad (Table 10).

Table 10: ROE and ROA Comparison (2001-2007)

	CITI-TR		CITI-GROUP	
	<i>ROA</i>	<i>ROE</i>	<i>ROE</i>	<i>ROA</i>
<i>2001</i>	1.75%	13.84%	19.40%	1.44%
<i>2002</i>	2.80%	-37.70%*	18.30%	1.44%
<i>2003</i>	4.10%	50.60%	19.50%	1.51%
<i>2004</i>	1.90%	50.60%	16.80%	1.21%
<i>2005</i>	5.00%	50.60%	22.10%	1.66%
<i>2006</i>	0.98%	23.50%	18.60%	1.28%
<i>2007</i>	3.95%	24.26%	3.00%	0.17%
Average	2.92%	25.10%	16.81%	1.24%

Source: CITI-TR's averages: our calculations based on the Banks Association of Turkey (BAT) database, http://www.tbb.org.tr/tr/Banka_ve_Sektor_Bilgileri/Veri_Sorgulama_Sistemi.aspx,

CITI-GROUP's averages: our calculations based on Citigroup's 2001-2007 annual reports on form 10-K format, <http://www.citigroup.com/citi/fin/sec.htm>

Note: *Negative value, due to data adjustments

Both Mutinellia and Piscitello (2001) and Esperanca and Gulamhussen (2001) explain that a bank's relationship with its customers consists of information assets, and information capital is one of the main resources that create a firm-specific advantage for banks. In line with this ideas,

as mentioned by Cleveland and Huertas (1985) Citibank's first action related with becoming a multinational bank was entrenched to opening of Buenos Aires branch in 1914 to follow its customers like U.S. Steel. Consequently, when it comes to *Internalization advantages* of Citibank, the *follow the customer* approach might explain why the bank prefers direct presence in Turkish banking sector rather than offices. Although it is impossible to reach the exact number of Citibank's clients that has entered Turkey during the study period, according to the Turkish Treasury, in total 23,377 U.S. based or funded firms operate in Turkey as of March 2010. In addition, total volume of FDI from the US to Turkey has a parallel manner with other countries' total FDI flow directed to Turkey (Figure 19). Therefore, it might be concluded that Citibank achieves internalization advantages in Turkish banking sector by entering Turkish market in order to preserve its established accounts and to protect knowledge and information networks.

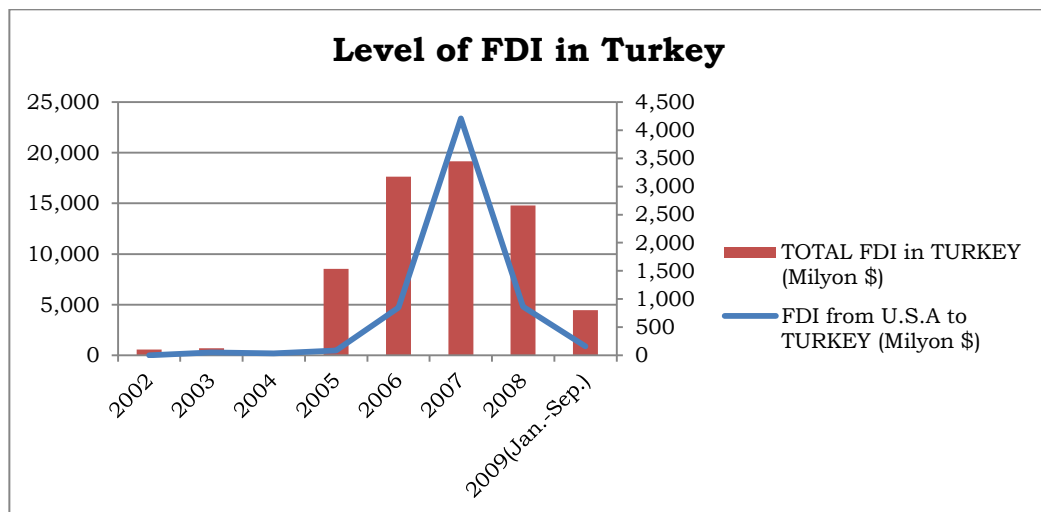


Figure 19: Total Level of FDI in Turkey

Source: FDI data obtained from Republic of Turkey Prime Ministry Undersecretariat of Treasury,
<http://www.hazine.gov.tr/irj/portal/anonymous?NavigationTarget=navurl://ece24785e13b51af18464d81e80b65f0&LightDTNKnobID=1728274996>

Moreover, the analysis is also consistent with Citigroup's strategy for entering emerging markets as: "...to serve global customers, providing them with cash management, trade services, short-term loans and foreign-exchange services." (Citigroup Inc., 2002).

The last required condition for the eclectic theory to hold in the Citibank case is the *location advantage*. Our study also shows that the Citibank also has this advantage. There are favorable differences in regulatory structures between the US and Turkey. Turkish banking regulations are less restrictive. Due to the financial crises followed by the huge devaluations of Turkish Lira in 1994 and 2001 there is the desire of investors in the Turkish financial sector for splitting currency risk from political risk. Citibank also entered other developed and emerging markets around the world, so its client base is geographically dispersed (Appendix Table A1). It also enhanced its informational advantage by acquiring a large national bank (Akbank) in Turkish banking sector.

Citibank's international banking presence and reputation as a giant creditworthy organization, -despite the crisis- attracts customers over local banks. Recent technological advancements and remote access to financial markets, keep Citibank to expand in Turkey. As a final point, as Golberg and Saunders (1981) suggests that current profitability, expected future domestic business, and regulatory changes in the host are major variables that have effect on the growth of foreign banks. Therefore, Turkey's expected EU integration and the integration related regulatory changes have also related with location advantages of Citibank in Turkey.

Thus, we can conclude that, Citibank's growth and presence in Turkish banking sector depends significantly on: (1) ownership advantages related to the bank's dimensional scale; (2) the need to follow its clients who have already expanded their activities into Turkish market in order to save their pre-existing relationships; and (3) the access to positive externalities offered by the Turkish market.

The study reveals that despite its profitability rates, Citibank increased the number of branches in Turkey and improved loan growth. This finding is parallel to Vanderlip's belief about international branch banking (Cleveland and Huertas, 1985). In addition, it supports the governments in Turkey by investing in government debt instruments that comprise a huge portion of the securities portfolio.

Since Citibank has diverse interests across different countries around the world, the volatile environment in Turkish financial system is expected to have no or little effect on its credit quality.

On the other hand, in Turkish banking sector there is a decrease in percentage of loan level of domestic banks whereas foreign banks display a more stable loan level (Figure 20).

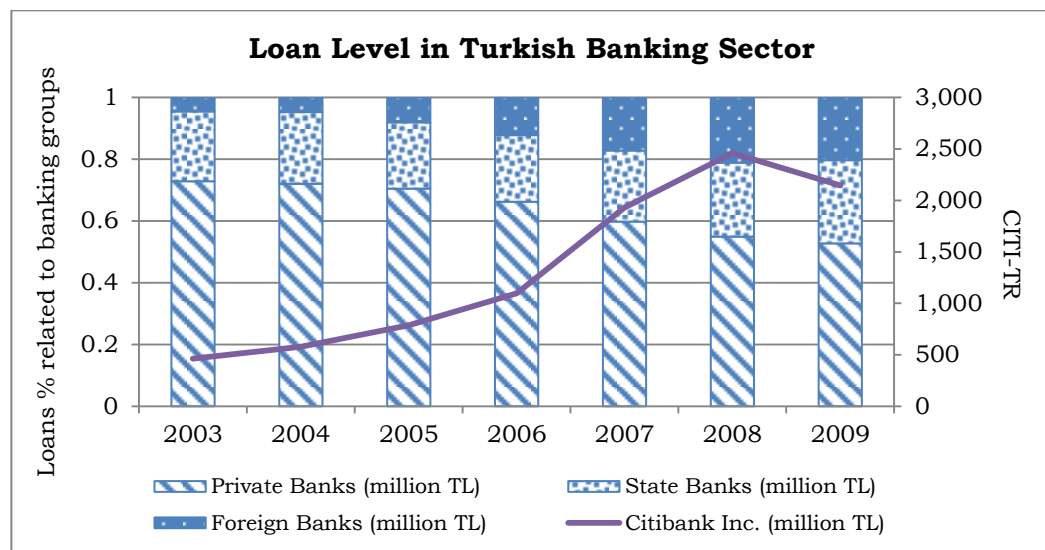


Figure 20: Total Volume of Loans in Turkey

Source: Banking groups related data obtained from Banking Regulation and Supervision Agency, Turkey (BRSA), <http://ebulten.bddk.org.tr/AylikBulten/Gelismis.aspx>;

Citibank data acquired from Banking Association of Turkey (BAT), http://www.tbb.org.tr/tr/Banka_ve_Sektor_Bilgileri/Veri_Sorgulama_Sistemi.aspx

Meanwhile, CITI-TR's lending growth displayed in Figure 20 also moves in a parallel manner with its foreign counterparts. These findings support Dages, Goldberg, and Kinney (2000), since both findings denote that foreign banks have stronger and less volatile lending growth than domestic ones. This finding is in line with de Haas and van Lelyveld (2006) and The World Bank (2009) findings, which imply that the credit supply of foreign banks remains stable during crisis periods in the host country. Besides, this type of lending behavior is supported by the findings of Peria, Powell, and Hollar (2002) as well. They find that in Latin American countries over the period of 1985-2000, foreign bank lending did not decrease significantly even during the crises. This might imply that multinational banks provide a stabilizing factor during financial turmoil. Likewise, Ashcraft (2004) states that during a local financial turmoil, multinational bank subsidiaries experience less financial distress and they recover more quickly than domestic banks because of capital injections by the parent company.

Our analysis shows that CITI-TR's level of capitalization is strong during the turmoil periods. Its *total equity to total assets* ratio findings indicate a protected bank by its owners. Meanwhile, we find that CITI-TR as a result of parental support, which is not available to domestic banks, do not curtail its lending during the financial stress periods in Turkey (Figure 21). Hence, growth in equity could be the explanation for the source of lending growth with well-managed borrowing and lending strategies.

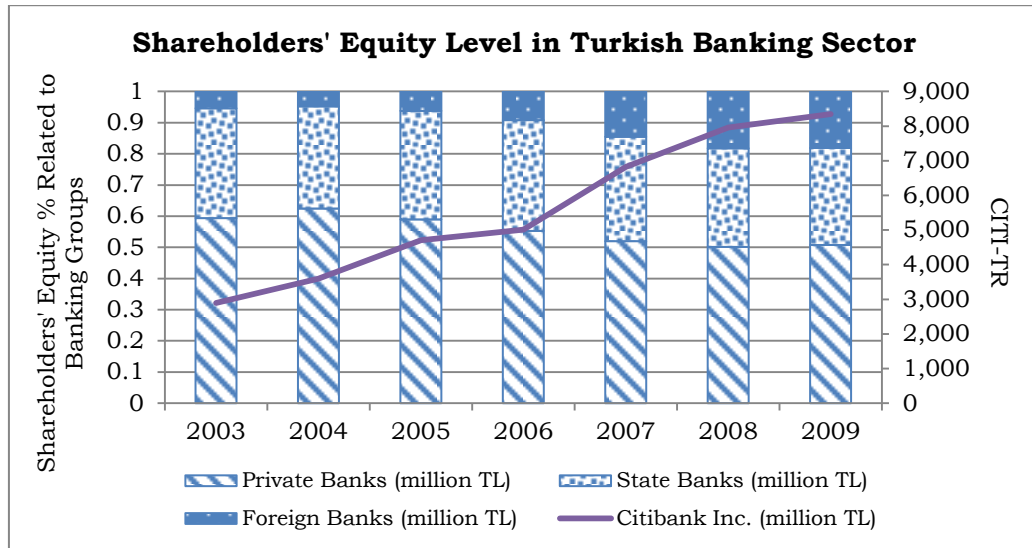


Figure 21: Total Level of Shareholders' Equity in Turkey

Source: Banking groups related data obtained from Banking Regulation and Supervision Agency, Turkey (BRSA),

<http://ebulten.bddk.org.tr/AylikBulten/Gelismis.aspx>;

Citibank data acquired from Banking Association of Turkey (BAT),

http://www.tbb.org.tr/tr/Banka_ve_Sektor_Bilgileri/Veri_Sorgulama_Sistemi.aspx

Furthermore, de Haas and van Lelyveld (2006) state that keeping less liquid assets on the balance sheet helps foreign banks to grow faster. However, when the liquidity risk of the CITI-TR is examined, it is concluded that the portfolio of the bank contains high amount of liquid assets. Hence, its liquidity level is above average when Turkey encounters liquidity crises. This high liquidity position might be the reason of slow market growth of CITI-TR with respect to other foreign counterparts in terms of assets (see Table 11), but decreases the liquidity risk of the banks at the same time.

Table 11: Assets Shares of Banks in Turkey (%)

	2009	2008	2007	2006	2005	2004	2003	2002	2001	2000
Domestic Banks (Private and State Commercial Banks)	83.1	81.8	81.5	84.4	91.1	92.3	90.3	88.1	88.8	81.6
<i>Per Domestic Bank</i>	5.5	5.5	5.4	5.6	6.0	6.1	6.0	5.9	5.9	5.4
Foreign Banks (without CITI-TR)	12.9	14	14.2	11.4	3.9	2.7	2.3	2.4	2.3	4.8
<i>Per Foreign Bank</i>	0.8	0.9	0.8	0.8	0.3	0.2	0.2	0.2	0.2	0.3
CITI-TR	0.6	0.8	0.8	0.8	1.3	0.7	0.5	0.7	0.8	0.6

Source: Data acquired from Banking Association of Turkey, (BAT),
http://www.tbb.org.tr/eng/Banka_ve_Sektor_Bilgileri/Istatistiki_Raporlar.aspx

In addition, Sengupta (2007) applies a theoretical model in order to determine the market segment foreign banks serve. His findings support that foreign banks tend to serve large firms while domestic banks lend to riskier market segments. Hence, CITI-TR uses the advantages of expertise in multinational banking in order to make business with more profitable and creditworthy borrowers. Thus, as *nonperforming loans to total loans* ratio indicate, the bank applies improved risk management techniques or more realistic provisioning against bad loans than the domestic banks. Similarly, CITI-TR has a cost advantage in the form of a better screening technology and network. Likewise, foreign banks in the Turkish banking sector are better performers than the local ones in credit scoring techniques (Figure 22). This superiority of foreign banks helped the advance securitization techniques and led to improvement in the Turkish banking sector with the help of regulations being enforced after the Turkish banking crises (2000). Hence, we might conclude that risk management ability of foreign banks in Turkish banking sector has effect on the improvement of stability of the local financial system.

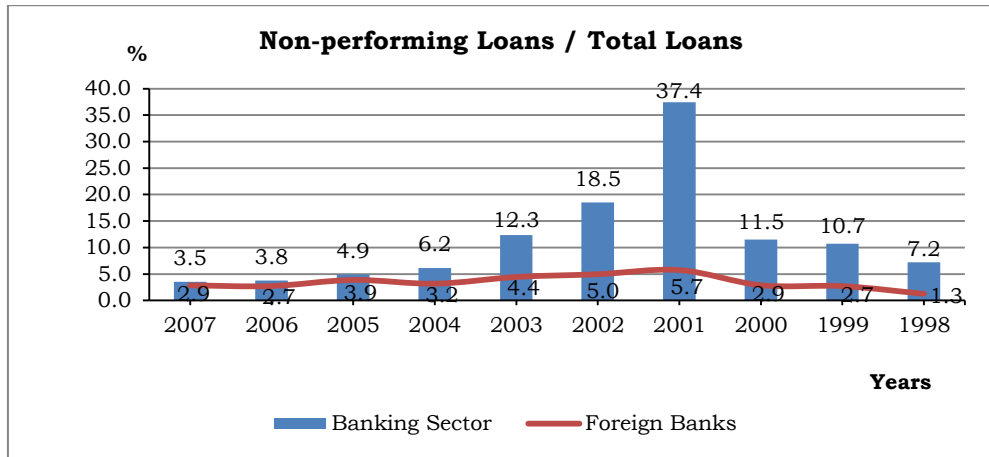


Figure 22: Non-Performing Loans to Total Loans

Source: Data obtained from Banking Association of Turkey (BAT), http://www.tbb.org.tr/eng/Banka_ve_Sektor_Bilgileri/Istatistiki_Raporlar.aspx

It is worthwhile to note that there are arguments against foreign banks concentrating their lending on large enterprises rather than opaque ones (The World Bank, 2002). By expanding their banking services to small and medium sized enterprises, foreign banks make that critique less convincing. Moreover, there is no significant cross-country empirical evidence, which proves that foreign bank entry adversely affects lending to small and medium-sized enterprises (Clarke, Cull, and Peria, 2002). In our case, CITI-TR's CEO explicitly stated their desire to work with small and medium-sized enterprises and the bank began to providing *Commercial Banking* in 1998 (Citibank A.Ş.,2006).

Collecting deposits and then turning these collections into loans is vital for the well-being of banks. The deposit level in the country has an increasing trend over the years (Figure 17). Therefore, Turkish market is also classified as an efficient source for money collection. However, when the deposit holder banks' structure is examined in detail, the findings show that state owned banks still have a key position in the Turkish banking sector. Nevertheless, it is also noteworthy that foreign

banks' percentage of deposit holding increased dramatically during the same period (Figure 17). Furthermore, Citibank's deposit level in Turkish market is higher with respect to other foreign banks in the market except for 2009 (Table 12). The analysis reveals that CITI-TR's ability to convert the amount of deposits into loans is strikingly good as well.

Table 12: Deposits Shares of Foreign banks and Citibank in Turkey (%)

	2009	2008	2007	2006	2005	2004	2003	2002	2001
Foreign Banks	12.2	12.4	13.5	10.3	4.1	2.4	1.7	1.7	1.6
Per Foreign Bank	0.8	0.8	0.8	0.7	0.3	0.2	0.2	0.2	0.09
<i>CITI-TR</i>	<i>0.7</i>	<i>0.9</i>	<i>0.9</i>	<i>1.7</i>	<i>0.7</i>	<i>0.7</i>	<i>0.5</i>	<i>0.7</i>	<i>0.5</i>

Source: Data acquired from Banking Association of Turkey, (BAT), http://www.tbb.org.tr/eng/Banka_ve_Sektor_Bilgileri/Istatistiki_Raporlar.aspx

However, the analysis also suggests that in some years the bank gives more loans than its deposits. On the other hand, the total loans to total deposit ratio implies that especially after 2000 during the crises periods, the bank reduced extending loans. Moreover, the bank has high percentage of liquid assets either as deposits in the banks or investments in short-term securities and government bonds.

In conclusion, the patterns mentioned throughout the study related with profitability, liquidity, credit quality, and capital adequacy levels suggest Citibank Inc. in Turkey has proved its ability to cope with highly volatile market conditions during the recent years. The economic recovery and the re-establishment of economic stability following the domestic and global crises influenced its performance positively. Even though the bank needs improvement to keep pace with its domestic counterparts in terms of efficiency, competitive pressures and market expansion in Turkish banking sector, CITI-TR has increased the quality and the variety of its services consistently in compliance with its global strategy to serve its global customers at local level. Thus, it can be stated Citibank achieved its aim of gaining market share and improving operations and providing various banking services to local customers and enjoying higher returns than the CITIGROUP as a result.

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APPENDICES

APPENDIX A

CITIBANK'S GLOBAL PRESENCE

Table A1: Citibank's global presence

Emerging and Developing Economies	
Country or Territory	Date of Office Established
Algeria	1992: Rep. office, 1997: Corporate bank
Angola	1996
Argentina	1914
Bahamas	1959
Bahrain	1970
Bangladesh	1987: Rep. Office, 1995: Full-service bank
Barbados	1959
Bolivia	1965
Brazil	1915
Brunei	1972
Bulgaria	1998: Rep. office, 2000: Corporate bank
Cameroon	1997: Rep. office, 1998: Corporate bank
Chile	1916
China	1902: Branch opened, 1941-2: All branches closed, 1945: Some branches reopened, 1950: All branches closed, 1983: Rep. office opened, 1988: Rep. office became a full branch
Colombia	1916
Costa Rica	1968
Dominican Republic	1917
Ecuador	1960
Egypt	1955: Rep. office, 1975: Corporate bank, 1999: Consumer bank
El Salvador	1964
Gabon	1966: Rep. office, 1976: Corporate bank
Germany	1926
Ghana	2003: Rep. office
Guatemala	1974
Haiti	1922
Honduras	1965

Table A1 cont'd.

Hungary	1985: Corporate bank, 1995: Consumer bank
India	1902: Branch opened, 1942: Closed, 1944: Reopened
Indonesia	1918: Branch opened, 1929: Closed, 1974: Reopened
Jamaica	1960
Jordan	1974: Corporate bank
Kazakhstan	1994: Rep. office, 1996: Corporate bank, 1998: Consumer bank
Kenya	1974: Corporate bank
Kuwait	2006: Corporate bank
Lebanon	1955: Corporate bank
Malaysia	1904: Branch opened, 1908: closed, 1959: Reopened
Mexico	1884: Banco Nacional Mexicano and Banco Mercantil Mexicano merge to form Banamex. 1903: Citibank opened in Mexico City as a branch of the International Banking Corporation.
Morocco	1967: Corporate bank
Nepal	1984
Nigeria	1965: Rep. office, 1984: Corporate bank
Pakistan	1961: Corporate bank
Panama	1904
Paraguay	1958
Peru	1920
Philippines	1902
Poland	1870: Bank Handlowy w. Warszawie S. A. opened for business, 1991: Citibank opened as Citibank (Poland) SA.
Qatar	2007: Corporate bank
Romania	1995: Corporate bank, 2003: Consumer bank
Russia	1917: Branch opened, 1920: Branch closed, 1974: Rep. office opened, 1980: Rep. office closed, 1996: Branch opened, 2002: Consumer bank launched
Senegal	1976: Corporate bank
Serbia	2007
South Africa	1958, 1995: Corporate bank
Sri Lanka	1979
Tanzania	1994
Thailand	1967
Trinidad & Tobago	1919
Tunisia	1978: Rep. office opened, 1989: Branch opened
Turkey	1976: Rep. office, 1981: Corporate bank, 1996: Consumer bank
Uganda	1999
Ukraine	1997: Rep. office, 1999: Corporate bank
United Arab Emirates	1964: Corporate bank
Uruguay	1915
Venezuela	1917
Vietnam	1972
Zambia	1979: Corporate bank

Table A1 cont'd.

Advanced Economies	
Country or Territory	Date of Office Established
Australia	1929
Austria	1970: Corporate bank
Belgium	1919: Corporate bank
Canada	1925
Czech Republic	1991: Corporate bank, 2001: Consumer bank
Denmark	1919: Rep. office, 1975: Corporate bank, 2002: Consumer bank
Finland	1977: Corporate bank, 2004: Consumer bank
France	1908: Corporate bank
Greece	1964
Hong Kong	1902, 1941: Closed, 1945: Reopened
Ireland	1965: Corporate bank
Israel	1996: Rep. office, 2000: Corporate bank
Italy	1916: Corporate bank
Japan	1902
Luxembourg	1970: Corporate bank
Netherlands	1964: Corporate bank
New Zealand	1982
Norway	1973: Corporate bank
Portugal	1985: Corporate bank
Singapore	1902
Slovakia	1995
Spain	1919: Corporate bank branch, 1941: Closed all branches, 1973: Rep. Office
Sweden	1976: Rep. office, 1986: Corporate bank
Switzerland	1963: Corporate bank
Taiwan	1964
United Kingdom	1902
United States	1812
Other Economies	
Country or Territory	Date of Office Established
Aruba	1969
Cayman Islands	1971
Channel Islands	1969
Congo Democratic Republic of	1971: Corporate bank
Guam	1969
Ivory Coast (Cote d'Ivoire)	1975: Corporate bank
Macau	1983
Monaco	1972
Puerto Rico	1918
South Korea	1967
Virgin Islands	1966

Source: Citibank Inc., 2009; International Monetary Fund, 2010

Note: Economies are classified by using International Monetary Fund Country Composition data set as *Emerging and Developing Economies*, and *Advanced Economies*. *Other economies* category is named by us for countries that are not stated in International Monetary Fund Country Composition data set.

APPENDIX B

GROWTH RATES

Table B1: Growth rates

	Equity growth	Liability growth	Banks growth	Loan growth
1982	13.02040816	4.293650794	3.76034483	53.818
1983	0.473071325	2.56428036	1.22057226	3.024
1984	0.957509881	0.917398391	1.94226064	0.470
1985	0.089601212	0.204294293	0.05138866	0.484
1986	0.057447301	0.146139308	0.51202151	-0.436
1987	0.11128149	0.275633257	-0.1632319	1.304
1988	0.446875616	1.406983445	1.70336723	0.123
1989	0.08719346	0.239663539	0.75674426	0.077
1990	3.299498747	1.460932199	0.7012987	6.852
1991	2.901486447	0.120702454	-0.6129049	0.118
1992	0.281338712	3.201476154	12.7806795	1.541
1993	0.649661847	0.210769078	0.0152189	0.969
1994	0.358897332	0.714715139	0.86204499	-0.043
1995	1.642392718	1.692704898	0.83877122	2.713
1996	2.474409449	0.634195472	2.20890125	0.182
1997	2.24815864	4.969776156	4.06536061	5.649
1998	0.26286412	0.56291347	0.67609611	0.573
1999	1.815400552	0.905102623	1.18345739	-0.013
2000	0.161208821	0.630419346	0.4005097	1.069
2001	2.515072139	0.957003278	1.38566072	1.220
2002	-1.521027644	0.342343987	-0.1529091	0.597
2003	-0.317881406	-0.128027563	-0.6715468	0.242
2004	-0.293917719	0.458316406	0.83179239	0.363
2005	-6.388078645	0.174321187	1.03811859	0.395
2006	0.135832704	1.53687339	0.68668837	0.581
2007	1.668911489	-0.399625642	-0.6625167	0.114
2008	0.167366280	0.32543632	-0.9474686	0.287
2009	0.070162548	-0.135109419	8.779598	-0.1698

Table B1 cont'd.

	Asset growth	Deposit growth	Net interest income growth
1982	5.067	5.725609756	-3.098901099
1983	2.136	2.267150196	8.335078534
1984	0.921	0.324484322	1.181716209
1985	0.193	0.221663524	-0.33033419
1986	0.138	0.494083348	1.268330134
1987	0.262	0.376453933	-0.446268404
1988	1.337	0.98304378	0.446875616
1989	0.233	0.130501822	-0.220069204
1990	1.534	1.321140732	3.173025732
1991	0.309	-0.09001068	4.001913672
1992	2.611	0.890695627	0.477724877
1993	0.242	1.900925236	0.338300443
1994	0.681	1.551796474	1.598684493
1995	1.689	2.544555452	0.179526204
1996	0.773	0.862856467	0.249649369
1997	4.566	3.225179445	10.52020202
1998	0.537	-0.05317438	1.201032685
1999	0.970	1.309717371	0.503197964
2000	0.583	0.274132787	0.54070846
2001	1.073	2.314087934	0.63394427
2002	-0.122	0.701702746	-0.447479078
2003	-0.188	-0.21177909	0.188949458
2004	0.620	0.60941018	0.392589427
2005	0.503	0.42666546	0.301449905
2006	1.564	1.836235164	0.305126291
2007	-0.284	-0.39399647	0.326871036
2008	0.299	0.30053440	0.193675665
2009	-0.105	-0.14506532	-0.1442248741

Note: All rates are our calculations and based on the Banks Association of Turkey data base, http://www.tbb.org.tr/tr/Banka_ve_Sektor_Bilgileri/Veri_Sorgulama_Sistemi.aspx
We calculate X account's growth rate by applying: $(X's\ value\ in\ 2007 - X's\ value\ in\ 2006) / (X's\ value\ in\ 2006)$