Increasing Foreign Banks' Presence through M&As: The Case of Turkey

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Abstract— Turkey had been a closed economy until the beginning of 1980s. However, this changed once the government adopted liberalization and de-regulation programs at that time. Decreasing entry barriers and approved foreign ownership in the banking sector naturally triggered more foreign bank entry in the coming years. This trend got changed in nature especially after the currency crisis of 2001. Recovering from the crisis stronger with a growing economy, Turkish banking sector with its technologically advanced banks evoked the appetite of foreign counterparts that mostly chose the entry method of M&As. This created the empirical fact that while the number of foreign banks have been increasing, the number of (local) private banks have been decreasing due to these acquisitions in the decade of 2000s. This paper presents data for the mentioned result together with the review of Turkish banking sector starting from 1980s. The paper also examines the major deals that were realized in the last decade and tries to understand the reasons of increased foreign bank presence by outlining the 'pull factors' of the Turkish economy.

Key-Words: acquisitions, de-regulation, foreign bank entry, globalization, pull factors.

1 Introduction

When the topic comes to foreign banks expansion into emerging markets, there has been a significant trend towards the Central and Eastern European (CEE) markets ever since the beginning of the Cold War in the late 1980s. In relation to the ongoing globalization process ever since, the countries started to liberalize their economies step by step, and thus opened themselves up for foreign investors. Clearly, Turkey has been no exception and with the decreasing entry barriers it has become a new region for foreign banks to be explored. This trend has continued until now and especially accelerated following the financial crisis of 2001 after which Turkey had a time of economic boom.

This paper studies the historical evolvement of Turkish banking sector by portraying the increase in the foreign banks' presence especially in the last decade. On the other hand, while section 4 reviews the most recent acquisitions done by the foreign banks, the final section of the paper outlines the most important reasons or the 'push factors' behind this trend.

2 Evolution of the Banking Sector: 1980-2000s

Accordingly, in the 1980s the policymakers started to re-structure and liberalize the Turkish banking system. Several financial reforms and structural programs were adopted in order to eliminate controls on interest rates and relax entry barriers in order to promote competition and consequently increase the efficiency. Especially, the opening up of the capital account in 1989 had been an important step in the liberalization program. The overall number of banks between 1980 and 1990 increased from 28 to 52. However, since most of the new entrants had focus on trade finance and wholesale corporate banking, their impact on the Turkish retail banking market remained quite limited.

With the increasing total number banks, there has been also a strong increase in foreign bank entry as the new open economy required adequate financial services and a proper financing. Foreign banks had usually been smaller than local banks. The largest foreign bank has been the "Ottoman Bank", which was established in 1863. Moreover, it has been the only foreign bank engaged in retail banking. The entrance of other foreign banks after the liberalization had a big impact on competition that led to decrease in prices for fee-based services (Denizer 1997: 5-17; Denizer 2000: 2-11).

The following figure presents the change in the number of deposit banks in the Turkish banking market between 1980 and 1990:

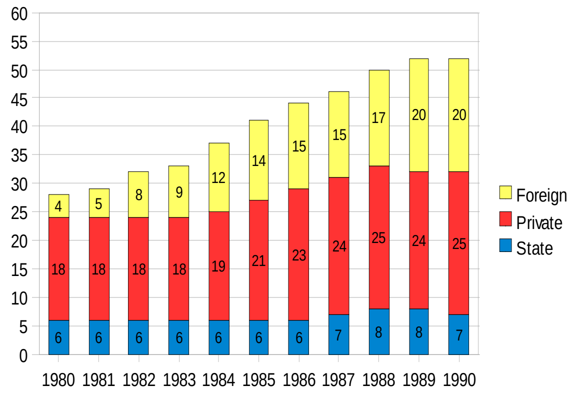

Fig.1: Number of deposit banks by ownership category, 1980-1990. Data generated from The Banks Association of Turkey.

By looking to this graph, we can observe that there was a significant rise in the number of foreign banks due to the deregulation efforts taken during this period. In fact, it is striking to see that the number of foreign banks actually quadrupled which indicates the Turkey's open economy at that time. On the contrary, the number of Turkish private and state owned banks rather stayed constant in the first half of the respective period, and later on just slightly increased.

With the following figure, we are able to see the further evolution of the number of deposit banks in Turkey from 1990 until 2000:

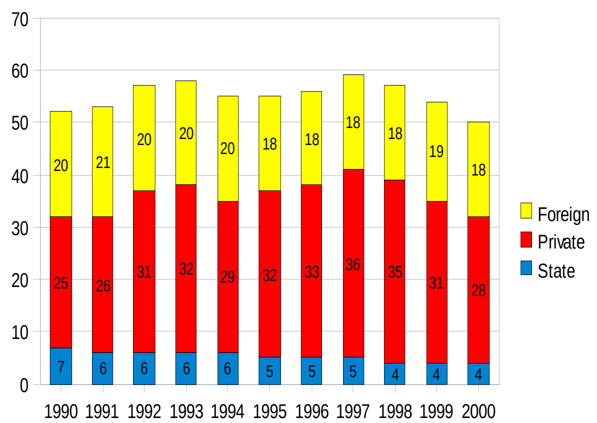

Fig. 2: Number of deposit banks by ownership category, 1990-2000. Data generated from the Banks Association of Turkey.

Figure 2 above illustrates that the number of banks in each category rather stayed constant during this decade that is especially true for foreign banks. Another interesting observation from this graph is the number of state-owned banks plummeted. This decade also coincides with the currency crisis of 1994 that does not seem to have an adverse effect on the foreign bank entry in the following years. This crisis was mainly due to the overvaluation of Turkish Lira prior and Turkey's high current account deficit. Furthermore, debt management of the government was not adequate at that time which led to a flight of capital. The Turkish lira depreciated almost 70% percent against the US dollar and the Central Bank had to intervene in the foreign exchange market, which led to a high loss of its international reserves. However, Turkey still remained an interesting market for foreign investors since lower prices in stock and bond markets combined with the depreciation of Turkish Lira provided them an opportunity for high profits (Özatay 2000: 327-330).

3 2000s and Onward

When the time comes to 2000s, Turkey lived through another crisis that was triggered by a combination of high inflation and a large increase in the current account deficit. The crisis revealed the fragility of the banking sector and created an even bigger capital outflow than the one experienced in 1994. This negative development really hit the Turkish economy, especially due to high-risk accumulation and increases in nonperforming loans, which made the banking sector very vulnerable. At this time, the fixed exchange rate regime adopted by Turkey also collapsed and it had to be replaced with the floating exchange rate system.

During this decade, the Banking Regulation and Supervision Agency (BRSA) was also established in order to audit the sector and enforce the sound banking practices. Following the crisis in May 2001, Turkey joined a new International Monetary Fund (IMF) program. This program consisted of three pillars: Fiscal and monetary discipline, structural reforms and external financial support. Furthermore, the Central Bank adopted as the primary goal of the monetary policy maintaining the price stability. In short, these developments positively contributed to Turkey's economic situation after the 2001 crisis. However, a high current account deficit and reliance on (short-term) foreign capital inflows remained to be important problems. Starting from late 2000s up-to-date, the Turkish economy and the financial sector seems to be largely recovered from the crises faced in the previous decades except the recent political instability of 2013. In spite of the general recovery in the economy, the banking sector does not seem to be very positively evolving especially for the local private banks which is observable from the following graph. (Aysan and Ceyhan 2006a: 12-13; IMF 2007: 6-10).

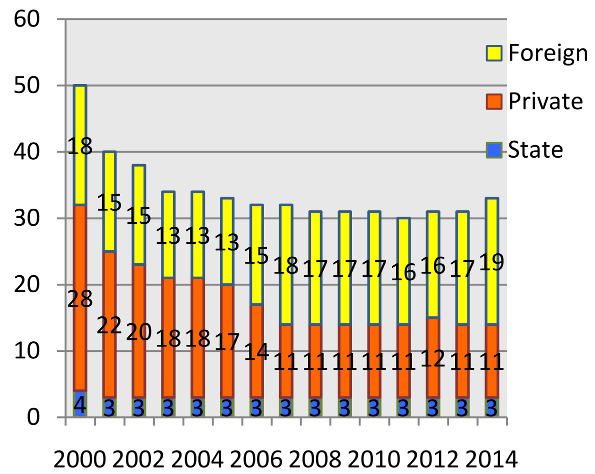

Figure 3: Number of Deposit Banks by ownership category, 2000-2014. Data generated from the Banks Association of Turkey.

We observe from Figure 3 that the number of local private banks dramatically decreased from 28 to 11. One of the reasons of this is that SDIF (Saving Deposit Insurance Fund) took over the financially unsound banks of the sector during the recovery and stabilization period that is realized between 2001-2004 following the crisis (Akin, Aysan and Yildiran, 2008). Another observation is that the number of state banks fell by one in 2001 and ever since it stayed constant. On the other hand, the number of foreign banks kept falling until 2005 that got reversed in the following year and reached to 19, which is almost the same number at the start of this period.

By only looking to this graph, one can conclude that the involvement of foreign banks in Turkey did not change much except for some volatility due to the crisis in 2001. But if one inspects closely the classification of those foreign banks with respect to their entry modes that are the ones only have branches versus the ones that are founded in Turkey, one may realize the following fact as is evident in Figure 4. In 2000 while the number of foreign banks that opened up branches Turkey was 13, the number of foreign banks founded in Turkey was only 6. Now in 2014 the situation has been completely reversed meaning that while the number of foreign banks that has branches in Turkey are only 6, the number of foreign banks founded in Turkey has become 13. This considerable increase in the number of foreign banks established in Turkey has been mainly due to (mergers and/or) acquisitions of private local banks (with) by foreign banks during this decade, which also explains why the number of private local banks reduced by more than half.

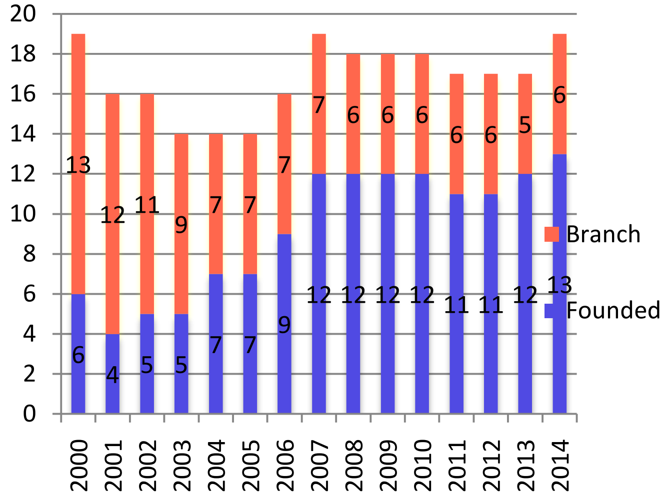

Figure 4: Number of Foreign Banks with respect to entry modes. Data generated from the Banks Association of Turkey.

Another way to study the evolution of foreign banks' participation is to have a look at their totals assets compared to (local) private and state banks. Figure 5 below illustrates clearly that the total assets of foreign banks in Turkey kept increasing constantly until 2008 where it reached its maximum of 25.3%. In 2009 there is a decline that is supposedly related to the global credit crisis of 2008-2009. In the following years, there is stabilization in the total assets of foreign banks and in the foreign bank entry. One may also notice that the total assets of (local) private banks decreased a lot while the total assets of foreign banks were increasing during the 2003-2008. As it is mentioned earlier, this effect is mainly due to the acquisitions of (local) private banks by foreign banks.

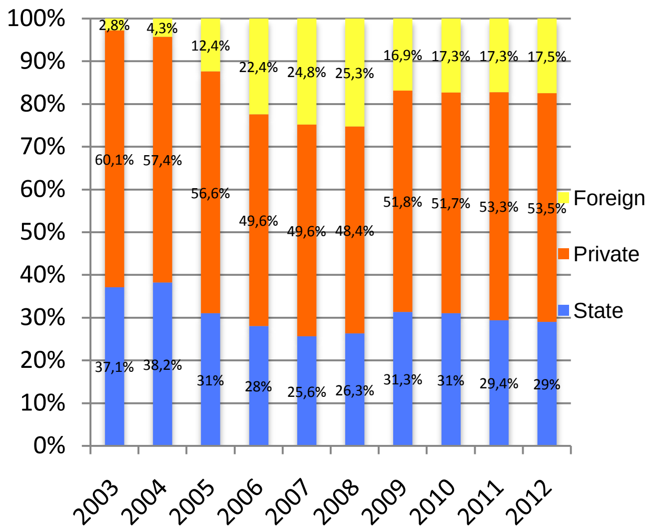

Figure 5: % of Total Assets according to ownership category, 2003-2012. Adapted from TCMB.

4 Recent Bank Acquisitions

Previous section points out that the recent increase in the foreign ownership is due to the acquisitions of local banks by foreign entrants. On the other hand, this section will review the most recent acquisitions that are realized in the last decade.

The acquisitions wave of Turkish banks started with the case of Demirbank, which was transferred to SDIF in 2000 and then was sold to HSBC Group in 2001. After the acquisition, Demirbank got merged with the existing subsidiary of HSBC in Turkey. The biggest wave of the acquisitions hit in the year of 2005 during which the ownership of four major Turkish banks were changed hands: i) Yapi Kredi Bank was taken over by Koc Financial Services which is a 50%-50% joint venture between Koc Group (Turkish) and Uni-Credit Group, ii) Disbank acquired by Fortis Group, iii) Garanti Bank's 25% stake sold to General Electric (GE) which later on sold its shares to Banco Bilbao Vizcaya Argentaria (BBVA) in November 2010 and iv) Turkish Economy Bank (TEB) acquired by BNP Paribas Group.

The wave continued in the next year as well with the sale of Denizbank to Dexia Group and Finansbank to National Bank of Greece (NBC). However, Dexia Group resold Denizbank to Russian Sberbank in 2012 due to its financial difficulties. Another interesting case was the case of Sekerbank that was planned to merge with Rabobank but finally sold to Kazak BTA Bank again in 2006. With this acquisition, a Turkish bank had been sold to an Asian acquirer for the first time. In the following year, another transaction proved the interest of large banking groups in the Turkish market: Accordingly, in 2007 Citigroup bought 20% shares of Akbank that is originally owned by Sabanci Holding Group. Two other notable deals of 2007 were the acquisitions of Tekfen Bank by Eurobank EFG and Oyakbank by ING Group. Similar to previous deals, later on Greek Eurobank EFG resold Tekfen Bank in 2012 to Burgan Bank Group that is originally from Kuwait.

Finally, the latest deal of the sector was the purchase of Alternatifbank by the Commercial Bank of Qatar in 2013. All the details of these deals are presented in the following table.

Year	Acquirer	Acquirer's Nation	Target	% Acquired
2001	HSBC Bank	UK	Demirbank	100%
2005	UniCredit	Italy	Yapi Kredi Bank	50%
2005	Fortis	Belgium	Disbank	89.3%
2005	GE Group	USA	Garanti Bank	25%
2005	BNP Paribas Group	France	TEB	73%
2006	Dexia Group	France-Belgium	Denizbank	99.85%
2006	NBC	Greece	Finansbank	100%
2006	Kazak BTA	Kazakhstan	Sekerbank	31%
2007	Citigroup	USA	Akbank	20%
2007	Eurobank EFG	Greece	Tekfen Bank	100%
2007	ING Group	Netherlands	Oyak Bank	100%
2010	BBVA	Spain	Garanti Bank	25%
2012	Sberbank	Russia	Denizbank	99.85%
2012	Burgan Bank	Kuwait	Tekfen Bank	100%
2013	Commercial Bank of Qatar	Qatar	Alternatif Bank	100%

Table 1: Recent Bank Acquisitions of Turkish Banking Sector

5 Reasons of Increasing Foreign Banks' Presence

As the above paragraphs has highlighted, there has been a dramatic increase in the presence of foreign banks in Turkey mostly through acquisitions of local banks. This section will discuss the main reasons of this trend.

After taking a closer look on these acquisitions in the previous section, we realize that mostly European banks were the acquirers. Keeping that in mind, we list below the most important of the Turkish economy.

i) Increasing population and per capita income:

One of the foremost pull factors to Turkey especially for European banks is its high growth potential with an increasing population especially compared to the European economies (Besinci, 2005). Following the 2001 crisis, Turkey went through a recovery and stabilization program that triggered its GDP growth, which reached to its peak with 9.4% growth in 2004. (World Bank, 2015)

ii) Geo-strategic positioning:

Another important reason for European banks' entry to Turkey is its proximity to Europe and its strategic position between Europe and Middle East. In this respect, it offers a favorable location for banks that want to enter into emerging economies in order to have a new customer base.

iii) De-regulation and Strengthened Supervision:

Turkey's deregulation process that started in 1980s eased and supported the entry of foreign banks by setting no limitation on the share of foreign ownership and keeping equality in the treatment of Turkish and foreign banks. Last but not least, there has been better regulation and auditing of the Turkish banking sector especially after the establishment of Banking Regulation and Supervision Agency (BRSA) in 2000. Furthermore, Turkey has adopted Basel II Agreement starting from 2007, which introduces risk-based approach and enables financially sound banks to have lower capital ratios. This development also attracted large and financially strong foreign banks into Turkish market. In addition, BRSA required banks to match their up to one-month short-term liquid liabilities with 100 % of liquid assets (Özdincer and Özyildirim, 2008). These regulations were important to ensure the soundness and to control the riskiness of the whole banking system so that bank failures can be prevented. (Vodova, 2011)

iv) Technological Infrastructure:

One other very interesting reason of foreign bank entry is the entrants' conjecture to benefit from the technological development of the Turkish banking sector Being different than many other host countries, Turkey offers technological improvement as it became evident by the case of Finansbank that is acquired by NGB, which aimed to decrease the product development and IT related costs in the Southeastern European region (Aysan and Ceyhan, 2006b).

v) Highly Leveraged Banks:

In addition to all the factors highlighted above, those acquired local banks during this decade had high amounts of debt, which might be another pull factor for foreign entrants as evidenced by Kraft (2002).

6 A Comparison with the CEE countries

Historical evolution of Turkey shows similarities with the Central Eastern European (CEE) countries considering the fact that they all started to open up their economies towards the end of 1980s and/or beginning of 1990s. Another common feature is the origin of the foreign bank entrants. As it has been evidenced above in Table 1, most of the entrants to Turkish banking sector are from Western European countries which is also the main origin of the entrants into the CEE economies especially due to the geographical proximity.

Similar to the Turkish experience, the method of M&As or the acquisition of the local banks has become also very prominent in the CEE countries in 2000s once after these countries applied for a membership in the European Union (EU) and then some of them joined in 2004. Accordingly, the following table lists the major deals in Poland, Czech Republic and Slovakia which all joined to the EU in 2004. (Fritsch, Gleisner and Holzhäuser, 2007)

Year	**Acquirer**	**Acquirer's Nation**	**Target**	**% Acquired**
1999	Fortis AG	Belgium	Pierwszy Polsko-Amerykanski Bk (Poland)	58.8%
1999	UniCredit	Italy	Bank Polska Kasa Opieki SA (Poland)	52.1%
1999	AIB European Investment Ltd	Ireland	Bank Zachodni SA (Poland)	80%
1999	KBC Bancassurance Holding NV	Belgium	CSOB (Czech Republic)	65.7%
1999	Bayerische Hypo- und Vereinsbank	Germany	Bank Przemyslowo-Handlowy SA (Poland)	27.85%
1999	Deutsche Bank	Germany	Bank Wspolpracy Regionalnej SA (Poland)	89.20%
1999	Erste Bank	Austria	Ceska Sporitelna Savings Bank (Czech Republic)	52.07%

2000	Citigroup Inc	USA	Bank Handlowy (Poland)	56%
2000	Danske Bank	Denmark	Polsko-Kanadyjski Bank (Poland)	83%
2000	Unicredit	Italy	Polnobanka (Slovakia)	51.2%
2000	Erste Bank	Austria	Slovenska Sporitelna	87.18%
2001	Societe Generale	France	Komercni Banka (Czech Republic)	60%
2002	Unicredit	Italy	Zivnostenska Banka	85.16%

Table 2: Major Deals in some CEE countries.

7 Conclusions

Turkish banking system has changed a lot after Turkey opened up its economy in 1980s. After the liberalization program, the overall number of banks between 1980 and 1990 increased from 43 to 66 due to new foreign banks' entry. Despite this increase, retail banking sector did not get much affected since the focus of the new foreign entrants was on corporate banking. This increasing trend in the number of foreign banks has continued especially in the decade of 2000s after restructuring and better supervision of the banking sector with more regulatory constraints following the 2001 crisis. Large banking groups that wanted to benefit from high economic growth potential of the Turkish Economy preferred to enter the market mostly through M&As. Local private banks were acquired by new foreign entrants, which created a considerable decrease in the number of private banks and in the % share of total assets of private banks. The paper presents the details of those major deals and outlines the factors attracting the foreign banks into Turkey. Currently, Turkish banking system seems to be rather stabilized with the constant number of banks in almost every category.

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