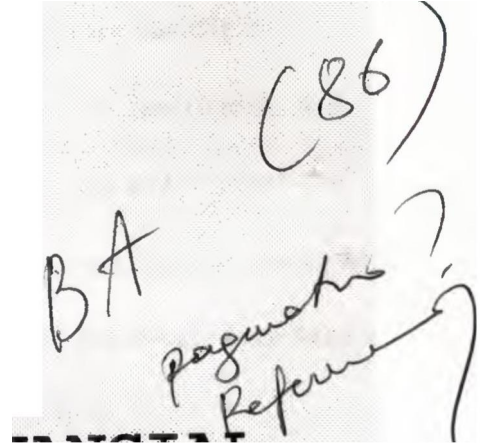




NEAR EAST
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BUS 478



INTERNATIONAL FINANCIAL
ACTIVITIES OF ECONOMY BANK

Submitted by: PROF. DR. Mevlüt Çağlar

Submitted to: Salih Aşehitoğlu (90042)

CYPRUS ECONOMY BANK
(KIBRIS İKTİSAT BANKASI)

AIM OF THE STUDY

Banks are the most important financial institutes in every country's economy. In this study we will try to investigate and report the functioning, and activities of the Cyprus Economy Bank. We will look at the local and international aspects of the bank. TRNC, being a small country, - one may think that the banks do not have much to do with the outside world but as we have found out, even such a new and small bank has a lot of international work to deal with.

Economy in TRNC has not yet been institutionalized. Even the banks are not yet formally institutionalized in TRNC. We were not able to find printed and published material. All we could find was the annual report of the bank in Turkish. We have made some interviews and read books on banking to complete our report.

Introduction

Cyprus Economy Bank, CEB is one of the fairly new banks in TRNC. It is founded by one of the most prominent lawyers of TRNC Mr. Menteş Aziz, who is also in business of construction, construction materials wholesale, and representative of Hyundai Cars in TRNC. The bank was established in 1991. One of the most modern

and original building was custom built as the center for the operation of the bank, in Bedreddin Demirel Caddesi.

CEB is active in all aspects of banking. Since their establishment, they have managed to open branches in all the major cities in TRNC.

PRESENT SITUATION OF THE BANK

CEB is famous for their elegant buildings. Big part of the bank belongs to a lawyer who is also known as one of the rich-men in TRNC. As stated earlier this bank is a new one. Its only four years old. The Fourth Annual General Meeting of shareholders was held on 7th April 1995 at the Bank's Head Office in Nicosia:

The paid-up capital was increased to TL 25 billion during the past year and it will be increased to TL 50 billion before the end of May, 1995 in order to conform to local banking legislation. In preparation for this increase, our Board has resolved to recommend that the Company's authorized capital be increased to TL.100 billion.

At the 3rd Annual General Meeting (in June 1994) the hope was expressed that a mutually acceptable solution might be found to the political problem of our island but although the general elections did bring in a coalition government which, in certain circles, was credited with strong leaning's towards such a solution, a settlement again eluded the efforts of the two communities.

Only a part of the anticipated expansion of the business and improvement in trading results has been achieved due to the effects of the monetary crisis in Turkey adversely affecting North Cyprus. As well known, the long drawn out crisis and economic recession in Turkey and North Cyprus lead some banks operating in Cyprus suffering liquidity problems and three of those banks have had to cease operations.

Despite the adverse financial climate the management feel pleased and proud to advise that the Bank has achieved the following growth as compared with the previous year end results:

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Liquid assets	+(58.4 %)
Deposits & other a/e's	+ 134.3%
Advances	+ 233.6 %

Income:

Interest & commissions	+ 1315.2 %
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Other	+108.8%

According to the government official statistics, the rate of increase in the cost of living (Dec.1993-1994) has been 215.01 %, which largely explains the increase 209.2% in their staff costs.

In their constant drive to improve the quality of service rendered to their customers, they have acquired in Kyrenia purpose built new premises and hope to be operating from similar bank premises in Famagusta. Also, they hope to introduce real time, on-line automation in their records by mid 1995. I am also very pleased to be able to advise that we have now been able to bring about the planned restructuring of their top management with the appointment of their senior manager at Head Office with direct responsibilities for line management, finance and accounts, budgeting, planning and marketing, and personnel training. They are confident that this will further improve the quality of service to their customers and their competitive edge.

Financial Summary	1994	1993
	TL million	TL million
Net Profit Before Tax	2,076	1,323
	764	515
Net Profit After Tax	1,312	808
Reserves	2,206	937
Capital and Reserves	27,206	11,937
Deposits	308,591	134,265
Advances to customers	209,122	62,336
Total Assets	371,887	157,638

Cyprus Economy Bank Ltd.

Balance Sheet as at 31 December 1994

	1994	1993
	TL Million	TL Million
ASSETS		
Cash-in-hand and balance at Central Bank	79,288	30,907
Balance with Banks	55,505	54,185
Advances to customers	209,122	62,336
Other assets	5,691	1,876
Interest receivable accrued and prepayments	18,235	6,294
Tangible fixed assets	4,046	2,040
TOTAL ASSETS	371,887	157,638
LIABILITIES		
Deposits	308,550	134,209
Bank deposits	41	56
Other liabilities	20,889	4,010
Tax payable	853	137
Interest payable and accrued expenses	14,652	7,211
Minority interest	196	78
Share capital	25,000	11,000
Reserves	2,206	937
Shareholders funds	27,206	-11,937
TOTAL LIABILITIES	371,887	157,638

The accounts, which have been fully audited, have been prepared under the historical cost convention basis. The auditor's report is unqualified.

As at 31 December 1994 the bank has contingent liabilities in respect of letters of credit and guarantees for and on behalf of customers for an amount of TL 54,933 (TL 29,883 for 1993).

As per the Extra Ordinary Meeting of shareholders dated 23 January, 1995 the authorized share capital of the company has been raised to 100 billion TL.

FUNCTIONING OF BANKS

Every bank performs three basic functions:

- (i) it accepts and safeguards deposits of money from customers;
- (ii) it permits money to be withdrawn or transferred from one account to another;
- (iii) it lends the surplus of deposited money to customers who wish to borrow.

A sound banking system depends primarily on the control exercised by the central bank and, to a large extent, on trust: that is, the customer's trust that his deposits will be looked after in the best possible way and that when he wishes to withdraw his money, the funds will be available. The banks have a major responsibility to behave like good citizens in business: while profitability remains a major consideration, this must sometimes be set aside in favor of an informed and

ethical judgment that takes account of the interests of others. In Britain in the early 1970s, for instance, some banks made errors of judgment in lending too much to certain sectors of the business community, notably in the property market.

Several of the smaller banks would have failed if it had not been for assistance

organized by the Bank of England, funded mainly by the clearing banks.

Whenever banks lend money it is their customers' money that is being advanced, so it is important that they should lend where there is a minimal risk of non-repayment. They have often been criticized for not lending more freely, but a high risk of loss will frequently deter them from granting an advance, even if the highest rates of interest could be charged.

The Role of the Banks in The Finance

We mentioned above the basic functions of any bank are to accept, safeguard and lend the surplus funds of its customers while permitting the withdrawal of funds, or their transfer from one account to another]. Nowadays, the banks have come a long way from their origins in the London goldsmiths of the late seventeenth century and while some specialize in meeting the needs of particular groups of customers, such as companies or small savers, the clearing banks provide a range of services to satisfy the financial needs of all types of customer, from the smallest personal account holder to the largest company. These services can be grouped under the following headings:

- (i) deposits and savings;
- (ii) advances;
- (iii) money transmission;
- (iv) financial and advisory services;
- (v) foreign services.

We shall consider the scope of these services briefly, one by one, though each is dealt with in greater detail later in this book.

(i) **Deposits** are the funds that customers leave in their accounts, whether these are current accounts, which are for 'current' money/ that is not intended to be saved, or deposit or savings accounts which are for money that **will** not be required immediately. Customers with a current account are usually issued with a cheque book which enables them to draw or write out cheques that instruct the bank to pay cash from the account or to make payments to other people. Deposit and savings account holders do not have the **bendi 1f** a cheque book; instead they are paid interest on moneys **left** with the ban

(ii) **Advances** are the moneys lent by a bank, generally in the form of an overdraft on a current account, by which the customer draws out more money than he has

put in to the account. They may also be *made by means of a loan or personal loan.*

Interest is charged on all advances, the rate varying with the method of granting the advance, the creditworthiness of the customer and the length of time for which the funds are borrowed. Advances represent that part of customers' deposits which the bank consider may safely be lent, while the remainder is retained in the form of cash and other assets.

(iii) **Money transmission** enables customers to make payments without having to carry around large sums of cash, because the cheque is a convenient method of settling a debt. Equally a customer can pay in money at any bank branch for the credit of an account at another branch by completing a simple form known as a bank giro credit. He may also instruct his bank to debit or deduct amounts from his account to make regular payments to meet recurring debts, such as club subscriptions, life assurance premiums or mortgage repayments, by means of the standing order or direct debit systems.

Besides enabling customers and, to some extent, non-customers to transfer funds quickly and easily by means of a piece of paper, the banks physically move many thousands of pounds worth of notes and coin from branch to branch each day. This is to ensure that branches which regularly pay out more notes and coin than they receive will never be short of cash. For instance, some denominations of coin are in constant demand by shopkeepers, and other coins are needed by private



customers for gas and electricity meters. So some branches, particularly those where gas and electricity boards and bus companies pay in, regularly have surpluses of coin needing to be transported to other branches that have a deficit.

(iv) **Financial and** advisory services cover a wide range of facilities that can be tailored to suit the individual needs of the customer. Financial services vary. One form is the cheque guarantee card for personal customers, which can be used to guarantee or 'back up' a cheque when paying for goods in a shop or drawing cash at branches other than that at which the account is maintained. Another might be a business service such as factoring, in which the bank administers a client's sales ledger and enables a company to obtain an advance against debts which are due to it. The major banks are always willing to give advice, from suggesting suitable investments to a customer with a few hundred pounds, to advising a private limited company of the best time to 'go public', that is, to have its shares quoted on a stock exchange.

(vi) Foreign services of the banks include ~~trav~~ and currency services; they also make international payments. All large banks have links with overseas banking groups, so payments of this kind can easily be made. Some banks have

linked more formally with a number of overseas banks to form consortia which are able to provide large-scale finance to suit the needs of multi-national corporations.

INTERNATIONAL ACTIVITIES OF CEB

CEB gives full range of services to their customers, including international services. We can summarize their international activities as follows;

Cheques and Credit Cards

It is not a satisfactory payment method to use a normal cheque when buying goods abroad or to settle with an overseas supplier for goods imported. One of the problems concerns a country's exchange control regulations, since a cheque used in this way must be officially stamped to confirm that exchange control approval for the payment has been granted. Also, the cheque would normally have to be drawn in the home currency and this might not suit the overseas supplier who would have to ask the bank to collect the proceeds, on his behalf this would cost money in bank charges and he would have to wait some time before receiving the proceeds.

Both cheque and credit cards can be used abroad to obtain cash from banks. The cheque card, however, cannot be used as a guarantee for a cheque to pay for goods and services. The credit card can be used as a means of payment at overseas outlets of the card company and its associated companies.

Telegraphic and Mail Transfers

A customer may instruct his bank to use one of these transfer methods to make a payment to a person abroad. The differences between them lie in their speed and cost, a telegraphic transfer being quicker but more expensive. The customer has his account debited in sterling and the beneficiary receives the sterling equivalent in his own currency, either paid in cash or credited to his bank account. All charges are normally debited to the sender's account but can, if required, be deducted from the amount received by the beneficiary. As with all overseas payments, the relevant exchange control regulations must be observed.

The actual transfer of funds is effected by the bank of Britain contacting convenient bank in the overseas country. All the major banks have their correspondent banks overseas with whom they maintain currency accounts, and similarly the correspondent banks maintain sterling accounts in this country. These accounts are known as *nostro* and *vostro* accounts—the Latin words for 'our' and 'your' respectively. A United Kingdom bank's *nostro* accounts are those which are maintained in its name in the books of banks overseas, such as an account maintained with an American bank in New York in US dollars; its *vostro* accounts are those maintained with it in sterling in the United Kingdom by overseas banks. The method of transferring funds is simple. If a customer of a United Kingdom bank wishes to remit sterling to an overseas beneficiary in, for example, Toronto, the procedure is as follows:

(i) the customer completes a bank application form stating the beneficiary and the method of remittance to be used-telegraphic or mail transfer, or banker's draft;

(ii) the necessary exchange control evidence is produced by the customer (if required) and checked by the bank;

(iii) the bank debits the customer with the amount and credits the (sterling) vostro account of the Toronto correspondent bank it proposes to use;

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(iv) the remittance is then made and the beneficiary receives or is credited with the Canadian dollar equivalent¹ of the sterling amount;

(v) to complete the book-keeping, the Toronto bank debits with the sterling amount an account it maintains in its books which mirrors its sterling account in London.

If a customer of a United Kingdom bank wishes to pay a currency (rather than sterling) amount to a beneficiary in, for example, New York the procedure is as follows:

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(i) the application form is completed as before;

(ii) the bank debits its customer with the sterling equivalent of the dollars; (iii) the United Kingdom bank credits the mirror account in its books of its dollar account maintained in New York;

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(iv) the remittance is then made and the New York bank debits the United Kingdom bank's nostro account and credits the beneficiary with the dollar amount.

Some 500 of the largest European and fifth American banks have recently joined together to form an international communications network to speed up the transfer of international payments and their messages between themselves. This network is called SWIFT (the Society for Worldwide Interbank Financial Telecommunication) and uses the computer systems of participating banks. Thus when a customer wishes to make an international payment by mail transfer his bank, if a participant in SWIFT, sends a 'SWIFT message'; transfers and messages previously sent by telegraph or cable will become 'urgent SWIFT messages'. As a safeguard, wherever funds are sent by urgent SWIFT message or telegraphic transfer, some form of coding is included which is checked by the recipient bank to prove the authenticity of the instruction.

Bankers' Drafts

A draft used to pay an overseas debt is a bankers' cheque similar to the draft used as an inland payment method, but instead of being drawn by a branch bank on head office, it is drawn by the overseas department of a British bank on one of its correspondent bank accounts. An overseas draft is usually available either in sterling or foreign currency amounts. A customer requesting a draft has his account debited in sterling and, within a few minutes, is handed the draft to send direct to the beneficiary. The transfer of funds from bank to bank is effected in the same way.

International Money Orders

Banks has recently introduced a simple method of sending relatively small amounts of money abroad called the International Money Order. International money order can be obtained from the bank, in our case this cheque is of a major bank's cheque from London. The payer then mails the money order direct to the beneficiary abroad; it will be accepted by major banks worldwide either for the credit of an account or to be cashed. - is -suitable method of payment where the sender wishes the beneficiary to receive an exact sum of money in a currency other than US dollars or sterling; it is, however, ideal for use in sending gifts of money to friends and relatives overseas.

Bills of Exchange and letters of Credit

Both these methods of payment are used extensively by firms in Britain making payments for imports and arranging to receive money from abroad for exports supplied.

FINANCE FOR EXPORTS

Central Bank of TRNC and The Bar. Development have attractive financial assistance schemes for exporters. The main one being the re-discount credits. These are linked with the Central Bank, but the bank also aids the exporters in the following way.

Several methods of finance are used by the banks to assist their exporting customers and a number of these involve ECGD giving a direct guarantee to a bank.

(a) Advances against shipping documents

Most banks like CEB are prepared to grant overdraft facilities to customers who export on credit terms of up to 6 months. When the bank is handling the shipping documents by passing them to a correspondent overseas bank for collection, it is usually prepared to grant an advance based on an agreed percentage of outstanding collections pending receipt of the proceeds. In some cases acceptable security for

the advance would be the shipping documents which give control of the goods, together with bills of exchange in course of collection.

(b) **Negotiation of bills of exchange**

Banks are usually willing to naqtj e iscount) sight bills of exchange or bills maturing within six months, hether .denominated in sterling or in a foreign currency. The customer i credited with the sterling amount, less discount, and the bank collects the proceeds of the bill when it becomes payable. The bank usually retains a 'right of recourse' to debit the customer's account with the full amount in the event of non-payment.

(c) **Documentary letter of credit**

Provided the exporter comp~ the terms of a documentary letter of credit. he may obtain either an immediate payment or acceptance of his bill of exchange by the advising bank. In the latter case. after acceptance of the bill, the exporter may arrange with a discount house to have the bill discounted at the rate of ruling for that particular type of acce~ he can receive cash almost immediately.

Bills or notes scheme. As the exporter ships his goods, he gives the bank bills of exchange drawn on the buyer or the buyer's promissory notes, together with invoices and documents evidencing shipment. The bank then makes finance available to the extent of 100 per cent of the face value of the bills or notes. The bank subsequently handles the documents on a collection basis and receives the cash proceeds from the buyer.



Open account scheme. This is a little different; when goods are exported in this way the payment is made by the buyer direct to the exporter. The bank is therefore guaranteeing a loan from the bank to its customer in respect of the transaction and the payment is not collected by the bank as it is under the bills or notes scheme. When the exporter wishes to borrow against the guarantee he produces to the bank a copy invoice and evidence of shipment. The finance is made available and, at the same time, the exporter gives the bank his own promissory note undertaking to repay the loan on a certain date, usually the last day of the month in which payment is due to him from the overseas buyer. Thus the sale proceeds are received by the exporter direct from his customer, and at the end of each month he repays the bank for the finance provided against the promissory notes.

CONCLUSION

Banks in TRNC are small banks. There were only a few banks in TRNC immediately after the 1974 Piece Operation. Many banks opened afterwards. Today there are many banks, and there is a lot of competition in the sector. We can not say however, that the borrowing rate is low enough. CEB, as one of the smaller and new banks in TRNC is functioning and serving for all the needs of their clients. Despite the recession of the TRNC economy, they've managed to grow. They have completed establishment stage, and now are operating in all the major cities. They should try to get a bigger share of the market. They should work on promotional aspects, since they are not really doing much in this area. Efficiency in the banking sector has to be improved. Computers may be useful to achieve this. I think the bank should introduce new credit system products.