



NEAR EAST UNIVERSITY

DEPARTMENT OF BUSINESS

MAN 400

GRADUATION PROJECT

STRATEGIES OF TURKISH
BANK

SUBMITTED BY: MUSTAFA KÖKSALAN

SUBMITTED TO: GÜNÇE ÜNVERDİ

AUGUST 2000

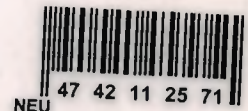




TABLE OF CONTENTS

1. Introduction.....	3
1.1. Banks As Financial Intermediaries.....	3
1.2 Advantages Of The Financial Institutions	4
1.3 Central Bank Regulations	6
2. Turkish Bank	9
2.1 Background.....	9
2.2 International Financial Activities Of Turkish Bank ..	9
2.1. Turkish Bank London	10
2.2 Turkish Bank Turkey.....	10
3 Pest Analysis	11
3.1 Political Situation	11
3.2 Economic Situation	12
3.3 Social Conditions In Trnc.....	15
3.4 Technology	16
3.4.1 Use Of Computers	16
3.4.2 Credit Cards	16
3.4.3 Bank Cards.....	19
4. Competition In Market Guided Economies	20
5. Competition Forces	22
5.1 New Entries	22
5.2 Substitutes.....	23
5.3 Power Customers	23
5.4 Power Of Supplier	24
5.5 Rivalry	24
6. Swot Analysis	25
6.1 Strengths	25
6.2 Weaknesses	25
6.3 Opportunities	25
6.4 Threats	26
7. Financial Situation Of Turkish Bank.....	26
8. Impact Of Use Of Turkish Lira In Trnc Banking.....	28
8.1 Currency Vs Tl Option	28
8.2 Benefits Of Using Tl	30
9. Bank Failures.....	32
10. Conclusion	36
10.1 Future Strategies	37
References	39

1. INTRODUCTION

Banks are the hottest issue in TRNC in the recent months as I am trying to finalize my theses. A wave of bank crises started in Turkey and in no time the banking sector of the TRNC has been effected. Six banks has been collapsed and closed by the state and many clients are now waiting for the government to pay their deposits. The following study will be about the Turk Bank which is the oldest private bank in Turkey. The report will include information about the banking sector, the general economic climate in TRNC, and conclusion and recommendations. There are various arguments about the banking sector in TRNC. Some claim that the use of the Turkish Lira without a right of printing money is one of the main problems. Is Turkish Lira the real problem? To find an answer to our question we have to look into the banking system of TRNC. Turkey is also using Turkish Lira and as far as we know the banking sector is very good in Turkey.

I believe that the problems of banking in TRNC lies in other areas. To blame the Turkish lira is not fair. It is true that not having our own currency may create some problems, but isn't that what the EU is trying to do? Monetary union and introduction of Euro money will mean that the local central banks of these countries will not be able to act freely.

Banking is an important sector in the economy, especially for the developing countries. TRNC is one of these countries and banks have vital role in the development of the country. In 1974 when the Turkish community were freed from economical domination and strict embargoes imposed on them by Greek side, there were only 3 Banks in operation, one of them being a Turkish Bank from mainland and the Other Turkish Bank and the Cooperative Central Bank. Since then many new banks were established and their numbers total to over 25 today¹. Newly passed legislation allows opening off-shore banks as well. First private bank to be established after 1974 was the Cyprus Credit Bank. Cyprus Credit Bank (CCB) was established in 1978 as a private bank. CCB was a competitor of the Turkish Bank for a long time. This bank is now in trouble. Today there are around twenty banks offering full service. There are also increasingly growing offshore banking activities in North Cyprus

1.1. BANKS AS FINANCIAL INTERMEDIARIES

There are many different ways of attaining finance to an organization. Stocks and shares can be issued and finance can be obtained from the sales of these. Primary markets are those in which financial assets are originally issued. Since the amount of existing financial assets is much

¹ TRNC Central Bank Quarterly, Autumn 1999

greater than the amount of new ones being issued, there is a great deal more activity in the secondary markets.

Indirect methods for transferring money involve the use of a group of financial institutions called financial intermediaries, for example, banks. Financial intermediaries purchase the financial liabilities of firms and individuals; they also borrow by issuing their own financial liabilities. As a simple example, consider a bank that has loaned money obtained from savers to a person who is buying a house. The new financial assets that have been created here are a home mortgage owned by the bank and savings accounts owned by savers. In a direct transaction there would be only one financial asset-the mortgage owned by savers. There are several advantages to money transfers performed by financial intermediaries.

1.2 ADVANTAGES OF THE FINANCIAL INSTITUTIONS

One of the advantages of the financial intermediaries is their flexibility and liquidity. The intermediary is able to provide large sums of money to a borrower by pooling the savings of several investors. Moreover, the intermediary can provide investors with financial assets which may be money or readily convertible into money at the same time that it is making loans which will not be repaid for a long time.

Second advantage of the financial intermediaries is their diversification. By purchasing the debt issues of many different borrowers, the intermediary is able to increase the chances that most of the money lent will be repaid. Therefore, it is able to provide relatively low-risk assets to investors. The federal government further decreases the risk by insuring accounts in several types of financial institutions from losses.

Another important advantage of the financial intermediaries is their convenience. Intermediaries offer a variety of financial services to their customers besides loaning money and creating financial assets. It is convenient for a single person (individual or business) to deal with a single firm that can supply whatever services are needed.

Finally the financial intermediaries become experts in their activities and they offer expertise services. The intermediary, because it is continuously purchasing financial assets issued by many borrowers, becomes expert in the process. A single person, whether borrower or investor, is apt to be much less knowledgeable as to exactly what the proper form of the assets should be.

1.3 CENTRAL BANK REGULATIONS TO BANK OPERATIONS IN TRNC

Like any other commercial set-up the Bank's objective in providing the services to borrowers and depositors is the generation of profit. The more money they can lend, the more profit the Banks can earn. However a Bank can not lend out all the funds which it obtains on deposit which it must retain enough money in liquid form to be able to meet depositor's request for repayment. In this lies the Banker's dilemma because the more liquid the form in which the funds are held, less the rate of return. Cash holdings, being the most liquid form of asset, generate no profit at all. The bank must therefore effect a careful balance between the maximisation of lending and minimization of liquidity to the lowest level consistent with safety. The conflicting requirements of profitability and liquidity can be reviewed as resulting directly from the conflicting desires of two groups who have provided the Bank's financial resources. The shareholders and the depositors. The shareholders jointly own the Bank and look to it to provide a return on their capital. The depositors have provided the vast bulk of the funds used by the bank and require safety and the ability to get their money out in accordance with the terms agreed upon at the time of deposit. A successful bank has to reconcile the interests of these

groups. To some extent this task is taken out of the bank's hands by official controls but there is still considerable room for maneuver.

Under the Central Bank of the TRNC Law, the minimum ratio of the overall liquidity which Banks shall maintain against their liabilities shall be fixed by the Bank. Besides this overall liquidity Banks are required to deposit additional reserves in a special blocked account to be opened by the Bank. The ratio of the additional cash reserves to total deposits, excluding interbank deposits, shall be fixed by the Bank in the light of general economic conditions in the country. In the TRNC the minimum ratio of the overall liquidity which banks shall maintain against their liabilities were fixed at 10% in the minimum, in the Banking Law of 1976 and has remained the same ever since. The ratio applicable to additional cash reserve which the banks are required to lodge in a special account by the Bank is 15% for Turkish Lira deposits and 20% for foreign currency deposits.

In the TRNC the Central Bank is empowered to fix the maximum rates of interest receivable or payable as the case may be, on Turkish Lira and foreign currency deposits of all description and on credit transactions of Banks, cooperative banks and other establishments, as well as the nature and maximum limits of other benefits to be supplied and expenses to be recovered and in the case of deposits the duration of fixed terms and

whether interest should be left free wholly or in part and their dates of enforcement. These matters are put into operation on the recommendation of the Minister of Finance? and by decision of the Council of Ministers as from the date of publication in the Official Gazette. Rates of interest so fixed and the matters connected with the rates of interest shall be applicable also to all debt-credit relationships outside the banks.

Under the banking law of the TRNC extensive powers have been given to the Central Bank regarding control of the banks. These include the ascertainmant and analysis of the relationship and balance between assets of banks, debts due, their capital, debts and profit and loss accounts and all other factors affecting financial structure. Several administrative measures have been provided for this end. For instance where it is established that in contravention of specified laws, transactions likely to jeopardize the secure operation of a bank and of its participitations have taken place, subject to the right to institute legal proceedings against the bank employees responsible for the operation in question, upon the demand of the controlling body it would become mandatory to terminate their appointment. Subject to the right to institute legal proceedings against responsible employees of the banks in question the Central Bank of the TRNC

is empowered to terminate advance and rediscount credits and revoke credits already issued.

2. TURKISH BANK

2.1 Background

Established in 1901, Turkish Bank is the first private bank of North Cyprus. It was initially functioning as a small savings bank. Today it is operating in Cyprus, Turkey and England. It has become a truly international bank. It is the biggest private bank of TRNC.

Establishment of Turkish Bank was a historic event in Cyprus. It was the one and only financial institution to support the Turkish Cypriot business community to compete with the dominant Greek business community. Turkish Bank has done this very successfully. Today they grew into a truly international bank operating successfully in three different countries.

In our work we will concentrate mainly on the activities of the Turkish Bank in Turkey

2.2 INTERNATIONAL FINANCIAL ACTIVITIES OF TURKISH BANK

Turkish Bank is the first bank in TRNC which started international activities in real sense. First thing to talk about is the establishment of Turkish Bank in the other countries.

2.1. TURKISH BANK LONDON

Turkish Bank opened a branch in London in 1975. Their objectives were to serve the Turkish Cypriot community living in London. They could also use this branch to invest their deposits in international markets, since London is the center of international finance.

Turkish Bank in London became very successful and they opened another two branches in the next few years. Their operation as branches were limited. To operate more freely and give banking services as any local bank of England they needed to register as local bank. This was a big, and difficult thing to achieve since the regulations of Bank of England are very strict. After a few years they succeeded and, today Turkish Bank is operating and giving services to all their clients, just like another bank in UK, like Barclays or Midlands bank.

2.2 TURKISH BANK TURKEY

Turkish Bank has opened a branch in Turkey, at the mid seventies. Turkey is the biggest trading partner of TRNC. And the main objective of the bank was to serve the business communities of both countries.

Liberalization of economy in the early eighties had led to improvement and growth in the banking sector. Local Turkish Banks were not much experienced in international business. Relatively

more experienced Turkish Bank, did well in these years and became successful. Today like the Turkish Bank UK Turkish Bank Turkey is operating as a local Bank of Turkey serving in all aspects. Turkish Bank of Turkey has five branches in Istanbul One in Ankara, in Mersin, Izmir and Bursa. They are one of the fastest growing bank in Turkey as well as TRNC.

3 PEST ANALYSIS

3.1 Political Situation

TRNC is a democratic country. Just like many western countries the TRNC is a liberal economy. There are very flexible rules and regulations in every aspect. In the market guided economies, formation and operation of banks are not very difficult. So the first thing one can realize is the huge number of banks in operation. This can be easily seen in TRNC. There are many banks operating in such a small country. The real competition is in the interest rates.

All the banking activities in TRNC are regulated by the Central Bank and decision of the Board of Ministers.

There are two main grounds where banks can compete, firstly the interest rates and secondly, the quality of service. The image of a bank is very important. Any person who is to choose a bank, first thinks of the safety of their money, specially if they are depositing money. Secondly

they look for high interest. Thirdly they look for quality services. In small countries like TRNC people are used to personal attention. In many cases trust and good service may attract clients even if the interest rates are slightly lower.

3.2 Economic Situation

When we look at the pre-crises period, that is before the bank crises, we can say that despite all the problems and difficulties, economy in TRNC was improving. If financial organizations can operate in TRNC with normal interest rates, then the improvement is inevitable. One of the biggest assets of the TRNC is its undistorted natural beauty. South Cyprus enjoying the recognition, had huge number of visitors from all around the world. Unfortunately, they got so carried away, they turned south Cyprus into a concrete block. On the other hand we have been very careful not to destroy the nature in the North. If and when the embargoes go North Cyprus will be more attractive than South.

We can summarize the economic difficulties under the following topics.

- ⇒ Inability to adopt any monetary policies
- ⇒ shortcoming of fiscal policies
- ⇒ Political situation and embargoes
- ⇒ balance of foreign trade

- ⇒ transport
- ⇒ shortage of currency earnings
- ⇒ High budget deficit,
- ⇒ heavy burden of transfer expenditure
- ⇒ high inflation
- ⇒ devaluation
- ⇒ high cost of capital
- ⇒ shortage of incentives
- ⇒ Management inefficiencies

States, like any business, have incomes and expenses. State has to create revenues to spend for their expenses. Theoretically the state is to serve the community, harmonize the social, cultural and economical life. The difference of the TRNC from any other independent state is that the TRNC has not have their own money. Turkish Lira is used as the official currency. The state claims that they have a fiscal policy, but to have a fiscal policy without a money is questionable. It is stated by the State planning Organization that the basic aim of the fiscal policy in the Turkish Republic of Northern Cyprus is the creation of the necessary conditions for internal monetary stability, supporting the more productive infrastructure projects, reducing the dependence on foreign loans needed to finance the budget deficits and limiting the rate of growth of personnel expenditures, transfers and subvention.

The total local revenues which is composed of tax revenues, non-tax revenues, factor incomes and the social funds, showed an ascending tendency during the period 1988-1990. But in 1991 the local revenues dropped to 124.3 million \$ and in 1993 rose again to the level of 152.1 million \$. The tendency of local revenues can be seen in the table 5 prepared at dollar basis.

Until 1975 only 19.6% of the budgetary expenditures was met by the local revenues. In 1993 this ratio rose to 67.5%. Within this context the share of the taxes in the GNP rose from 10.7% in 1977 to 20% in 1993.

The breakdown of State Revenues and Expenditures in the TRNC and The Balance of Resources and Expenditures are seen in the tables below.

	(Millions of TL)					
	1988	1989	1990	1991	1992	1993
Total Revenues	106.0	120.2	200.4	212.1	198.6	225.5
1) Domestic Revenues	76.8	91.4	149.1	124.3	127.2	152.1
2) Foreign Aid and Loans	29.2	28.8	51.3	87.9	71.4	73.4
a) Foreign Aid	15.6	17.4	19.4	27.1	21.9	26.7
b) Loans	13.6	11.4	31.9	60.8	49.5	46.7
Total Expenditures	106.0	120.2	200.4	212.2	198.6	225.5
1) Current Expenditures	53.4	60.3	94.6	95.3	94.9	104.7
2) Transfers	38.8	40.0	69.7	78.9	72.0	81.1
3) Investments	7.7	14.0	28.4	26.8	19.5	28.3
4) Defense	6.1	5.9	7.7	11.2	12.2	11.4

Annual average exchange rates at dollar basis;

1988 1 US \$ = 1,422.00 TL

1989 1 US \$ = 2,139.52 TL

1990 1 US \$ = 2,618.98 TL

1991 1 US \$ = 4,199.67 TL

1992 1 US \$ = 6,896.25 TL

1993 1 US \$ = 11,106.99 TL

Source : State Planning Organization, 1996

3.3 Social Conditions in TRNC

Turkish Cypriot society is highly educated society. University diploma does not mean much in TRNC since most of the population get one. However the small population of the island does not help much to the private sector to bloom. The country has not yet specified the appropriate preferential sectors in order to improve the economy. Because of the shortcomings in the private sector there is a great inclination in the society to get a job at the government. In order to avoid refuge from the country, the state has always hired as many people as possible. Now days the state is the biggest employee paying checks for more than 40 thousand people. Society highly depend on the government salaries. This means that the money earned in the society enters the banks as deposits. The money is not used for investment. This is why the deposit per capita in TRNC is very high and this is why there are many banks in TRNC.

Turkish Cypriots are quite modern and they live European style. They are keen to hold property and they like cars. Almost every house has the basic furniture and household products. Average family also takes holidays at least once a year.

3.4 Technology

3.4.1 Use of Computers

Banking has gone through many phases. But The basic functions of the banks is still the same. Collecting money from the people who save them and lend it to those who need it for investment. The way the banking is practiced has changed tremendously. Banks have always used the highest technology. They started to use computers from the first days of its invention. Use of the plastic money, the visa and master cards can be considered as revolutionary, and these replaced real money in a certain extent.

There is a great deal of automation in the banking sector. Banks, these days give services 24 hours a day.

Today the hottest issue on banking is the electronic banking. Many banks have already taken their place on the Internet. Talks of the future is the Digital money and banking on the Internet.

3.4.2 Credit Cards

Credit cards are very convenient tool in the world. It has replaced hard cash in many countries. One of the international activities of the banks today is the issuance of credit card to their clients, to use anywhere in the world, for business and pleasures. The goal is to widen the

distribution of its credit cards and hence the Bank's share of the card business in the domestic market. This will be achieved through active marketing to special consumer groups while paying particular attention to enhancing the speed and flexibility of credit card-related transactions.

Credit cards in TRNC are used in a various ways. There are credit cards and bank cards. Credit cards are mainly the visa cards. Is Bank is a pioneer in this field in TRNC. As stated earlier they are the first bank to introduce credit cards in TRNC. In cooperation with Is Bank of Turkey, they are issuing the Visa card in TRNC.

One of the modern developments in the money markets were the introduction of the credit cards, business cards, etc. These are also called plastic money. Thanks to these cards, one does not have to carry huge amounts of cash with himself, or go through complex banking formalities. Credit cards, such as Visa, Master Card, American Express etc. Are issued by the banks all over the world. Client who holds an international credit card can do shopping, and draw money from the automated cash-points, and pay for services, with this card. Payments and money drawn are in the currencies of the country that they are visiting. Recipients obtain their money in cash within days of transaction. The amount spent by the card holder is then paid by the local bank, that issued the

card to the holder, to the account of the Bank in that country.

Use of the Credit cards are growing rapidly, and it promises to be more and more important in the lives of the people.

We have to distinguish between the credit cards and the bank cards. Credit cards, such as Visa, are the cards that acquired for a annual fee. There are many important issues that has to be addressed before a card is issued. The applicant has to provide credentials and a guarantor. The bank, after evaluating the credibility of the client, issues a credit card. The limits vary from client to client. There are ordinary credit cards and premier credit cards. Premier cards have higher limits.

Visa cards are now being issued at almost every bank in TRNC. The cost of a premier VISA card is about 150 dollars a year. The card holder can then use the card to obtain money or pay for shopping anywhere in the world. Most of the payments via Internet and international orders are made by visa cards. One can easily order a book in London and give the visa card and the amount is deducted from the card. The card holder has to pay the sum of money they spent, in the following month. The failure to make the payment means interest rate. The use of Visa cards are in the following fields;

- obtain cash from postmachines

- make payments for any purchase
- international payments
- payments via Internet
- use as a telephone card
- hotels use the card number as a deposit.

3.4.3 Bank Cards

Another version of electronic banking is the bank cards. These are cards that are issued to the account holders. The card holders usually have an account, and they can use these cards to manage their money at their account. The idea is to save time. instead of the client going into the bank and waiting in the queue, they can use the cards to draw money. There are various transactions that can be done with these cards.

- draw money from account,
- transfer money from account to other accounts,
- manage the money at the account,
- invest in the stock exchange or transfer money to different investment activities.

Use of cash is almost forgotten in the developed countries. Apart for little payments on small amounts, people meet their basic needs, such as shopping from the markets to buying refrigerators, using their cards. The cards are

sometimes as credit cards, and sometimes bankamatic. These are also called plastic money. Thanks to these cards, one does not have to carry huge amounts of cash with himself, or go through complex banking formalities. Credit cards, such as Visa, Master Card, American Express etc. Are issued by the banks all over the world. Client who holds an international credit card can do shopping, and draw money from the automated cash-points, and pay for services, with this card. Payments and money drawn are in the currencies of the country that they are visiting. Recipients obtain their money in cash within days of transaction. The amount spent by the card holder is then paid by the local bank, that issued the card to the holder, to the account of the Bank in that country.

Although it took a little long the bank automation is now taking place in TRNC. There are automated teller machines in many banks, where people can use their cards to manage their money.

It is disappointing on the other hand to realize that the local business are not very familiar with the card system.

4. COMPETITION IN MARKET GUIDED ECONOMIES

One hardship in the banking sector of TRNC is not from the use of Turkish Lira but due to the very high number of banks in the small country. In countries of liberal economy, there is naturally a

big competition in banking activities just like any other sector. In the market guided economies, formation and operation of banks are not very difficult. So the first thing one can realize is the huge number of banks in operation. This can be easily seen in TRNC. There are many banks operating in such a small country. The real competition is in the interest rates. The banks aim to give as high interest as possible, to the depositors, and charge the lowest possible to the borrower.

There are other factors effecting the interest rates in liberal economy. These are;

- * devaluation

- * and inflation

All the figures for the three, should be very close, by the end of the year. This means that interest rate may not be much less than the devaluation of the currency, since the holder of the money can also choose to invest in foreign currency.

Likewise, interest rates may not be much lower than the inflation rate since depositor may choose to invest in stocks.

All the banking activities in TRNC are regulated by the Central Bank and decision of the Board of Ministers.

There are two main grounds where banks can compete, firstly the interest rates and secondly,

the quality of service. The image of a bank is very important. Any person who is to choose a bank, first thinks of the safety of their money, specially if they are depositing money. Secondly they look for high interest. Thirdly they look for quality services. In small countries like TRNC people are used to personal attention. In many cases trust and good service may attract clients even if the interest rates are slightly lower.

5. COMPETITION FORCES

5.1 New Entries

One of the main problems of the banking sector has been the new entries in the market. The government regulations had been so relaxed that it was almost possible for any businessman to open a bank. Any company or real person with two million dollars is eligible to open a bank. The amount of capital prior to recent new laws was much less. This situation led to new entries there are now almost 30 banks operating in TRNC with branches everywhere. There are more bank branches than grocery shops in the country. Some of the banks that has been established in the past 5 years are:

- Viya Bank
- Tilmo Bank
- Yeşilada Bank
- Akfinans Bank
- Demir Bank

5.2 Substitutes

As well as banks there are many small cooperatives, saving organizations and finance firms that act as substitutes to the banks. For example there are currency exchange shops who deal in currency exchange business. Cooperatives such as the Teacher's Cooperative bank, civil servant's cooperative banks are established to collect money from the members and give credits to the members.

Banking services are very extensive. A bank can give many services ranging from simple deposit taking to advances electronic banking and cross-country banking. Turkish Bank gives all the main services to the clients. But the many new banks give substitute services. For example most of the banks that failed in the recent months are the banks that belonged to certain businessmen who established these banks for collecting deposits that they would use for other business interests. While they were collecting deposits they gave higher interest rates to attract clients. They gave higher interest rates at the cost of security of the accounts and other services. On the face of it they appeared as good banks that give high interest rates but at the end it was realized that these banks were not secure enough.

5.3 Power Customers

Due to incredible high number of banks the consumers have many choices. At one stage the

banks were forced to increase the interest rates in order to attract clients. But in many cases people also wanted their money to be in safe hands. Collapse of some of the high interest rate banks increased the importance of strong banks. This situation worked for the benefit of the Turkish Bank.

5.4 Power of Supplier

For a bank supplier is the Central Bank. All the bank regulations are controlled by the Central Bank. The Central Bank give the same treatment to all the banks therefore there is no competition role of the supplier in this case.

5.5 Rivalry

There was a rivalry from the Cyprus Credit Bank which was established by the main clients of the bank at the beginning. Turkish Bank was a big and only private bank in the country. Some of the big clients and managers of the Turkish Bank left the bank and established the Cyprus Credit Bank. There was a natural rivalry between these banks. However mismanagement of the CCB had led to a point where the bank is now in deep trouble unable to function. Apart from the Cyprus Credit Bank in TRNC and many more banks here, there are also strong competitors of the Turkish Bank in Turkey and UK. In Turkey smaller banks such as Toprak Bank and Iktisat Bank can be considered as rivals.

6. SWOT ANALYSIS

6.1 Strengths

Turkish Bank is one of the oldest and best known banks in TRNC. This year is its centennial of foundation. To work with this bank is tradition for many people. The bank has wide range of products that help all the business community to resolve their financial needs. Its branches in Turkey and London are also practical and it give strength to the company. Another strength of the company is the financial security. People who deposit their savings feel safe. Finally the Turkish Bank has some of the most experienced staff that serve to the customers.

6.2 Weaknesses

Despite its many positive aspects the Turkish Bank has become very large and the employees are aging. Aging employee population means that there are hardly any new recruitment to the bank. Bank is also slow in adopting new managerial concepts.

6.3 Opportunities

Negotiations are going on about the settlement of the Cyprus problem. If there is a solution to the Cyprus problem the TRNC will become part of EU. This will mean that Turkish Bank will be able to make use of international finances. This will bring down the cost of finance for the bank. In

such a situation the bank will increase its customer base and profits

6.4 Threats

So far the bank has not faced any major problem from the bank crises. But there is a danger if people try to withdraw all their money at the same time. If the government fail to build up the confidence there can be new crises in no time. Another threat may come from the EU. A possible integration with the EU may bring serious competition.

7. FINANCIAL SITUATION OF TURKISH BANK

PROFIT AND LOSS ACCOUNT

	1999 Million TL	1998 Million TL
Interest, commission revenues	32,776,492	15,016,102
Interest, commission expense	<u>22,844,790</u>	<u>9,237,895</u>
	9,931,702	5,778,207
Other income	<u>1,076,665</u>	<u>591,694</u>
	11,008,367	6,369,901
Personnel expenditure	4,079,144	1,663,198
Administrative expenses	3,624,225	3,007,024
Amortization	511,613	248,895
	<u>8,214,982</u>	<u>4,919,117</u>
Activity Profit	2,793,385	1,450,784
Revaluation	<u>346,449</u>	<u>0</u>
Profit before tax	2,446,936	1,450,784
Profit provision	<u>981,085</u>	<u>642,262</u>

Profit after tax	1,465,851	808,522
Foreign minority share	544,279	342,676
1999 profit and reserves	921,572	465,846

CONSOLIDATED BALANCE SHEET

	1999	1998
	Million TL	Million TL
		(Revalued)
ACTIVES		
Cash, reserves	20,293,995	11,988,321
Money at banks	93,414,707	61,374,689
State	14,462,094	5,433,965
Advances and Credits	28,529,401	16,181,631
Other actives	378,854	510,298
Rediscounts	4,123,797	1,676,609
Fixed assets	9,032,102	5,394,981
Total Actives	170,234,950	102,560,494
Passives		
Deposits	135,730,174	74,208,959
Bank accounts	9,153,349	13,749,738
Other passives	1,013,186	1,294,279
Tax provisions	892,364	273,834
Interest	2,973,112	2,042,193
Foreign shareholder reserve	3,745,407	2,229,224
Capital	7,000,126	4,000,077
Reserves	9,727,222	4,762,200
Assets	16,727,358	8,762,277
Total Passives	170,234,950	102,560,494
LIABILITIES	173,234,950	102,560,494
Guarantees	5,758,395	4,884,737
Letter of Credit	10,630,818	6,533,993
	16,389,213	11,418,730

8. IMPACT OF USE OF TURKISH LIRA IN TRNC BANKING

TRNC is using Turkish Lira as national currency unit. At the same time there is a total freedom to use any other currency. The banks can open foreign currency accounts and individuals can carry checkbooks that they can write foreign currency checks. We can not therefor say that there is any restriction and that the use of Turkish Lira has this or that effect. The main part of the accounts are in Turkish Lira however and we need to address the question.

8.1 CURRENCY VS TL OPTION

Holders of funds in TL will compare the interest rate obtained by lending on TL assets with the expected total return that can be obtained by temporarily lending abroad instead. There are two points to note. First, it is the total return that counts. The total return from lending in a foreign currency (dollars) is the interest rate on dollar assets such as US government bonds plus the capital gain (loss) from a depreciation (appreciation) of the dollar-TL exchange rate while the money is lent abroad. Someone who converts TL1m. into \$20 and then converts it back into TL after the exchange rate has fallen from \$20/m.TL to \$10/m.TL will be able to get TL2m for their \$20. They will have made a

capital gain of 100 per cent (from TL1m to 2m.) by holding their funds in dollars, while the dollar-TL exchange rate fell.

Second, since speculators cannot be certain how exchange rates are going to change over time, it is the expected exchange rate changes, and hence the expected capital gains or losses from temporarily lending abroad, that influence decisions today about which currency looks the most attractive currency in which to lend.

Before 1980'ies currency exchange business was a black market business, both in Turkey and TRNC. In Turkey the gold and bullion dealers were acting as exchange bureaus. The exchange rates were unrealistically fixed and no one would go to the banks for exchange. In TRNC some of the big importer merchants acted as currency exchange bureaus. 1980 was a turning point for the Economy of Turkey and hence TRNC. Free market economy has been put in effect and everything was considered at the real value.

Prior to 1980 anybody who had any foreign currency was to be punished. After the 1980 there were a gradual relaxation in the laws and at later years it became totally free to exchange import or export any foreign currency.

Exchange rates were fixed by the government, and they were adjusted to the changing economic conditions by very seldom and high rate devaluations during the period before 1980. The

fixed exchange rates, together with the increasing rate of inflation after 1977, resulted in significantly overvalued real exchange rates. Additionally, the foreign exchange operations were restricted and highly controlled due to the projectionist industrial policies. Under these conditions; banks were highly restricted in their reign exchange operations. Hence, the prominent measures of the 1980 Stabilization Program were related to the liberalization of foreign exchange operations.

8.2 BENEFITS OF USING TL

TRNC is not only using TL but also exchanging it with the other currencies freely. The weak situation of TL is not creating much problem to the banks, on the contrary, the banks are making huge profits from this situation. Since the people, the customers of the banks and the public at large, do not trust the TL, the people change their reserves to the foreign currencies. The banks make money by exchanging the TL into a foreign currency. After a while the same people, when they need TL they exchange their foreign reserves. Billions of TL are changed and exchanged every day. And thew banks are making profit out of these.

In TRNC exchange of foreign currency is totally free. Central Bank has nothing much to do with currency affairs. Mainland Turkish Central

Bank, has sufficient amount of currency, and they can interfere by selling and buying currency, but the TRNC Central Bank does not practice this sort of activity.

Turkish Bank is the biggest bank of TRNC, they total branches of thirteen, with two branches in London and also a branch in Istanbul. They are fully computerized, and connected to international networks. They are instantly aware of the world market conditions. They are also the biggest currency stock holders in TRNC. This characteristics of Turkish Bank make them a leader organization in the country. This is the basic reason why everybody in business watches Turkish Bank and their rates set the market rates.

Turkish Bank, in setting the currency rates, watches Turkish markets very carefully. They have to keep to these rates, since, otherwise, the Turkish brokers may come to TRNC markets (If the currency selling is to high) and people who want to exchange currency may decide to go to Turkey to exchange (If rate is low).

Opening of a currency exchange bureau is very easy in TRNC. One can simply start a business with \$30,000. This is the only condition. It is also important that the person has a clean record. The currency exchange bureaus has to keep to the certain rules and regulations set by law. Money and Foreign Exchange Law No:38/192 amended 46/1994, has the list of the requirements for the

establishment and responsibilities of the currency exchange bureaus.

Turkey and TRNC have come a long way in respect of the liberalization in monetary aspects. Once it was illegal to carry even one dollar of foreign currency. Today there is a total freedom both in Turkey and Cyprus. Due to the inflation, the foreign currencies are used as a choice of investment. People change their small savings into foreign currencies. This is unique to the Turkish people. when we talk about foreign reserves, we talk about the official reserves at the Central bank. But the amount of foreign currency in Turkey is in fact very high, since everybody has foreign currencies in their pockets.

To reverse this situation, the amount of the Turkish Lira must be reduced in circulation. Once the demand for the Turkish Lira will increase the devaluation will also decrease.

9. Bank Failures

Bank (depository institutions) failures are have greater adverse effects on the economy. Failure of banks are more important than the failure of other types of business firms. Bank failures are more damaging than other failures because of a fear that they may spread in domino fashion throughout the banking system. We have witnessed this in a way in TRNC. Failure of some banks had lost the confidence of people in the

banking system and there are still people running around taking their money from one bank to the other. Thus, the failure of an individual bank introduces the possibility of system-wide failures or systemic risk. This perception is widespread. It appears to exist in almost every country at almost every point in time regardless of the existing economic or political structure. As a result, bank failures have been and continue to be a major public policy concern in all countries and a major reason that banks are regulated more rigorously than other firms.

A bank fails economically when the market value of its assets declines below the market value of its liabilities, so that the market value of its capital (net worth) becomes negative. At such times, the bank cannot expect to pay all of its depositors in full and on time. The bank, or indeed any firm, should be resolved as quickly as possible in order to treat all depositors (creditors) fairly and not allow a run by depositors holding demand and short-dated deposits. The longer an insolvent bank is permitted to operate, the more time such informed depositors have to withdraw their funds at par value and effectively strip the bank of its valuable assets. The entire loss will then be borne by less informed depositors and holders of longer-dated deposits.

In most countries, the failure of an individual bank should be no more important than the failure of any other firm of comparable size in the community. This is particularly true today when most bank products are no longer unique and are being provided in many countries by an ever growing number of nonbank firms that are gaining market share at the expense of banks. Moreover, to the extent that bank or branch office charters are not restricted, if the demand for banking services in the community is sufficiently strong, a new bank or office should be expected to enter. In the absence of deposit insurance, potential adverse effects to the community would be minimized, the faster the insolvent bank is resolved and the smaller the losses to depositors.

Losses accrue to shareholders and most likely also to depositors, unsecured creditors, and the deposit insurer. Small loan customers may be particularly inconvenienced by changes in their loan officers, loan standards, and other aspects of their ongoing bank relationship. But this is no different from the losses and disruptions in firm-customer relationships that accompany the failure of almost any business entity of comparable size in the community.

What makes, at least, the perception of bank failures more important, particularly for public policy, is the fear that the failure may spill over to other banks and possibly even beyond the

banking system to the financial system as a whole, the domestic macroeconomy, and other countries. Similar fears are generally not perceived for the failure of other firms. The failure of a steel mill, software manufacturer, or grocery store is not widely perceived to spill over to other firms in the same industry. Indeed, as Larry Lang and Rene Stulz (1992) note, the surviving firms frequently benefit from losing a competitor and being able to expand their market shares.

Whether or not bank failures are more serious than other failures, individual banks are viewed as more susceptible to failure or more "fragile" than other firms and the banking industry more susceptible to contagion than other industries. Banks are viewed as more fragile for three reasons. They have

Low capital-to-assets ratios (high leverage), which provides little room for losses;

Low cash-to-assets ratios (fractional reserve banking), which may require the sale of earning assets to meet deposit obligations: and

High demand debt and short-term debt-to-total debt (deposits) ratios (high potential for a run), which may require hurried asset sales of opaque and non-liquid earning assets with potentially large fire-sale losses to pay off running depositors.



10. CONCLUSION

Until recently Turkey and TRNC was a closed economies with many restrictions on banking and currency exchanges. It was illegal to keep any foreign currency an exchange. After 1980, Turkey started a series of liberalization. As a result of these efforts a lot of freedom has become a reality in the sector. Today money exchange is totally free and there are many shop fronts where people can just walk in and buy and sell any currency they want.

For Turkish residents, an exchange rate of \$1.00, TL600,000 measures the international value of Turkish Lira; the number of units of foreign currency (dollars) that exchange for one unit of the domestic currency (TL).

Before 1980'ies currency exchange business was a black market business, both in Turkey and TRNC. In Turkey the gold and bullion dealers were acting as exchange bureaus. The exchange rates were unrealistically fixed and no one would go to the banks for exchange. In TRNC some of the big importer merchants acted as currency exchange bureaus. 1980 was a turning point for the Economy of Turkey and hence TRNC. Free market economy has been put in effect and everything was considered at the real value.

There are problems but also there is a continuous improvement in the banking sector in Turkey. It is inevitable that this effects the

TRNC banking. There are many Turkish Banks operating in TRNC and these are using the banking systems as in Turkey. The structural changes in the banking sector continue. The benefits of the investments in personnel and automation infrastructure of the 1980's began to become visible after 1990.

During this period banks have concentrated on consumer services. The number of plastic cards has risen rapidly to nearly 14 million, of which around 2.5 million are credit cards. The volume of transactions conducted by using these cards grows by leaps and bounds each year.

Concept such as consumer credit, investment consultancy, portfolio management and investment funds became widespread after 1990. Banks have broadened the range of services they offer for the expanding securities market.

Before 1980 investment opportunities were very limited, being basically restricted to deposits or gold. During the 1990's the number of alternatives increased considerably. Investors were offered a range of new instruments, such as deposits, forex, gold, investment funds, Treasury bills, asset-backed securities (VDMK's) or repurchase agreements.

10.1 Future Strategies

Turkish Bank has done a good job by diversification and opening branches in Turkey and UK. It would be advised that the bank continues

with its diversification. The Turkish market is particularly a large market and the bank should open new branches and serve in every large city.

Another important step to be taken is to increase the automation and become an Internet Bank. Although the bank is giving full services in the banking sector they are not using the Internet like the Ask Bank and İş Bank. The bank should get into the Internet banking as soon as possible.

Another area for development is the human resources. There should be extensive training to the personnel to increase the quality of services and also increase the customer satisfaction.

REFERENCES

TURKISH BANK ANNUAL YEAR BOOK, 1999

Baughn, William H. and Mandich, Donald R., eds. The International Banking Handbook. Dow Jones-Irwin, 1983.

Central Bank Quarterly reports, Autumn 1999

Davids, Lewis E. Dictionary of Banking and Finance. Rowman & Littlefield, 1999.

Davis, Steven I. Excellence in Banking. St. Martin's, 1986.

Palferman David, and Ford P. Elements of Banking, Pitman, 1988

Thomson, William. Thomson's Dictionary of Banking. Pitman, 12th ed., 1974.

Timberlake, Richard H., Jr. The Origins of Central Banking in the United States. Harvard, 1978