

Introduction

This report provides an overview of the investment banking industry in Turkey which is considered an emerging market. The focus of the report is on the evaluation of the Turkish market suitability from an investment bank's point of view.

Economic Outlook. Turkey is considered one of the oldest emerging markets and in 1995 the US Department of Commerce identified it as one of the 10 “Big Emerging Markets”. Turkey is amongst the most industrialized nations outside of US, Western Europe and Japan and its economy is regarded as the 18th largest in the World (Hurh, 1998). Turkey’s economy has grown steadily, bouncing back from the financial crisis of 1994 and 2001. The latest information from institutions such as OECD¹ and International Monetary Fund and Fitch Ratings² seems to support Turkish governmental reports that the country is on the right path and economic prospects are somehow looking brighter (**see appendix 1**).

Financial/Banking Structure. The financial system in Turkey consists of the banking sector and other areas such as insurance, leasing, stock brokerage etc. Most activities taking place in the Turkish money and capital markets (**see appendix 2**) are carried out by banks, as is the case with most emerging market economies. Indeed the banking sector constitutes a great part of the Turkish financial system and based also on the historical development it is safe to say that the Turkish banking sector and the financial system are synonymous (PMO³, 2005). Research indicates that investment banking industry in Turkey does not exist in the same state as it does in most advanced economies, but nonetheless it does exist. There are a handful of investment & development banks in Turkey which aside services typical to investment banks, also offer commercial services such as loans to individuals and small/medium sized companies (CBANK, 2005; GSD Bank, 2005; DiLER Bank, 2005)⁴.

In January 1980 the Turkish government introduced and began the implementation of a new economic policy, which aimed the integration into world markets by establishing a free market economy (CBT, 1994). The opening of the market was seen as an opportunity by foreign banks, however their presence was and still remains low. According to (PMO, 2005) in 1980 out of 37 banks operating in Turkey, there were only 6 investment and development banks out of each *none* was foreign owned. The balance did change in the later years, however the foreign presence in the investment banking group was very low, whereas it did increase in the commercial part of the sector. Even though under this new liberal policy introduced by the government the banking sector in Turkey did undergo a series of restructuring and reforms which were aimed at increasing the efficiency of the financial system by boosting competition between banks, by 2004 there were only *two* foreign investment banks – Calyon Bank and Taib Banks - compared to eleven domestic ones (PMO, 2005; BRSA, 2005)

The reason for this low participation of foreign investment banks was due to the banking structure inherited by the participating domestic banks amongst other things. The largest private banks in Turkey were largely and closely linked to industrial groups. For example, Yapi ve Kredi Bankasi is owned by the Çukurova conglomerate (Çukurova, 2004), Akbank – considered the most successful bank in Turkey – is owned by Sabancı

¹ Organisation for Economic Co-operation and Development - it constantly keeps record on Turkey’s development

² A rating agency

³ Turkey’s Prime Minister’s Office - banking system reports.

⁴ All these banks are classified as ‘Investment & Development’ banks, however their services vary from investment banking to commercial banking.

Group and some other banks have similar relations (Country Studies, 1995). These banks provided the financing that was needed by the conglomerates, which operated and still do, in the most vital sectors of the Turkish economy, such as telecommunications and trade. For their part, most other Turkish companies financed expansion through their closely held groups of shareholders, therefore side-passing investment banks which could have offered their expertise. Another reason is the limitation of inter-business activity created by most large businesses, which continue to float publicly only a minority portion of company shares in order to limit outside interference in company management. However there is no attempt by the private sector or government to restrict foreign participation; on the contrary it is encouraged (Political Risk Yearbook, 2005).

Financial Markets. Potential new market entrants should bear in mind that Turkey is still contributing to the reforms which started in 1980's, as it is considered an on-going process. The Turkish government has taken very important steps to promote competition amongst banks and to further open the markets.

In 1986 the Istanbul Stock Exchange (ISE) was established after having closed in the late 1970's. The ISE is made up of three markets: the Stock Market, the Bond & Bills Market and the International market. The computerised trading system of the ISE⁵ was completed in mid November 2004 enabling members to trade in stocks and rights coupons. On 17 June 1991 the Bond & Bills market was established with the purpose to provide an efficient and competitive environment for the trading of fixed-income securities comprising of government bonds, Treasury bills, revenue-sharing certificates, bonds issued by the Privatization Administration and corporate bonds listed on the ISE. In the most recent development, the Real Estate Certificates Market was launched on June 3, 1996 within the ISE Bonds and Bills Market (ISE, 2005).

On 24 July 1995 the ISE International Securities Free Zone became effective, therefore encouraging the flow of international capital to ISE while providing a secure environment for the trading of securities issued in international markets.

On 1 September 1997, Pensions & Investments⁶ announced that the Chicago Board of Trade (CBOT) and the Izmir Commodity Exchange (ICE) in Turkey signed a memorandum of understanding to develop a derivatives market and clearinghouse in Turkey. The initial product to be offered was contracts on cotton futures (Business Source Premier, 2005).

Competition & Service Opportunities. According to PMO (2005) supported by BRSA⁷ (2005) the number of investment banks through the years in Turkey is as shown in the table below (*):

⁵ Currently, there are 309 companies listed in the ISE. 100 companies selected from among the listed companies in the National Market are included in the ISE National 100 Index, which is the main index of the ISE Stock Market.

⁶ Founded in 1973, Pensions & Investments is the pre-eminent international financial newspaper for institutional investing and fund management.

⁷ Banking Regulation and Supervision Agency – set up by the Turkish government in 1999, becoming operational in 2000 (US Department of State 2005). Its aim is to regulate the Turkish banking system.

	1980	1990	1994	1999	2004
Investment and Development Banks	6	10	12	19	13
State-owned	4	3	3	3	3
Private	2	4	6	13	8
Foreign	-	3	3	3	2
Total	37	64	67	81	48

(*) for the complete list of investment banks and branches please check **appendix 2, 3**

The table above clearly shows the increase in number of investment banks, although the highest number was in 1999, dropping down to only 13 investment banks in 2004 after the liquidation of various banks, amongst which also the Dutch ING Bank and Credit Suisse First Boston (CBT, 2003).

The figures are however a bit misleading. As I indicated earlier in the report, not all investment banks present in Turkey are listed under the heading '*investment & development banks*'. For instance, although the table shows the presence of only two investment banks indeed the Turkish market seems to have accommodated banks whose names are well known in the world investment banking such as Deutsche Bank A.Ş., and CITIBANK N.A. (BRSA, 2005). Other banks and financial institutions that have a presence in Turkey in one form or the other include Banca di Roma, ABN AMRO Bank N.V., JP Morgan – Chase Bank National Association, Societe Generale S.A., Westlb A.G.. Yet again, as is the case with the domestic investment banks, these institutions offer a wide range of services varying from commercial to investment banking. A clear example is the Westlb A.G which is a German commercial bank but its product units in Turkey, amongst others, include equity markets, mergers & acquisitions and asset management which are typical to investment banks.

Amongst common investment banking services like corporate finance, foreign exchange, underwriting of securities, mergers, acquisitions, and initial public offerings in which banks are already involved in Turkey, another one would be project financing. The majority of banks in Turkey do not have experience in project financing because of the lack of long-term funds in the capital markets. This has led to a crowding out of the demand by small and medium enterprises (SMEs) for project financing (Bankakademie⁸, 2004). This is an opportunity for foreign investment banks to bring in their expertise which could later lead to the market making for large sized project financing.

Privatising is also an area in which investment banks have been and still are involved in. The privatization of the public companies began in 1984, and since then over 183 privatizations have been concluded amounting to total of \$10bn. Future privatizations include various state-owned companies in textile, fertilizing, tobacco, motor-vehicles and telecommunications (OIB², 2005). Therefore the potential for profitable business for foreign investment banks, with more experience in privatisations, is great.

⁸ This is a German institution that provides assistance with project financing. Currently it is involved in Turkey in a project with the European Investment Bank.

² Turkish Prime Ministry Privatization Administration – this is a governmental body overseeing the privatization program.

Conflicts of Interests & Legal Framework. According to an OECD (2002) report on Turkey, it was the weak banking system that was the main cause of the 2000 – 2001 financial crises which took the country's economy at the edge of collapse. Referring to OECD's report and sources, one gathers that, amongst other reasons, the liberalisation program that started in 1980 had led the majority of banks to be careless in their deals and serious conflict of interests could have been identified throughout the last two decades.

Throughout the 1980's conflicts as a principal were a common 'phenomena' because of the fact that most banks were owned by private companies. In most cases investment banks arranged financing on 'softer' terms for their clients which were also their owners. Such was perceived to be the case in 1990's when Pamukkale bank arranged financing for a subsidiary of Çukurova conglomerate (the bank's owner), for a minimum price when it was clear that the fee-price was to be a percentage of the amount raised. Also the amount raised came at a time when Çukurova group was experiencing cash-flow difficulties. Although, at the time this deal was passed off as simply 'risky' and turned out well - the potential risk for the Pamukkale bank's credibility and its outside investor's financial position was enormous. After a couple of years Pamukkale bank was liquidated.

However, since then the government of Turkey has undertaken serious steps to prevent future deals which weaken the banking system. In 1999 the government introduced the new 'Bank Act' which all banks in Turkey are subject to. This Act brought to life the BRSA which along with the Central Bank and the Treasury are in a position to regulate the banking sector (see appendix 5).

The Capital Market law enacted in 1981 and amended in 1992 offers the legal framework for the capital market (primary market) in Turkey and the ISE. Together with this law there is Decree-by-Law No. 91, enacted in 1983, which constitutes the regulatory base for secondary markets.

Conclusions. If I was to evaluate the Turkish market bearing in mind Rybczynski's development stages for investment banks, it seems to be appropriate to say that Turkey is at the beginning of the stage two, where the majority of investment banks have started to operate in debt/equity markets. Nevertheless, there are indications that the market is trying to tap the third stage, by establishing – at the moment in a small scale – a derivatives market. This is good news for investment banks as it means that the market is developing and wants to accommodate trading in new markets.

Competition in the Turkish market does not seem to be very strong although a couple of well-known international investment banks are operating, offering a variety of commercial, retail and investment services. The mere size of the Turkish market and the bright economic prospects do not make competition something to worry about. Add to this the fact that domestic investment banks and the banking sector itself for that matter, has been and still is under restructuring and consolidation after the 2001 financial crises, largely attributed to the weakness of the sector, and we have a clear case of an investment banking industry in the making. This makes up for an excellent opportunity for a foreign investment bank to get involved and take part in the consolidation process, by ripping profits along the way.

The stable growth environment had positive effect on the banking system. To ensure financial stability, serious structural reforms have been introduced in the banking system. Thus, the structure of the banking system has become healthier. An independent agency was formed for increasing the effectiveness of banking supervision and control (the Banking Regulation and Supervision Agency- BRSA). The Banking Act and other banking regulations have been considerably harmonized with international best practices (BAT¹⁰, 2005). Furthermore, accession talks with European Union (EU) and the prospect of EU membership in the future make Turkey an attractive market to enter.

However, there a couple of issues that managers of investment banks might want to consider. The Turkish market is still 'young' and it has experienced a serious financial crises, not long ago. This was due to a weak banking system, and symptoms could resurface in the future. An investment bank could find itself in trouble if care is not taken in deal-making. Furthermore, although the government has followed an open-market policy, Turkey has a long history of political turbulences, so this is an area to be looked at cautiously. The country ranks 77th in the Transparency International Corruption Perceptions Index (TI¹¹, 2005) and this could cause managerial problems when dealing with the government. Also the amount of red tape, although not very high, is considerable. According to World Bank data (2004) it takes 18 separate procedures to enforce a contract in Turkey which takes about 105 days. This could make investment banks cautious as their managers need to think very carefully when signing contracts on prospect deals. On 1 January 2005 Turkey 'chopped off' the 6 zeros that accompanied its currency, Lira, thus giving a hard blow to inflation (CBT¹², 2005). However, inflation still remains high and this could cause a problem when evaluating deals, thus keeping an eye on it to avoid its peak periods would be a great help to investment banks.

¹⁰ Banks Association of Turkey provides up-to-date information on all banks operating in Turkey.

¹¹ Transparency International – reports annually on level of corruption

¹² Central Bank of Turkey (CBT) - As of 1 Jan 2005 **1,000,000** old Liras = **1** New Turkish Lira. However old currency will only be banned from circulation starting on 1 Jan 2006

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Appendix

Appendix 1

Economic Outlook

	2003	2004	2005
Real GNP Growth	5.9	5.5	4.0
Budget Deficit/GDP	-11.2	-9.5	-5.9
Government Debt/GDP	79.4	75.9	69.8
Inflation (% Annual Average)	25.3	15	11
C/A Balance (% GDP)	-2.8	-3.6	-3.3

Source: CBT, Turkish Treasury, Fitch Ratings

Appendix 2

Financial Assets (As percentage of GNP, %)

	2001	2002	2003	2004
Capital market	107	76	82	93
Shares (market value)	38	21	27	32
Bills and bonds	68	55	55	55
- Public	68	54	55	55
- Private	0	0	0	0
Investment fund	1	2	4	6
Total	167	127	126	140

Source: Capital Markets Board (CMB), CBT, (Banks Association of Turkey)

Appendix 3

Public Investment Banks				
		Address	Tel.	Fax.
1	İLLER BANKASI	ATATÜRK BULVARI NO:21 06053	OPERA/ANKARA	312-310 31 41 74 59
2	TÜRKİYE İHRACAT KREDİ BANKASI A.Ş.	MİLLİ MÜDAFA CAD. NO:20 06100	BAKANLIKLAR/ ANKARA	312-417 13 00 312-425 78 96
3	TÜRKİYE KALKINMA BANKASI A.Ş.	İZMİR CADDESİ NO: 35 06100	KIZILAY/ ANKARA	312-231 84 00 312-231 31 25
Private Investment Banks				
		Address	Tel.	Fax.
1	ÇALIK YATIRIM BANKASI A.Ş.	BÜYÜKDERE CAD. NO:209 KAT:16 TEKFEN TOWER	4. LEVENT/ İSTANBUL	212- 339 14 14 212 339 14 44 - 93
2	DİLER YATIRIM BANKASI A.Ş.	TERSANE CAD. DİLER HAN NO:46-48 80000	KARAKÖY/ İSTANBUL	212-253 66 30 212-253 94 54

3	GSD YATIRIM BANKASI A.Ş.	ANKARA ASFALTI KÜÇÜKYALI KAVŞAĞI İNÖNÜ CD. GÖKÇE SK. NO:14 81570	KÜÇÜKYALI / İSTANBUL	212-489 97 50	212-489 97 51
4	İMKB TAKAS VE SAKLAMA BANKASI A.Ş.	ABİDE-İ HÜRRİYET CD.MECİDİYEKÖY YOLU SK.NO:286 80260	ŞİŞLİ/İSTANBUL	212-315 25 25	212-315 25 26
5	NUROL YATIRIM BANKASI A.Ş.	NUROL PLAZA BÜYÜKDERE CAD. NO: 71 KAT:15-17 80670	MASLAK/ İSTANBUL	212-286 81 00	212-286 80 01
6	TAT YATIRIM BANK A.Ş.	KEMERALTI CADDESİ NO:24/2 80030	KARAKÖY/ İSTANBUL	212-293 17 00	212-249 46 85
7	C KREDİ VE KALKINMA BANKASI A.Ş.	MEYDAN SOK. NO: 28 BEYBİĞİZ PLAZA KAT:7 80670	MASLAK/ İSTANBUL	212-290 32 32	212-290 32 12
8	TÜRKİYE SINAİ KALKINMA BANKASI A.Ş.	MECLİSİ MEBUSAN CADDESİ NO:161 80040	FINDIKLI/ İSTANBUL	212-334 50 50	212-243 29 75
Foreign Investment Banks					
		Address		Tel.	Fax .
1	CALYON BANK TÜRK A.Ş.	YAPI KREDİ PLAZA C BLOK KAT 14 80620	LEVENT / İSTANBUL	212-339 37 00	212-282 63 01
2	TAİB YATIRIM BANKASI A.Ş.	BÜYÜKDERE CADDESİ ÖZSEZEN İŞ MERKEZİ NO: 122 A BLOK KAT: 6 34394	ZİNCİRLİKUYU / İSTANBUL.	212-347 54 54	212-347 01 11
Foreign Banks Established in Turkey					
		Address		Tel.	Fax.
1	ARAP TÜRK BANKASI A.Ş.	VALİ KONAĞI CAD. NO:10 80200	NİŞANTAŞI/ İSTANBUL	212-225 05 00	212-225 05 26
2	AK ULUSLARARASI BANKASI A.Ş.	1.LEVENT PLZ. BÜYÜKDERE CAD.NO:173 A BLK KAT:8-10 80620	1.LEVENT/ İSTANBUL	212-339 57 00	212-339 57 05
3	HSBC BANK A.Ş.	HSBC PLAZA, AYAZAĞA MAH. AHİ EVREN CAD. DEREBOYU SOK. 34398	MASLAK/ İSTANBUL	212-366 00 00	212-366 33 83-84
4	BANKEUROPA BANKASI A.Ş.	ABDİ İPEKÇİ CAD. NO:63 80200	MAÇKA/ İSTANBUL	212-231 40 10	212-248 37 91
5	CITIBANK N.A.	BÜYÜKDERE CADDESİ NO:100 80280	ESENTEPE/ İSTANBUL	212-288 77 00	212-288 77 60
6	DEUTSCHE BANK A.Ş.	İPEK SOKAK NO:1 34342	BEBEK/ İSTANBUL	212-257 76 84	212-257 73 27
Branches of Foreign Banks Established Outside of Turkey					
		Address		Tel.	Fax.
1	ABN AMRO BANK N.V.	TAMBURİ ALİ EFENDİ SOK. NO:13 80630	ETİLER/ İSTANBUL	212-359 40 40	212-359 50 50
2	BANCA DI ROMA	BÜYÜKDERE CAD.ÜÇYOLMEVKİİ NORAMİNİŞ MERKEZİ K:5	MASLAK/ İSTANBUL	212-285 93 10	212-276 94 25
3	BANK MELLAT	ABİDE-İ HÜRRİYET CADDESİ GEÇİT SOK. No:10	ŞİŞLİ/ İSTANBUL	212-296 31 20	212-296 45 85

4	HABİB BANK LİMİTED	ABİDE-İ HÜRRİYET CADDDESİ GEÇİT SOK.NO:12 80272	ŞİŞLİ/ İSTANBUL	212- 246 02 20	212- 234 08 07
5	JP MORGAN CHASE BANK NATIONAL ASSOCIATION	EMİRHAN CAD. NO:145 ATAKULE A BLOK K:11 80700	DİKİLİTAŞ/ İSTANBUL	212- 326 83 00	212- 326 83 84 - 85
6	SOCIETE GENERALE S.A.	NİSPETİYE CAD.AKMERKEZ E-3 BLOK KAT 9 80600	ETİLER/ İSTANBUL	212- 282 19 42	212- 282 18 48
7	WESTLB A.G.	EBULULA MARDİN CADDESİ MAYA PARK TOWERS 80630	AKATLAR/ İSTANBUL	212- 339 25 00	212- 352 22 42

Source: Banking Regulation and Supervision Agency (2005)

Appendix 4

Number of Branches in the System:

	2001	2002	2003	2004
Dev. And inv. banks	30	19	34	35
State-owned	11	4	21	21
Privately-owned	16	12	10	12
Foreign banks	3	3	3	2
Total	7.837	6.908	6.081	6.217

Source: PMO (2005)

Appendix 5

Supervision and Regulation in the Financial Sector

Financial Sector Institutions		Supervisory and Regulatory Authorities
<input type="checkbox"/> Banks (Publicly held banks)	→	BRSA CMB
<input type="checkbox"/> Special Finance Institutions	→	BRSA
<input type="checkbox"/> Insurance Companies	→	Treasury
<input type="checkbox"/> Leasing Companies	→	Treasury
<input type="checkbox"/> Factoring Companies	→	Treasury
<input type="checkbox"/> Consumer Finance Companies	→	Treasury
<input type="checkbox"/> Investment Trusts	→	CMB
<input type="checkbox"/> Private Pension Funds	→	CMB
<input type="checkbox"/> Intermediary Institutions	→	CMB

Source: Banks Association of Turkey (2005)