FOREIGN BANK PRESENCE AND DOMESTIC BANK PERFORMANCE IN TURKISH BANKING SYSTEM

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ABSTRACT

This study investigates the effect of the foreign bank presence on the performance of domestic banks in the Turkish Banking System. The findings of the study that has been conducted in the period 2004-2007, using the data of 13 deposit banks, have shown that interest spreads; non-interest incomes and overhead costs of domestic banks vary depending on the foreign bank presence; however no significant differences have been observed in terms of profitability and loan loss provisions. When evaluated together, even though the study has displayed some evidence on the effects of the foreign bank presence on the competition in Turkish Banking System, its effects on domestic banks can be considered negligible in terms of profitability and risk taking.

Key Words: Foreign bank presence, domestic banking system, Turkish banking system.

JEL Classification: G21, F10, F21

TÜRK BANKACILIK SİSTEMİNDE YABANCI BANKA MEVCUDİYETİ VE YEREL BANKALARIN PERFORMANSI

ÖZET

Bu çalışmada Türk bankacılık sisteminde yabancı banka mevcudiyetinin yerel bankaların performansı üzerindeki etkisi araştırılmıştır. 2004-2007 dönemine ilişkin 13 adet mevduat bankasına ait veriler kullanılarak yapılan analizin bulguları yabancı banka mevcudiyetine bağlı olarak yerel bankaların faiz spredleri, faiz dışı gelirleri ve genel yönetim giderlerinin farklılaştığını gösterirken, karlılık ve olağanüstü karşılıklarda bir farklılaşma gözlenmemiştir. Bir bütün olarak değerlendirildiğinde çalışmada Türk bankacılık sisteminde yabancı banka mevcudiyetinin sistemde rekabeti etkilediği yönünde bazı kanıtlara ulaşılsa da bu rekabetin karlılık ve risk alma konusunda yerel bankalar üzerindeki etkisi önemsizdir.

Anahtar Sözcükler: Yabancı banka mevcudiyeti, Yerel bankacılık sistemi, Türk bankacılık sistemi.

JEL Sınıflandırması: G21, F10, F21

INTRODUCTION

a. Foreign Direct Investments (FDI) and the Development of the Foreign Bank Entry in the World.

The 1990s have been a period during which the globalization and socio-economic integration tendencies have been intense worldwide. The economic structures of the countries have gained more liberal characteristics as a result of the globalization and integration and there have been significant increases in the volume of the foreign direct investments. Particularly, the countries so called as the emerging economies and transition economies have been most affected by this development.

The liberalization and adoption of the market economy that have occurred worldwide together with the globalization tendencies have led to deregulations in the financial markets and liberation of the exchange rate and the capital flow. In parallel with this general tendency, the emerging and transition economies have liberated their financial systems in that period. One specific outcome of the financial liberalization has been abolishing the restrictions on the entrance of foreign banks in to the local banking system. Thus in 1990s, foreign banks have started to display their presence in the national economies through opening branch offices or acquiring domestic banks in part or in whole and increased their share of the foreign-capital in the system. From 1995 to 2005, the share of foreign banks in the developing countries has increased from 23% to 36% in terms of the number of banks and from 10% to 15% in terms of total assets (Claessens, Van Horen, Gurcanlar and Mercado, 2008). In the recent years, the foreign bank presence has rapidly increased in the financial systems of the emerging countries. As of the year 2006, 897 foreign banks have acquired majority shares in the developing countries (World Bank, 2008).

Table 1: The Share of Foreign Banks in the Developing Countries as a Percentage of the Total Banking Sector.

	Number of the Banks (%)				Total Assets of the Banks (%)		
	1995	**2000**	**2005**	**2006**	**1995**	**2000**	**2005**
Domestic Banks	0.77	0.69	0.64	0.62	0.90	0.82	0.85
Foreign Banks	0.23	0.31	0.36	0.38	0.10	0.18	0.15

Source : Claessens, Van Horen, Gurcanlar and Mercado, (2008)

b. Foreign Bank Presence in the Turkish Banking System

The situation in Turkey has shown parallel developments as in the international world. Although important steps have been taken in regards to liberalization and integration in the 1980s and mainly to attract foreign capital from abroad, not much success has been achieved in attracting the direct foreign capital in the period between 1980 and 2000. However, after the implementation of the "Transition to a Strong Economy" program in the 2000s, a remarkable increase has been observed in the direct foreign capital investments flowing in to Turkey. The foreign direct investment level which was US$ 600 million in 2002 has reached US$ 19 billion in 2007. As of 2007, the foreign direct investments (FDI) have constituted approximately 3% of the gross domestic product (GDP) and 20% of the fixed capital investments (FCI) (Undersecretariat of Turkish Treasury, 2005, 2006, 2007; For detailed information please see Halıcıoğlu, 2008 and Afşar, 2004)

Table 2: The share of the direct foreign investments in Turkey (%)

	2000	2001	2002	2003	2004	2005	2006	2007
FDI/GDP	0.60	1.70	0.30	0.20	0.30	1.80	3.40	3.00
FDI/FCI	1.80	2.90	3.70	4.70	5.40	13.80	23.70	20.00

Source: Undersecretariat of Turkish Treasury, Foreign Direct Investment Bulletin and Statistics after Law no. 4875

Due to the efforts for adopting foreign-oriented policies, economic integration, and financial liberalization of Turkey in the 1980s, despite the number of foreign banks which have entered the system by opening branches has increased, the effectiveness of foreign banks in the banking system of Turkey has remained limited in that period. The privatization policies that were followed and the economic crisis that had occurred in Turkey in the 2000s have led foreign capital to intensify its interest on the financial services in the Turkish Capital Market. Leaving out the years 2003 and 2004, where there has been a recess, in the other years, almost half of foreign investments (61% in 2007) were aimed at financial services. In particular, right after the commencement of the official EU accession talks for Turkey in 2005, foreign banks have made important investments in the country increasing their numbers and their shares in the system considerably (Akgüç, 2007; World Bank, 2008).

Table 3: Share of the Financial Institutions in the Foreign Direct Investments in Turkey (%)

	2002	2003	2004	2005	2006	2007	2008
Financial Intermediation*	42	7	6	47	39	61	39
Total Foreign Direct Investments	**100**	**100**	**100**	**100**	**100**	**100**	**100**

*Excluding the Loans Obtained by the Foreign Capital Companies from Their Foreign Stockholders

Source: Undersecretariat of Turkish Treasury, Foreign Direct Investment Bulletin and Statistics after Law no. 4875

The number of foreign capital banks has increased rapidly after 2002 and reached 18 in 2007 (55% of the total banks). As of 2007, among the deposit banks, foreign capital banks have achieved 16% of the total assets, 20% of the total credits, 14% of the total deposits, 15% of the total net profits, 14% of the total equities, and 24% of the total employees in number.

Table 4: Share of Foreign Banks in the Turkish Banking System (%)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
% Total Assets	3	3	5	5	5	6	3	3	3	4	5	13	16
% Total Credits	2	2	3	3	3	3	4	4	4	5	7	16	20
% Total Deposits	3	3	3	3	3	3	2	2	2	3	5	12	14
% Total Branch Offices	2	2	2	2	2	1	3	3	3	3	6	16	23
% Total Personnel	2	2	3	3	2	2	4	5	4	5	8	19	24
% Total Number of Banks	33	32	31	30	31	30	35	38	36	37	38	45	55

Source: Banks Association of Turkey, Banks in Turkey, Annual Publications 1995-2007

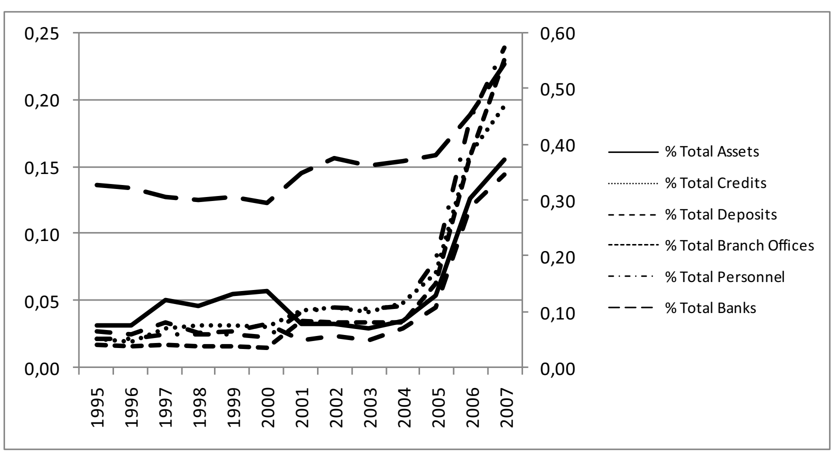

Figure 1: Shares of Foreign Banks in the Turkish Banking System

1. OBJECTIVE OF THE STUDY

The foreign bank presence is an important concept for the economies of the emerging countries and Turkey is also affected by that occurrence. There is an intense interest in the effects of the foreign bank presence on the financial systems and economical development of the emerging countries. An important number of the studies conducted on this issue have focused on the effects of the foreign bank presence on the domestic country's financial system and, in particular, on the banking system.

The findings obtained from the studies conducted to investigate the effects of the foreign bank presence on the domestic banking system are diverse. Besides the findings indicating that the foreign bank presence have positive contributions to the domestic banking system, there are findings showing that it might have a cost as well. Some positive contributions of the foreign bank presence on the domestic banking system can be summarized as follows: rendering the banking system more competitive and thus increasing the efficiency of the system; allocation the credits according to the rational principles that keep all the risks in view; helping to develop the domestic banking monitoring system and legal framework; hence bringing transparency to the system. Nevertheless there are some negative aspects of foreign bank presence as well. Such as, the fact that foreign banks will prefer the serve the more profitable segments of the marketplace, using more developed techniques, which will leave the more risky companies to domestic banks, shall increase the risk taking tendencies of domestic banks, and foreign banks may neglect the national priorities in their approach to credit allocation because of their different priorities and operational considerations, and the potential of foreign banks to increase the financial instability.

The aim of this study is to investigate the effects of the entry of foreign banks, which have begun to play an important role in Turkish banking system, on the performance of domestic banks.

2. LITERATURE REVIEW

Many studies have been conducted to investigate the ever-increasing effects of the foreign bank presence on the domestic banking system. These studies show that the foreign bank presence in the domestic banking system increases the competition in the banking sector and pushing domestic banks to increase their efficiency, thus having an effect on the performance of the domestic banking system. Moreover, those studies are also showing that the dissimilarity between the developed and developing countries and also the sequence of financial liberalization, are both important factors on the relation between the foreign bank presence and the performance of domestic banks.

In the study of Claessens, Demirguc-Kunt and Huizinga (1998) between the years 1988-1995 covering approximately 7,900 commercial banks described as "large" in the universe comprising the banks from 80 countries other than USA, Germany and France, findings have been obtained showing that the foreign bank presence improved the operation of the national banking market and caused a reduction in the profitability and expenses of domestic banks. According to the study, the number of foreign banks rather than their share in the system is important. Foreign banks do not need to reach a certain share to affect the competition in the domestic banking system while entry of these banks to the system is sufficient.

In order to test whether the findings of the study conducted from the data of developed and less developed countries (LDCs) by Claessens, Demirguc-Kunt and Huizinga (2001) were valid only for the LDCs, Hermes and Lensink (2001) have tested by employing the data of the LDCs and the same methodology. The findings indicated that the foreign bank presence is causing an increase in the revenues, profits and expenses of domestic banks in the LDCs. Those findings also show that the foreign bank presence is creating a different effect on the banking systems of the developed and less developed countries.

In the study of Hermes and Lensink (2004a) explicating the relation between the performance of the foreign bank presence and domestic banks taking the development level of the financial system in to account, they have used the data from 982 banks in 48 countries between 1990 and 1996. The findings show that when the financial development level is low, the foreign bank presence causes an increase in the cost and profit margin of domestic banks, and if the level is high, causing a reduction in the cost and profit margin.

Hermes and Lensink (2004b) have investigated the effects of the foreign bank presence on the short term behavior of domestic banks taking the level of economic development into account. This study was conducted with the data obtained from Beck, Demirguc-Kunt and Levine (2000) and BankScope and covered 3,967 observations between 1990 and 1996. The findings prove that the presence of foreign banks is leading to an increase in costs and interest rate spreads of domestic banks in short term at low levels of economic development. The results derived are somewhat conflicting for the high level of economic development. Because, the findings from the studies conducted show that the foreign bank presence is either causing a decrease in the costs, profit and interest rate spreads or has no effect on those items.

Using the data from a total of 4,437 banks from 30 countries, 740 of which were foreign banks, Bayraktar and Wang (2005) have investigated the relation between the foreign bank presence and the performance of domestic banks keeping the sequence of financial liberalization in view. Their findings show that the competition in the banking sector is increasing in parallel with the increase in the foreign bank presence. Moreover, the findings also showing that the sequence of financial liberalization plays a role on that relation.

In addition to studies conducted using global data that investigate the effect of the foreign bank presence to the performance of domestic banks worldwide, there are studies that investigate whether this relation is valid locally. The study of Denizer (1997; 2000) covering the period 1980-1997, indicates a relation between the foreign bank presence and the net interest rate margin, overhead costs and Return on Assets (ROAs) of the domestic banks in Turkey. The findings from the study have shown that the foreign bank presence creates an intense competitive effect on the banking sector causing a decrease in the overhead costs and return on assets (ROAs) of domestic banks as a result. At the same time, the foreign bank presence has a positive effect on the main operations such as planning, credit analysis, marketing and human resources.

The study of Unite and Sullivan (2001) conducted on the economy of Philippines in the period 1990-1998 has shown that foreign bank presence causes a decrease in the interest rate spreads and profitability of the banks owned by the groups of companies, moreover, the foreign bank presence increases the operational efficiency of domestic banks, but disrupting their credit portfolios as they turn to more risky customers; thus causing an increase in the overhead costs and a decrease in the non-interest revenues. The foreign competition leads domestic banks to concentrate on the essential operations and become more efficient.

In the period 1995-2001, Uiboupin (2004) has conducted a study using the data from 319 banks in the 10 Central and Eastern European (CEE) Countries in order to investigate the short-term effect of the foreign bank presence on the domestic banks in the CEE countries empirically. The findings from the study show that the foreign bank presence affects the revenues of domestic banks from the interest-earning assets, the non-interest income and profitability negatively. Moreover, the foreign bank presence causes an increase in the overhead costs of domestic banks in the short term. The findings from the study show that the foreign bank presence increases the competition in the domestic banking system.

Schäfer and Talavera (2007) have investigated the effects of the foreign bank presence on the Ukrainian banking sector in the period from the second quarter of 2003 to the third quarter of 2005 using the data on 160 banks. The findings from the study show that the foreign bank presence decreases the profitability of domestic banks by increasing the competition in the domestic banking system. In order to determine the effects of the foreign bank presence on varying bank groups, domestic banks were grouped as large and small by scale and most profitable and least profitable by profitability. The results show a negative relation between the foreign bank presence and profitability for both groups. This relation is stronger for the small and most profitable banks, but marginally important for the least profitable banks.

3. HYPOTHESIS

The studies conducted show that the foreign bank presence in the domestic banking system is affecting the competition in the banking sector, hence affecting the interest rate spreads, profitability, overhead costs, non-operating income and the tendency of domestic banks to take risks, thus affecting the performance and efficiency of domestic banks.

The increase in the competition caused by the foreign bank presence in the domestic banking system forces domestic banks to pay higher interests to the deposits in order to avoid losing their market shares, while applying lower interest rates to the loans provided. In connection with the foregoing, while the interest income decreases, the interest expenses increase and this causes a decline in the net interest rate spreads. Denizer (2000), Unite and Sullivan (2001), and Uiboupin (2004) have found an inverse relation between the foreign bank presence and the net interest rate spreads, while Claessens, *et al*. (2001) have found no meaningful relation. Predicting an increase in the competition in the Turkish banking system as the foreign bank presence increases, the following hypothesis has been developed:

H1: The participation of foreign banks in the banking system leads to a decrease in the interest rate spread of domestic banks.

The increase in the competition with the participation of foreign banks will force domestic banks to look for alternative resources outside their traditional banking activities. However, starting to earn money from the non-lending activities is a not a short-term, but a long-term result. Therefore, in the short term, the increase in the participation of foreign banks would constrict the net interest spreads and affect their profits, hence the profit for the period, adversely. The studies conducted show a negative relation between the foreign bank presence and the profitability of domestic banks (Denizer, 2000; Claessens, *et al*., 2001; Unite and Sullivan, 2001 and Uiboupin, 2004). Therefore, the following hypothesis has been developed on the foreign bank presence and the profitability of the domestic banks in Turkey:

H2: The participation of foreign banks in the banking system leads to a decrease in the profitability of the domestic banks:

As the participation of foreign banks will reduce the market shares in the traditional banking area, the domestic banks will start putting the emphasis on the non-traditional banking activities. However, according to Bayraktar and Wang (2005), foreign banks are providing better services in the non-traditional banking areas and therefore, a decrease would be predicted in the non-interest income of domestic banks. While Bayraktar and Wang (2005) have found a negative relation between the foreign bank presence and non-interest income, Claessens, *et al*. (2001) have derived a negative but un-meaningful relation. The following hypothesis has been developed on the foreign bank presence and the non-interest income of domestic banks.

H3: The participation of foreign banks in the banking system leads to a decrease in the non-interest income of domestic banks:

In order to cope with the increased competition resulting from the participation of foreign banks, domestic banks choose to increase their operational efficiencies and therefore, reduce their overhead costs. The studies conducted by Claessens, *et al.* (1889), Unite and Sullivan (2001), Bayraktar and Wang (2005) have shown a negative relation between the foreign bank presence and the overhead costs. However, this effect is not short-term. In order to be able to compete, domestic banks have to make new investments, hence an increase in the overhead costs should be expected in the short term. The studies conducted by Hermes and Lensink (2001, 2004a, 2004b); Uiboupin (2004); Micco, *et al*, (2004) show a positive relation between the foreign bank presence and the overhead costs. The following hypothesis has been developed on the foreign bank presence and the overhead costs of domestic banks.

H4: The participation of foreign banks in the banking system leads to a change in the overhead costs of domestic banks.

The increase in the competition caused by the foreign bank presence forces domestic banks to act more carefully in order to avoid losses, therefore they start lending more carefully. On the other hand, due to the increased competition with the participation of foreign banks and the advantage of foreign banks in lending to the companies with high credit ratings, domestic banks include the companies with lower credit ratings in their customer portfolios, which increase the risks taken by domestic banks. Consequently, foreign banks address the most profitable segment of the market and take the cream of the crop, which in turn forces domestic banks to take even more risks. Claessens, *et al.* (1889), Uiboupin (2004), Bayraktar and Wang (2005) have shown that the foreign bank presence is increasing the risks taken by domestic banks. These studies have lead to the development of the following hypothesis on the foreign bank presence and the risk taking tendency of domestic banks

H5: The participation of foreign banks in the banking system leads to an increase in the risks taken by domestic banks in the short term.

4. DATA AND METHODOLOGY

This study, in which whether the foreign bank presence results in any changes in the performance of domestic banks is investigated, covers the years 2004 to 2007. Although the participation of foreign banks in the Turkish banking system dates back to the 1980s, the weight of foreign banks in the system has been rather low until 2006. However, especially as of 2006, foreign banks have started to achieve important shares in the system through mergers and acquisitions. In this study, the performance of domestic banks in 2004 and 2005 before the increase and in 2006 and 2007, when the increase was observed, has been compared.

The study covers a total of 13 public and private domestic deposit banks operating in the Turkish banking system in the period covered by the study. Three of those banks are public banks and 10 of them are private banks. The banks controlled by the Deposit Insurance Fund as well as the Adabank have been excluded. Similarly, the investment banks and the banks that are not authorized to collect deposit have also been excluded from the study.

All the data concerning the banks included in the study have been obtained from the book titled "Banks in Turkey" published by the Banks Association of Turkey annually. The ratios given in that book have been used as they were, and the ratios unavailable in the book have also been calculated from the financial tables of the banks found in this publication.

In the literature, both the ratio of the number of foreign banks to the total number of the banks in the system and the ratio of the total assets of foreign banks to the total assets of the banks in the system are used as an indicator for the participation of foreign banks (Claessens, *et al.* 1998 and 2001; Denizer, 2000; Hermes and Lensink, 2001, 2004b; Bayraktar and Wang, 2005). When the participation of foreign banks in Turkey is considered in terms of both numerical share and total asset share, important differences are observed between the periods 2004-05 and 2006-07. Both situations have been considered as the foreign bank participation and the periods pertaining to the foreign bank presence have been divided as low and high foreign bank presence periods, and the two periods have been compared.

Claessens, *et al.* (1998, 2001) have used the net interest margin as a proxy for interest rate spread. They defined the ratio of net interest income to total assets as the net interest rate spread, and the net interest income is the difference between the total interest income and expenses. Similarly, the ratio of the net interest income to the total assets has been taken as the net interest rate spread in this study as well. As indicated in the previous studies (Claessens, *et al.* 1998 and 2001; Denizer, 2000; Bayraktar and Wang, 2005), the ratio of the profits before tax to the total assets, the ratio of the non-interest income to the total assets and the ratio of the operational expenses to the total assets have been taken as the measures of the banks' profitability; and non-interest income have been taken as the indicator for the revenues obtained from the non-lending operations, and the managerial expenses have been used as the overhead costs variable (e.g. wages and salaries, depreciation etc.). The loan loss provision has been taken as the indicator of the risks taken by the banks and the ratio of the loan loss provision to the total assets has been used as the measure of the risk (Claessens, *et al.* 1998 and 2001; Denizer, 2000; Bayraktar and Wang, 2005).

The purpose of the study is to investigate the effects of the foreign bank presence on the performance of the domestic banks in Turkey. The effects of the foreign bank presence on the performance of domestic banks for the period covering the years 2004 to 2007 has been analyzed for that purpose. Because, despite the presence of foreign banks in Turkey since 1980s, their share in the system has remained marginal and only in particular as of 2006 foreign banks have started to take important shares in the system through mergers and acquisitions. Therefore, the performance of domestic banks in 2004 and 2005 before the increase and in 2006 and 2007, when the increase was observed, has been compared. Paired sample t-test employed for the comparison of the periods and for determining whether the observed differences between the periods are significant. Accordingly, the years 2004 with 2006 and 2007 as well as 2005 with 2006 and 2007 have been matched separately to find out if there was any difference in the performance of domestic banks in those years. Furthermore, 2004, 2005 and 2006, 2007 are grouped separately and compared. The alpha has been taken as 10% as the significance level in the analyses.

5. EMPIRICAL RESULTS

The results obtained concerning the foreign bank presence and the performances of domestic banks between the years 2004 and 2007 are shown in Table 5. At the same time, the t-test results to show whether the indicators for the performance criteria in the same period displayed any variation with the increase in the foreign bank presence are given in Table 6, 7, 8, 9 and 10.

The average interest rate spread (1.5731) of domestic banks in the period 2006-2007, when the number of the foreign bank presence was higher, is lower than the average (1.7654) for the period 2004-2005 when the number of the foreign bank presence was lower. According to the t-test results, statistically there is a significant difference between the periods when the number of the foreign bank presence was low and high (P=0.10). According to this outcome, the hypothesis H1 stating that the interest spreads of domestic banks would decrease with the foreign bank presence is acceptable. When the years covered by the study are evaluated among themselves, the only significant difference is the difference between the averages of 2004 and 2006. The difference between the averages of 2004 and 2006 is 1.22308 (P=0.00), and this difference shows a significant average decrease of 1.22308 in the interest rate spread of domestic banks in 2006 as compared to 2004. No significant variation has been found between the other periods. This result can be interpreted as the foreign bank presence is generally affecting the interest spread of domestic banks after a period of more than one year and losing its effect in a short time.

The average ratio of the profit before tax to the total assets (2.4346) of domestic banks in the period 2006-2007, when the number of the foreign bank presence was higher, is larger than the average (1.7385) for the period 2004-2005 when the number of the foreign bank presence was lower. According to the t-test results, the difference between the foreign bank presence high and low periods is not significant statistically (P=0.25), therefore, the hypothesis H2 stating that the profitability of domestic banks would decrease with the foreign bank presence is rejected. When the years covered by the study are evaluated among themselves, none of the differences for all the years is significant statistically. When evaluated together, it can be said that the foreign bank presence does not affect the profitability of domestic banks.

The ratio of the non-interest income to the total assets (2.1808) of domestic banks in the period 2006-2007, when the number of the foreign bank presence was higher, is lower than the average (2.6269) for the period 2004-2005 when the number of the foreign bank presence was lower. According to the t-test results, the difference between the foreign bank presence high and low periods is significant statistically (P=0.04), therefore, hypothesis H3 stating that the non-interest income of domestic banks would decrease with the foreign bank presence is acceptable. When the years covered by the study are evaluated among themselves, the differences between the averages of the grouped years of 2004-2007 and 2005-2007 is significant statistically and the average of the year 2007 is the lowest value for all the years. Despite the lower average value for 2006 as compared to the years 2004 and 2005, the differences with the average values for the other years have not been found significant. When evaluated generally, it can be said that the foreign bank presence is causing a decrease in the non-interest income of domestic banks and the decrease is taking place not immediately but with a delay.

The ratio of the overhead costs to the total assets (3.2038) of domestic banks in the period 2006-2007, when the number of the foreign bank presence was higher, is lower than the average (4.0885) for the period 2004-2005 when the number of the foreign bank presence was lower. According to the t-test results, the difference between the foreign bank presence high and low periods is significant statistically (P=0.02), therefore, the hypothesis H4 stating that the overhead costs of domestic banks would vary with the foreign bank presence is acceptable. When the years covered by the study are evaluated among themselves, the differences between the averages of the matched years of 2004-2006 and 2004-2007 is significant statistically. Despite the highest average value for the year 2005, the differences with the average values for the other years have not been found significant. When evaluated generally, it can be said that the foreign bank presence is causing a decrease in the overhead cost of domestic banks and the decrease is taking place not immediately but with a delay.

The average ratio of the loan loss provisions to the total assets (1.5731) of domestic banks in the period 2006-2007, when the number of the foreign bank presence was higher, is smaller than the average (1.7654) for the period 2004-2005 when the number of the foreign bank presence was lower. According to the t-test results, the difference between the foreign bank presence high and low periods is not significant statistically (P=0.44), therefore, the hypothesis H5 stating that the loan loss provisions of domestic banks would increase with the foreign bank presence is rejected. When the years covered by the study are evaluated among themselves, only the difference between the years 2005 and 2006 among the years matched is significant statistically. When evaluated together, it can be said that the foreign bank presence does not affect the loan loss provisions of domestic banks.

CONCLUSION

This study was conducted to investigate whether the foreign bank presence has affected the performance of the domestic banks in the Turkish banking system. Because the foreign bank presence has increased significantly in 2006 in Turkey, the four years in the period 2004-2007 have been covered by the study. In the study, the performances of domestic banks in the two years before the increase and the two years after the increase have been compared. The study has covered a total of 13 domestic deposit banks in the system during the relevant period, 3 of which were public and 10 were private banks. The data obtained from the Banks Association of Turkey in connection with the variables selected from the literature as indicators for the performance of banks , have been subjected to the t-tests to compare differences between the average values for the periods. Time constraints and hence, inadequate data of foreign bank presence, which are the explanatory variables for the period, a relational analysis has not been possible and therefore, a difference analysis has been conducted.

In conclusion, conflicting evidences have been collected concerning whether the foreign bank presence has increased the competition in the banking system of Turkey and has affected the performance of domestic banks. The interest spread, non-interest income and overhead costs of domestic banks vary depending on the foreign bank presence as predicted. The findings concerning the interest rate spreads show that the foreign bank presence has caused a decrease in the interest rate spreads of domestic banks and this effect takes place after a period of more than one year and lasts for a short duration. The findings on the non-interest income and overhead costs indicate that the foreign bank presence causes a decrease in the non-interest income and overhead costs of domestic banks and those decreases are taking place not immediately but with a delay. On the other hand, no foreign bank presence dependent variation has been observed in the profitability and the loan loss provisions of domestic banks. Therefore, it can be said that the foreign bank presence is not affecting the profitability and the loan loss provisions of domestic banks in Turkey. Hermes and Lensik (2004a) explain this situation with the level of financial development. The authors point out that as the level of development increases, the difference between foreign banks and domestic banks also decreases and domestic banks become more efficient in cost reduction and protecting their market shares. Turkish banking system is at a rather developed stage in terms of financial development level. Many domestic banks can easily compete with foreign capital banks in domestic market. Moreover, according to Claessens, *et al.* (1998), the foreign bank presence does not have to reach a certain level of share in the system in order for the foreign bank presence to affect the competitiveness of domestic banks and just the participation of the foreign bank presence in the system should suffice; the important issue is the numbers rather than the shares of foreign banks in the system. Although the increase in the foreign bank presence has been experienced in the years 2006 and 2007, the foreign bank presence has existed in the Turkish banking system since a long time (since 1980s). Therefore, domestic banks have been competing with the foreign banks in the Turkish market since long years and have come a long way in competing with foreign banks during that time. Those reasons indicate that foreign bank presence cannot impress the expected effect on the performance of domestic banks.

As the studies cover a limited period, care has to be taken in issuing the policies. In particular, once the time limitation of the study is eliminated and as a result, when the studies are conducted with an improved data set that allows more detailed analyses, it will carry the findings obtained here much further. The studies conducted in that direction are very important for the economy of Turkey. Because, although domestic banks may own a larger share in the system yet in terms of the values such as the total assets, total deposits and total loans, when compared in terms of the numbers of the banks, the share of foreign banks has considerably increased in the system. Explicating the positive and negative aspects of this increase would provide infinite benefits for the economy of the country.

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FIGURES AND TABLES

Table 5: The Selected Performance Values of the Domestic Deposit Banks For the period 2004-2007 in Turkey

		2007	2006	2005	2004
Net Interest Income (Interest Income – Interest Expenses) / Total Assets	Mean	4.7	4.1	4.5	5.3
	Std. Deviation	1.2	0.9	1.6	1.7
Profit Before Tax / Total Assets	Mean	2.6	2.3	1.2	2.2
	Std. Deviation	1.1	0.9	4.5	1.3
Non-Interest Income (Net) / Total Assets	Mean	2.0	2.3	2.5	2.8
	Std. Deviation	1.2	1.3	1.1	1.1
Operational Expenses (Non-Interest Expenses) / Total Assets	Mean	3.2	3.2	4.3	3.9
	Std. Deviation	1.1	1.2	3.4	1.2
Loan Loss Provisions / Total Assets	Mean	1.5	1.7	1.9	1.6
	Std. Deviation	0.9	1.7	2.0	1.5

Table 6: Net Interest Income (Interest Revenues – Interest Expenses) / Total Assets, t-test Results

	N	**Mean**	**Std. Deviation**	**Std. Error Mean**
2004	13	5.29231	1.69433	0.46992
2005	13	4.46154	1.56766	0.43479
2006	13	4.06923	0.88070	0.24426
2007	13	4.73077	1.16647	0.32352
	Mean	**Std. Deviation**	**Std. Error Mean**	**Sig. (2-tailed)**
2005 - 2006	0.39231	1.16294	0.32254	0.25
2005 - 2007	-0.26923	1.22365	0.33938	0.44
2004 - 2006	1.22308	1.27093	0.35249	0.00
2004 - 2007	0.56154	1.49306	0.41410	0.20
	N	**Mean**	**Std. Deviation**	**Std. Error Mean**
2007-06	26	1.5731	1.0673	0.20932
2005-04	26	1.7654	1.6544	0.32445
	Mean	**Std. Deviation**	**Std. Error Mean**	**Sig. (2-tailed)**
2007-06 / 2005-04	-0.4769	1.4398	0.28237	0.10

Tablo 7: Profit Before Tax / Total Assets, t-test Results

	N	**Mean**	**Std. Deviation**	**Std. Error Mean**
2004	13	2.2538	1.36297	0.37802
2005	13	1.2231	4.46470	1.23829
2006	13	2.2692	0.89479	0.24817
2007	13	2.6000	1.07316	0.29764
	Mean	**Std. Deviation**	**Std. Error Mean**	**Sig. (2-tailed)**
2005 – 2006	-1.04615	4.14560	1.14978	0.38
2005 – 2007	-1.37692	4.14772	1.15037	0.25
2004 – 2006	-0.01538	0.74257	0.20595	0.94
2004 – 2007	-0.34615	0.86180	0.23902	0.17
	N	**Mean**	**Std. Deviation**	**Std. Error Mean**
2007-06	26	2.4346	0.98263	0.19271
2005-04	26	1.7385	3.27659	0.64259
	Mean	**Std. Deviation**	**Std. Error Mean**	**Sig. (2-tailed)**
2007-06 - 2005-04	0.69615	3.00073	0.58849	0.25

Tablo 8: Non-Interest Income (Net) / Total Assets, t-test Results

	N	Mean	Std. Deviation	Std. Error Mean
2004	13	2.7769	1.11964	0.31053
2005	13	2.4769	1.11292	0.30867
2006	13	2.3231	1.30713	0.36253
2007	13	2.0385	1.14422	0.31735
	Mean	**Std. Deviation**	**Std. Error Mean**	**Sig. (2-tailed)**
2005 - 2006	0.15385	0.56659	0.15714	0.35
2005 - 2007	0.43846	.87229	0.24193	0.10
2004 - 2006	0.45385	1.22720	0.34036	0.21
2004 - 2007	0.73846	1.10192	0.30562	0.03
	N	**Mean**	**Std. Deviation**	**Std. Error Mean**
2007-06	26	2.1808	1.21228	0.23775
2005-04	26	2.6269	1.10438	0.21659
	Mean	**Std. Deviation**	**Std. Error Mean**	**Sig. (2-tailed)**
2007-06 / 2005-04	0.44615	1.04316	0.20458	0.04

Tablo 9: Operational Expenses (Non-Interest Expenses) / Total Assets, t-test Results

	N	Mean	Std. Deviation	Std. Error Mean
2004	13	3.8769	1.24509	0.34533
2005	13	4.3000	3.38821	0.93972
2006	13	3.2000	1.16905	0.32423
2007	13	3.2077	1.15214	0.31955
	Mean	**Std. Deviation**	**Std. Error Mean**	**Sig. (2-tailed)**
2005 - 2006	1,10000	2,80387	0,77765	0,18
2005 - 2007	1,09231	2,50482	0,69471	0,14
2004 - 2006	0,67692	0,59603	0,16531	0,00
2004 - 2007	0,66923	0,83405	0,23132	0,01
	N	**Mean**	**Std. Deviation**	**Std. Error Mean**
2007-06	26	3,2038	1,13718	0,22302
2005-04	26	4,0885	2,51019	0,49229
	Mean	**Std. Deviation**	**Std. Error Mean**	**Sig. (2-tailed)**
2007-06 / 2005-04	0,88462	1,79637	0,35230	0,02

Tablo 10: Loan Loss Provisions / Total Assets, t-test Results

	N	Mean	Std. Deviation	Std. Error Mean
2004	13	1.6000	1.47422	0.40888
2005	13	1.9308	2.02047	0.56038
2006	13	1.6615	1.67955	0.46582
2007	13	1.4846	0.95206	0.26405
	Mean	**Std. Deviation**	**Std. Error Mean**	**Sig. (2-tailed)**
2005 - 2006	0.26923	0.43086	0.11950	0.04
2005 - 2007	0.44615	1.39141	0.38591	0.27
2004 - 2006	-0.06154	1.05478	0.29254	0.84
2004 - 2007	0.11538	0.85814	0.23801	0.64
	N	**Mean**	**Std. Deviation**	**Std. Error Mean**
2007-06	26	1.5731	1.34061	0.26292
2005-04	26	1.7654	1.74102	0.34144
	Mean	**Std. Deviation**	**Std. Error Mean**	**Sig. (2-tailed)**
2007-06 / 2005-04	-0.19231	1.23707	0.24261	0.44