Comparison of Financial Performances of Domestic and Foreign Banks: The Case of Turkey

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Abstract

Banking system plays an important role in the development of a country's economy and its financial stability. The aim of this study is to compare financial performances of foreign and domestic banks, which operate in Turkish Banking Sector. For this purpose, data of 10 domestic and 10 foreign banks, which operated, between the years 2005-2011 have been used. In this study, differences of domestic and foreign banks in terms of profitability, capital adequacy, asset quality, riskiness, size, liquidity and management effectiveness have been put forth. As a result of the study, it is determined that asset quality, return on equities, total assets and management effectiveness of domestic banks are higher than foreign banks. On the other hand, domestic banks are determined to have a lesser capital adequacy ratio than foreign banks.

Key Words: Domestic and Foreign Banks, Financial Performance, Turkey

1. Introduction

Banking system plays an important role in the development of a country's economy and its financial stability (Ryu, Piao & Nam, 2012). Stability or sustainable growth would not be possible in a country with an unhealthy banking sector. Foreign-capital banks increasingly become more important in Turkish banking system and banking markets of other developing countries (Karacaoğlan, 2011). Performance measurement of banks, which contribute, to economic activities especially by credit channels is important in terms of national and international assessment of sector's success (Demireli, 2010).

The developments in financial arena in world's economy and in Turkey have clearly proved that the strength of national economies and financial systems is important with regard to stability. These developments have created mobility in international banking sector as well. Foreigners who are having trouble in finding a market to transform their revenues to reinvestment saw Turkey as a profitable market and have made domestic market attractive consequently accelerating the entries of foreign banks (Ak, 2007). The conditions of today's financial sector where the levels of terms of competition are high, force banks to make use of their resources in the most effective way. This creates a need for the bank managers who hold the position of decision makers in banking sector: to compare their bank's activities with other competing banks' activities (Budak, 2011).

In the review of literature regarding this subject, it was observed that there were no studies carried out on Turkish banking sector. This study fills an important gap in literature by comparing domestic and foreign banks' financial performances and by putting forth differences and similarities of the aforementioned banks. Therefore, this study is quite important.

The aim of this study is to carry out a comparison of performance of domestic and foreign banks, which operated in Turkish banking sector between the years 2005-2011. In this study, differences of domestic and foreign banks in terms of profitability, capital adequacy, asset quality, riskiness, size, liquidity and management effectiveness have been put forth. Study consists of five sections. Second section after the introduction contains a summary of the studies comparing financial performances of domestic and foreign banks. Third section explains methodology of the study and introduces financial ratios used in the study. Forth section contains the results of analysis. And a general assessment of the study has been put forth in the last section.

2. Literature Review

Kunt & Huizinga (1999) have studied financial performances of the banks operating in developed and developing countries. As a result of their study in which they used data of the period 1988-1995, they determined that performance of foreign banks is higher than domestic banks. Chantapong (2003) compared financial performance of domestic and foreign banks operating in Thailand between the years 1995-2000. The result of the study showed that foreign banks have a higher profitability than domestic banks.

Pasiouras & Kosmidou (2007) studied internal and external factors determining profitability of domestic and foreign commercial banks operating in 15 European Union countries in the period of 1995-2001. As a result of their study, they have concluded that financial structure of the banks has an important impact on profitability. Nimalathasa (2008) compared financial performances of domestic, foreign, private and state banks operating in Bangladesh. As a result of the study that used data of the period 1999-2006, foreign banks have been observed to have a higher performance than domestic banks with regard to liquidity, profitability and interest income.

Alam, Raza & Akram (2011) compared performances of state and domestic banks operating in Pakistan between the years 2006-2009 with the help of financial ratios. The result of analysis showed that domestic banks have a larger size of assets than state banks. Additionally, it is concluded that state banks have a better performance in terms of profitability and liquidity than domestic banks.

San, Theng & Heng (2011) used Data Envelopment Analysis to analyze and compare efficiency of domestic and foreign banks operating in Malaysia. Data of 9 domestic and 12 foreign banks between the years 2002-2009 have been used. The result of the analysis showed that domestic banks are more efficient and have more management competency than foreign banks.

Jha & Hui (2012) compared financial performances of state, private and foreign-capital banks operating in Nepal between the years 2005-2011. The study showed that domestic and foreign banks are more effective than state banks. In addition, efficiencies of domestic and foreign-capital banks have been proved to be equal.

Matthew & Esther (2012) compared financial performance of domestic and foreign banks operating in Ghana between the years 2005-2011. They put forth the differences of said banks in terms of profitability, size, liquidity, asset quality and capital adequacy in their study. The study showed that domestic banks have a higher return on assets and equities when compared to foreign banks. In addition, foreign banks have proved to have more liquidity, capital adequacy, size, and asset quality than domestic banks.

3. Methodology

This study aims at measuring financial performances of domestic and foreign banks operating in Turkish banking sector comparatively. With this purpose, a data set has been formed by utilizing financial ratios of 10 domestic and 10 foreign banks operating within the period of 2005-2011. Data used in this study have been obtained from the web site of The Banks Association of Turkey[1]. The information regarding these variables is as below.

Table: 1 Financial Ratios

	Variable	Formulation
ROA	Return on Assets	Net Profit of the Period/Total Assets
ROE	Return on Equities	Net Profit of the Period/Total Equities
TE/TA	Capital Adequacy	Total Equities/Total Assets
NPL/TL	Riskiness	Non-Performing Loans/Total Loans
INT/TA	Management Effectiveness	Interest Income/Total Assets
QR	Acid Test Ratio	Liquid Assets / Short-Term Liabilities
LO/DE	Loan Ratio	Total Loans/Total Deposits
DE/TA	Deposit Ratio	Total Deposits/Total Assets
LO/TA	Asset Quality	Total Loans/Total Assets
SIZE	Bank Size	Logarithm of Total Assets

[1] www.tbb.org.tr

4. Findings

In this study, 10 financial ratios have been used to measure bank performance. These ratios have been dealt with as performance indicators and performances of domestic and foreign banks have been compared graphically with the help of these ratios.

Table 2: The Average of Financial Ratios of Banks in the Period of 2005-2011

	ROA	ROE	TE/TA	NPL/TL	INT/TA	QR	LO/DE	DE/TA	LO/TA	SIZE
DOMESTIC	0,013	0,105	0,132	0,0092	0,1015	2,54	0,862	0,606	0,527	16,22
FOREIGN	0,015	0,094	0,156	0,0095	0,1011	0,68	0,955	0,583	0,517	15,19

Figure 1

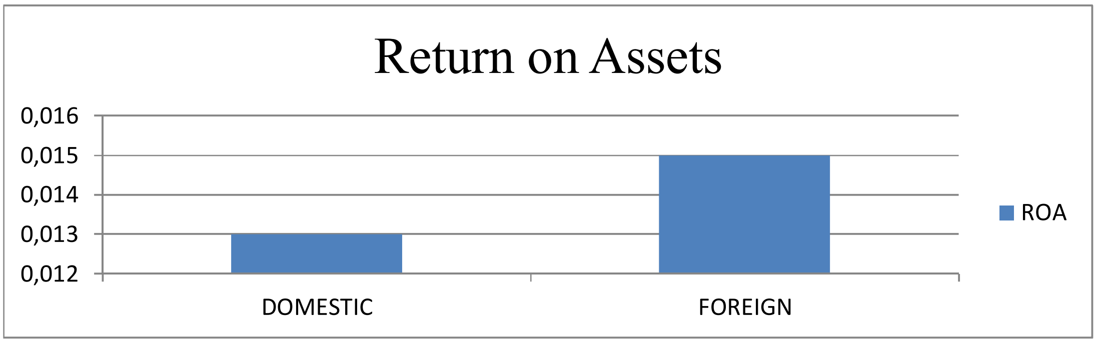


Figure 1 shows average "Return on Assets" (ROA) for the period of 2005-2011 which belongs to domestic and foreign banks operating in Turkish banking sector. Average ROAs belonging to domestic and foreign banks are 1.3% and 1.5% respectively. Foreign banks have a higher performance than domestic banks in terms of ROA. In other words, foreign banks have used their assets in a more efficient way when compared to domestic banks. This may be explained by the decrease of the amount of return per asset unit due to domestic banks having more assets than foreign banks.

Figure 2

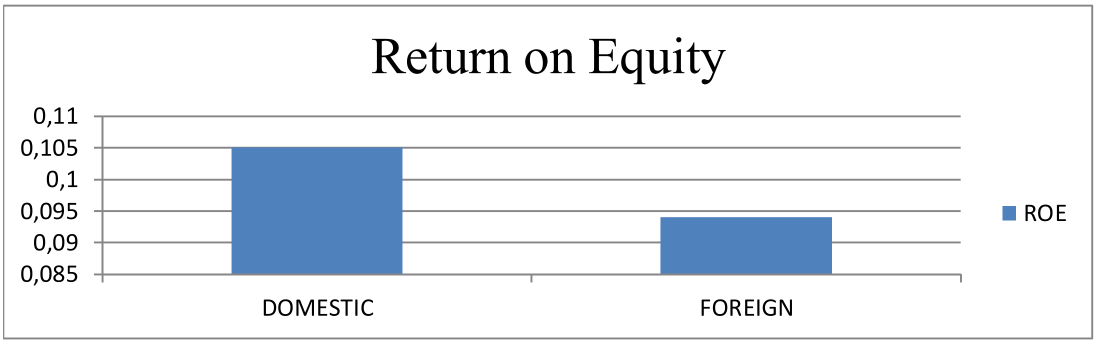


Figure 2 shows average "Return on Equity" (ROE) for the period of 2005-2011 which belongs to domestic and foreign banks operating in Turkish banking sector. Average ROEs belonging to domestic and foreign banks are 10.5% and 9.4% respectively. Domestic banks proved to have a better performance when compared to foreign banks with regard to ROE. In other words, domestic banks have used their equities in a more efficient way when compared to foreign banks. When compared in terms of profitability, foreign banks have a better performance with regard to ROA while domestic banks have a better performance with regard to ROE.

Figure 3

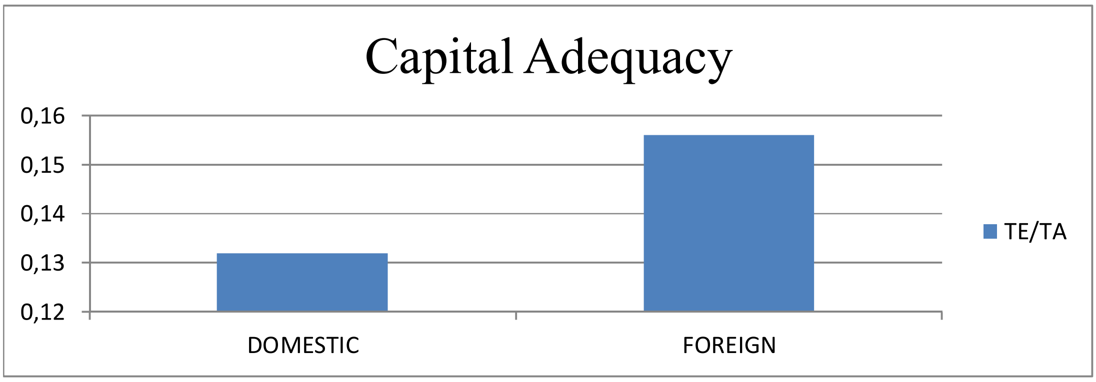
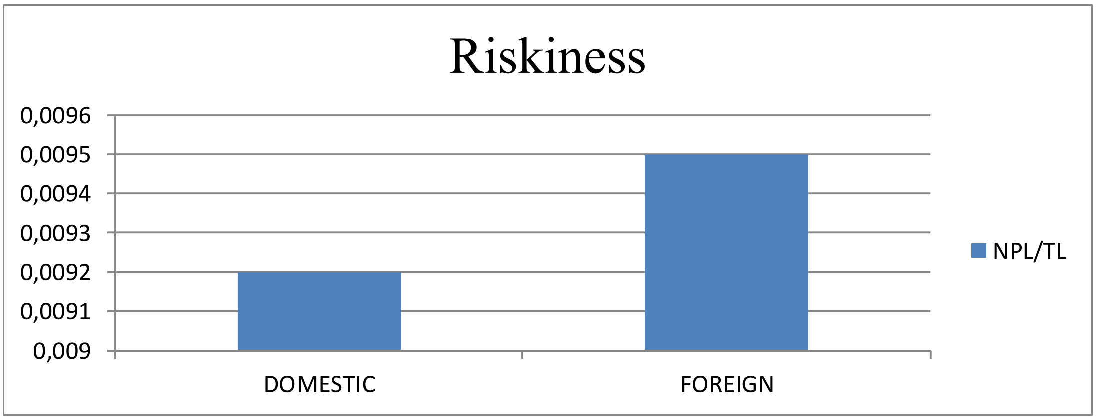


Figure 3 shows average capital adequacy ratios of domestic and foreign banks. Foreign banks are observed to have a higher capital adequacy ratio than domestic banks. This condition may be explained by the decrease of equity capital ratio in liabilities due to domestic banks having collected more deposits. In other words, domestic banks are more risky in terms of capital adequacy when compared to foreign banks. In the majority of the studies which analyzes factors that determine profitability of banks (i.e. Sufian and Chong 2008; Ramrall 2009; Berger et al. 2010; Ponce 2011; Javaid et al. 2011), a positive correlation has been detected between capital adequacy and profitability of the banks.

Figure 4



Ratio of non-performing loans to total loans shows individual and organizational solvency from the perspective of economy while it shows asset quality and risk level from the perspective of the banks. Therefore, this ratio is considered as a leading indicator in terms of the general condition of economy and it is one of the most considered indicators in measuring performance of economy as well as banking sector in every period (Yücememiş and Sözer, 2010: 89). That said, increase in non-performing loan volume causes decrease in liquid assets and has a negative impact on structure of balance. Figure 4 shows average ratio of non-performing loans to total loans of domestic and foreign banks in Turkey. Non-performing loan ratios of domestic and foreign banks are 09.2% and 09.5% respectively. Domestic banks have shown a higher performance in terms of non-performing loans compared to foreign banks. In other words, it could be said that domestic banks have a higher asset quality and lower riskiness compared to foreign banks in terms of non-performing loans.

Figure 5

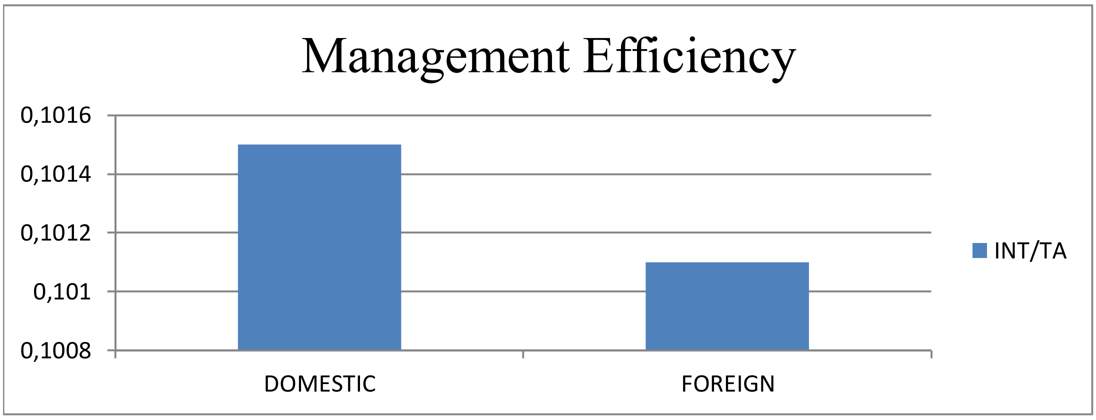
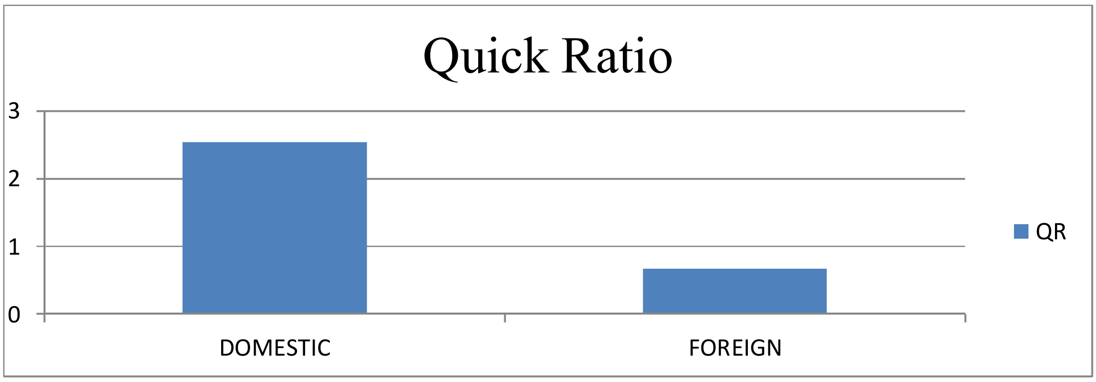


Figure 5 shows average of interest incomes of domestic and foreign banks within the total assets. This ratio shows management's competency and efficiency. Although an important difference is not observed between the interest incomes of mentioned banks, domestic banks are observed to have a higher average than foreign banks.

Figure 6



This ratio shows whether or not corporation could pay its short-term liabilities in their due date, in other words they indicate the relation between cashable asset values and short-term liabilities. In a way, ratios of liquidity show solvency (Çetiner, 2005, p. 143). Figure 6 shows acid test ratio (Quick Ratio) averages of domestic and foreign banks. Domestic banks have a higher short-term solvency compared to foreign banks. In other words, foreign banks have a higher risk of liquidity.

Figure 7

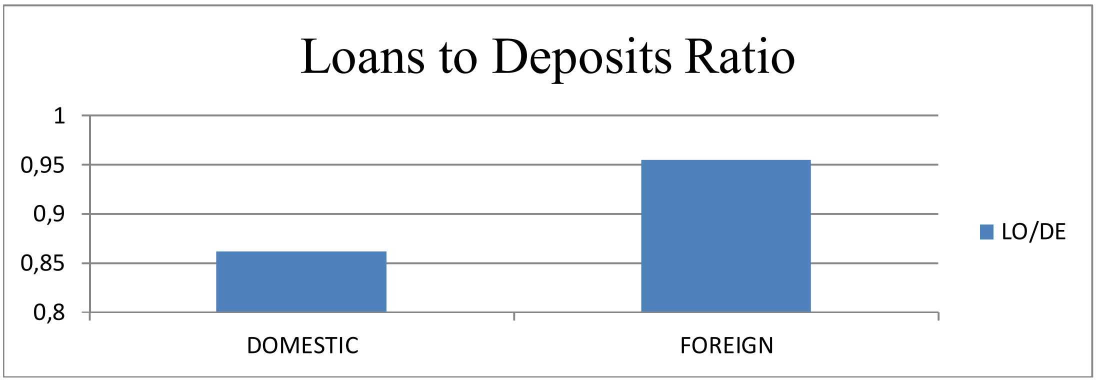


Figure 7 shows the ratios of loans to deposits of domestic and foreign banks. This ratio indicates the conversion of collected deposits to loans.

The increase in this ratio shows the branch's success in converting the collected resources to more profitable loans instead using them in branch current accounts. The increase in this ratio due to decrease in branch deposits should be considered negative while the increase due to newly given loans should be considered positive.[2] Foreign banks have a higher ratio of loans to deposit compared to domestic banks. In other words, foreign banks have a higher ratio of converting the collected deposits to loans.

Figure 8

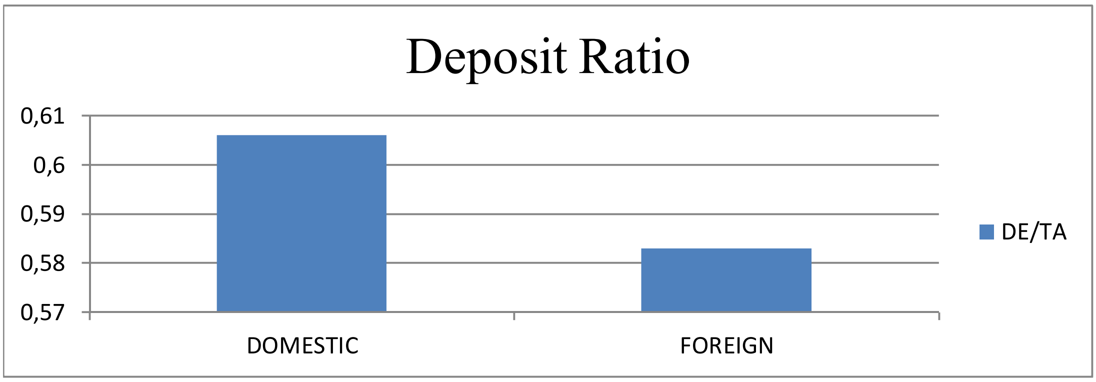


Figure 8 shows averages of deposits to total assets ratio of domestic and foreign banks. Deposit ratio indicates the level of liquidity as well as the responsibility towards deposit holders. Deposits to total assets ratios of domestic and foreign banks are 60.6% and 58.3% respectively. Domestic banks have collected more deposits compared to foreign banks.

Figure 9

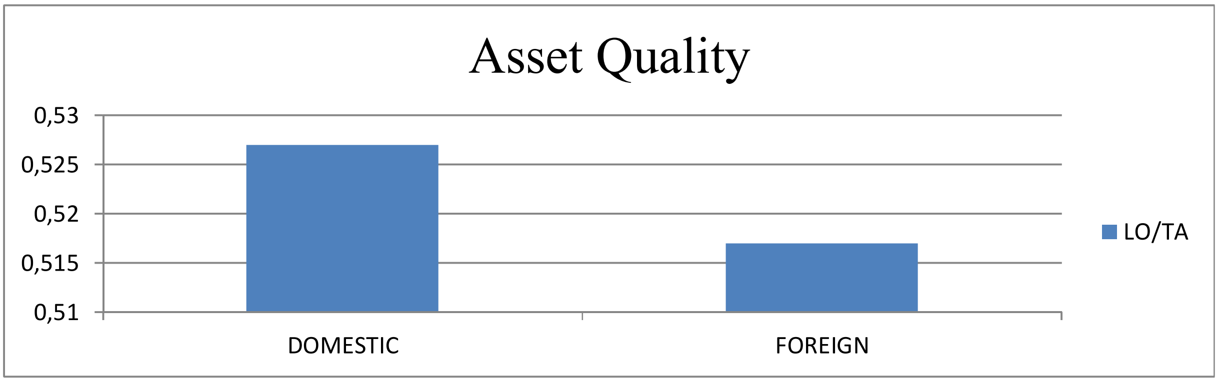


Figure 9 shows averages of loans to total assets ratio of domestic and foreign banks. This ratio shows the rate of credit to total assets. The highness and lowness of this ratio could create negative affects on profitability in various regards. A high ratio, which expresses a high credit level, means a high credit risk for the bank and disrupts the balance of risk-return (Poyraz, 2012: 43). As seen in Figure 9, domestic banks have a higher average in loans to assets ratio than foreign banks.

[2] http://www.turklider.org/TR/EditModule.aspx?TabId=1043&mid=8418&ItemId=3026, 08.12.2012

Figure 10

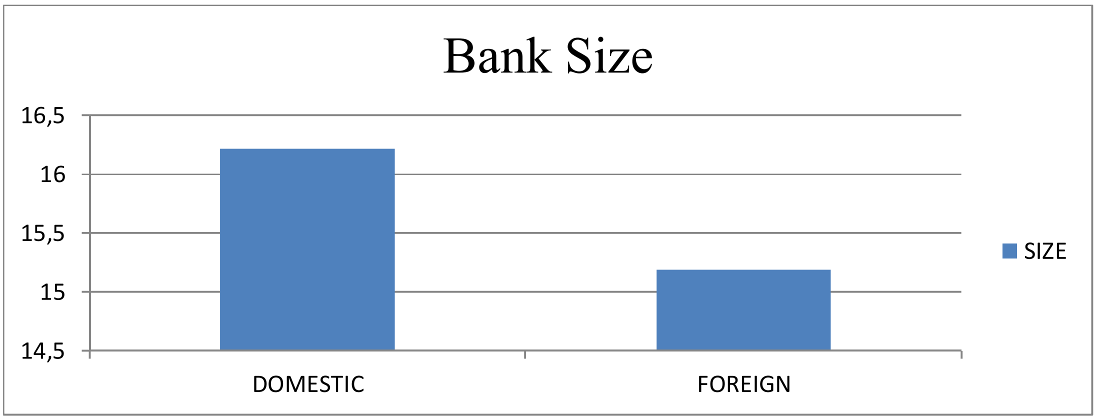


Figure 10 shows natural logarithms of the average of total assets of domestic and foreign banks. Domestic banks have higher total assets when compared to foreign banks. The assets of banks show their sizes and it could be said that domestic banks are larger in size than foreign banks.

5. Conclusion

The aim of this study was to carry out a comparison of performance of domestic and foreign banks, which operated in Turkish banking sector between the years 2005-2011. In this study, differences of domestic and foreign banks in terms of profitability, capital adequacy, asset quality, riskiness, size, liquidity and management effectiveness have been put forth. The findings of the study are as below.

- Foreign banks have a higher performance than domestic banks in terms of "Return on Assets".
- Domestic banks proved to have a better performance when compared to foreign banks with regard to "Return on Equities".
- Foreign banks are observed to have a higher capital adequacy ratio than domestic banks.
- Domestic banks have shown a higher performance in terms of non-performing loans compared to foreign banks.
- Domestic banks managements are more effective compared to foreign banks.
- Domestic banks have a higher short-term solvency compared to foreign banks. In other words, domestic banks have a lower risk of liquidity.
- Foreign banks are observed to have a higher ratio of loans to deposits than domestic banks.
- Domestic banks have a higher ratio of deposits to total assets when compared to foreign banks.
- Asset qualities of domestic banks are better than that of foreign banks.
- Domestic banks have higher total assets when compared to foreign banks. In other words, domestic banks are larger in size.

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Appendix

VARIABLE	MINUMUM	MAXIMUM	MEAN	MEDIAN	STD. DEV.
ROA	-0,126	0,0820	0,0146	0,0150	0,0183
ROE	-1,790	0,344	0,0997	0,1195	0,1840
TE/TA	0,067	0,830	0,1446	0,1235	0,1840
NPL/TL	0,0001	0,059	0,0094	0,007	0,010
INT/TA	0,028	0,171	0,101	0,100	0,028
QR	0,140	142,37	1,615	0,555	0,011
LO/DE	0,010	3,322	0,908	0,914	0,036
DE/TA	0,1230	0,879	0,5951	0,6085	0,141
LO/TA	0,01	0,8470	0,522	0,572	0,1682
SIZE	10,74	18,90	15,710	15,595	1,7141
BANK TYPE	0	1	0,50	0,50	0,502