Ümit Hacioglu · Hasan Dincer *Editors*

Managerial Issues in Finance and Banking

A Strategic Approach to Competitiveness

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ISBN 978-3-319-01386-2 ISBN 978-3-319-01387-9 (eBook)
DOI 10.1007/978-3-319-01387-9
Springer Cham Heidelberg New York Dordrecht London

Library of Congress Control Number: 2013950083

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Preface

The latest global recession has strong impacts on global economic activity and stock performance of international firms. The possible chain reaction of bank failures in advanced economies and sovereign defaults in Europe are still major concerns for investors in fragile capital markets as credit default swap spreads have been breaking new records high too. On the one hand, the latest policy steps by banking authorities in advanced economies seem to have negative effects on the performance of financial institutions. On the other hand, the fierce competition in financial markets with poor financial performance, plus the new withdrawal mechanism regulations in Europe for low performance banks resulted in poor growth rates for banks.

Volatile conditions in capital markets by the last quarter of 2008 affected the way businesses are organized and managed. It becomes a challenging issue for managers and stakeholders of profit organizations. Following the negative effects of the 2008–2009, global financial crisis on capital markets, investors now pay more attention to risk management and stock performance. The critical issue for top management in corporation centers is the stockholders' primary goal of value maximization. The competitiveness approach of top management as a strategic tool aligns managerial finance with successful corporate strategies for banks.

The main purpose of this book is to analyze the managerial issues in banking and finance from an interdisciplinary perspective. The fundamental approach of this publication brings together global issues in economics and finance, risk management and auditing, the competitive management strategies and custom finance, and models as well as unique approaches related to global finance in a reflective way.

The authors of the chapters in this publication have contributed to the success of our work by the inclusion of their respective studies. This book, consisting of 20 chapters, is divided into four parts: *Global Issues in Economics and Finance, Risk Management and Auditing, Competitiveness and Management in Financial Institutions, and Custom Finance in Theory and Practice.* In the first part of this book, the authors also assess the concept of globalization, bipolarity of risks in the E7 economies, social media strategies of banks in the globalized world economy, economic approach to consumption, and the changing role of central bank. In the second part, the authors discuss the issues related to risk management, hedge accounting, control mechanism, and auditing. In the third part, an innovative

approach to competitiveness and management in financial institutions is developed. Topics include game theory, competitive corporate governance strategies, price-based goods and services, reputation management, the impact of advertisement on financial performance, and the financial implications of corporate social responsibility for the banks. Consequently, in the last part of this book, the authors contribute to custom finance in theory and practice.

Chapter 1 evaluates the market prioritization methods for global firms. Advances in communication and information technologies, reduction in trade barriers, privatization, deregulation and opening of new markets have led to the expansion of trade and increased investment in new markets. One of the crucial decisions that global firms should take is the choice of markets to enter when there are many different alternatives present. The alternatives could be at the level of nations, regions, or even cities. To make informed decisions, critical macroeconomic, demographic, and cultural data elements must be available for analysis. The growth of global business in the last two to three decades has resulted in an explosion of data sources, both commercial and syndicated. Using these data sources and the product/service specific characteristics firms may use various algorithms to rank order markets for suitability of entry. This paper will try to outline the different methods for market prioritization utilizing the numerous global data sources available. Special considerations for global financial institutions will also be presented.

Chapter 2 analyses the performance of inward and outward U.S. Foreign Direct Investment (FDI) during recent financial crises. FDI plays an extraordinary and growing role in the global markets and represents an integral part of the U.S. economy. This research has descriptive character and focuses on the latest trends in inward and outward U.S. FDI illustrating the impact of the recent financial crises on FDI performance in the United States. The study analyzes the U.S. FDI stock contribution to the global FDI, performance of the inward and outward U.S. FDI flow and stock, the U.S. FDI flow and stock as a percentage of GDP, and geographical distribution of inward and outward U.S. FDI stock. The essential part of this research relates to inward and outward U.S. FDI employment and the structure of inward and outward US FDI financial performance, which includes equity, reinvested earnings, and intercompany debt.

Chapter 3 evaluates the globalization process and its implications on the state. In this chapter, it is aimed to present a thorough understanding of the process of globalization and analyze the current effects and changes of globalization.

Chapter 4 evaluates the globalization and social media strategies by financial institutions worldwide. The objective of this chapter is to investigate financial institutions on social media; their strategies and the ways they deal with customers in the light of globalization process. The research investigates how far the bank achieves the success online; the discourses between the bank and its customers on Facebook pages. Discourse analysis and semi logical analysis are applied to four categories—advertisements, feedback, surveys, and social activities on Facebook pages in four countries of an international bank within a three-month's period.

Chapter 5 develops an economic approach to consumption in the process of 2008–2009 global recession. The aim of this chapter is to illustrate the consumption of rich and poor populations in Turkey in the area of global crisis. This chapter illustrated that (i) income of consumer rises the share of necessary good's consumption as it decreases and the share of luxury and cultural good's consumption increases, (ii) the share of necessary good's consumption has decreased while the share of luxury and cultural good's consumption have increased since 2007.

Chapter 6 is based on the claim that the changing role of Central Bank of the Republic of Turkey and Its Financial Implications on Turkish Economy. This chapter notifies (i) central banks are extremely important institutions responsible from the coinage, monetary policy applications, and healthy operations of the economies, (ii) the policies applied by Central Banks and their ongoing corporate structures cannot be disassociated from the political, social, and the whole economic developments of the countries in which they are located, (iii) the concept of central bank which had been in development since twentieth century, first appeared in Turkey in 1930. In this chapter, the concept of Central Bank of Turkey and its financial implications have been examined by periods the monetary policies of the Central Bank and their effect on Turkish Economy are discussed.

Chapter 7 develops a theoretical framework for Financial Risk Management and Hedge Accounting for companies. This chapter clarifies that minimizing the losses in the investments which are made by enterprises or the financial risks that are taken in case of borrowing in an environment, which has intense competitive conditions has become an important necessity. One of the most basic ways to deal with these risks is the use of derivative instruments. It is well known that derivative instruments are the tools which are used by enterprises in order to reduce or cut the financial risks, which affect the financial structure of enterprises in a negative way. In the Chapter IAS 39 Financial Instruments: Cash accounting and Measuring Standard which are subject to derivative instruments have been examined, and this study includes also hedge accounting.

Chapter 8 evaluates the financial risk and contributes to the portfolio selection process. This chapter introduces the concept of portfolio as simply a basket of revenue generating assets. Besides money and capital market instruments, these revenue generating assets can also include derivative market instruments. The principle of risk diversification allows variety in portfolio investments. Changing investment instruments of portfolios might affect yields. Portfolio investment is mostly private equity securities and bonds, and debt securities exported by the state. Measurability of portfolio risk and variability of investment instruments might affect also the maturity of portfolio investment. Therefore, portfolio investments might fail in satisfying short-term expectations and lead to capital outflow. In this context, the study examines the theoretical framework related to the risks and investments in portfolio management.

Chapter 9 explores the control mechanisms of management processes in global operations. In this study, the aim is to draw the attention of enterprises active at a global scale to this important subject by emphasizing factors which must be taken

into consideration in order to establish an effective control mechanism, elements rendering operational control difficult, and the important of operational control in the international management process.

Chapter 10 underlines the importance of developing a proactive approach to organizational crisis in banking. This chapter underlines a broad perspective on the impacts of the crisis on business sustainability and performance, and states that there are major factors inside business architect, considered as key solutions for strategies out of global recession. In this context, proactive organizational culture also provides top managers with opportunities to implement strategies out of global recession while adopting competencies of forecasting and evaluating economic risk within an interdisciplinary approach. This chapter advocates that business organizations locating strategies out of global recessions firstly should evaluate inside resources such as skilled workers and managers. In this study, it is aimed to demonstrate the importance of proactive organizational culture in banking sector as a strategic kit for developing effective ways out of global recession

Chapter 11 builds on the Game Theory and its reflections on competitive strategies in the banking sector. This chapter centers on the game theory which pays attention to the behavior of people who put their money into the banks that offer the highest interest rates expecting a high income or the ones who expect a crisis try to draw their money before the due date. It is possible for a bank to go bankrupt in the financial system if it offers the highest interest rates compared with its rivals and has a relatively high funding resource cost. This study aims to find out the interaction between customer and competitors in the banking sector within the scope of the game theory.

Chapter 12 develops a comparative approach to competitive corporate governance implementation in the southeast Asia banking industry. This chapter analyses the implementation in three countries based on corporate governance rules and practices, enforcement, political and regulatory environment, IGAAP (accounting and auditing), and a corporate governance culture. A major implication of this chapter is that Singapore is the best country in good corporate governance implementation in its banking industry followed by Malaysia and Indonesia.

Chapter 13 addresses the competitive strategies for priced-based goods and services in the banking sector. To create awareness in a highly competitive environment, actors in the banking sector need to create diversity in the products and services they present to customers and thus provide a price advantage. Introducing various pricing techniques and analyses for the provided products and services is now a necessity. In this study, price analysis-based product and services of banking sector have been clarified in a competitive environment and the product and services, which affect the sales and customer behaviors have been also determined in detail.

Chapter 14 explores the importance of reputation management in global financial institutions. This chapter focuses on the most destructive effect of the crisis on global financial institutions, which has been the loss of reputation. It is

obvious that "large scale" factors such as disruptions in current financial structures, the fragile structure of global financial architecture, assessments of risk system, and requirements for new regulations have impact on reputation and its management. This chapter develops a comprehensive framework for reputation management which is a comprehensive approach which involves the anticipation of all variables available, and where different stakeholders and circumstances are taken into consideration. In this chapter, it has been illustrated that reputation of global financial institutions depends on the administrative processes of these institutions, that is, whether or not they are managed well.

Chapter 15 examines the impact of advertising on the financial performance in the era of global economic crisis. The aim of this study is to examine advertising and financial fields working for the same purpose but seemingly different, to examine theoretically the support of advertisement as seen as an abstract investment for the same purpose-the profitability of the business to the strengthening of the company's financial performance can be seen clearly by becoming concrete with the help of some data and analysis. In this study, the focus is to encourage managers to analyze the company's financial performance especially during a crisis.

Chapter 16 explores the financial implications of corporate social responsibility in the banking sector. This research aims to analyze corporate social responsibility activities of deposit banks, which operate on the Istanbul Stock Exchange based on various financial indicators. The main objective is to identify the importance banks place on institutionalization in their promotions and its consequences. This research observes that banks that do not place importance on promotional activities have lower profit margins; whereas, those that only focus on advertising and public relations hardly compensate their expenses; thus, the highest profit margin is achieved by banks that coordinately use both promotional methods.

Chapter 17 discusses the banking sector and the Islamic banking in the Middle Eastern and North African countries. The models of Islamic banking which emerged in the banking sector in a modern way did not remain exclusively limited to Muslim countries, but have also grown internationally. Islamic banks mostly operated in the MENA region in the past, but proliferated in the Muslim parts of Asia after the 1980s. This chapter focuses on the proliferation of Islamic banking which was particularly made possible by the fact that Islamic banks continued to operate successfully and holding a greater proportion of liquid assets than other banks made Islamic banks more resilient and successful during the crisis.

Chapter 18 takes a contrary view of the development of Islamic financial system in Turkey. Today, as Islamic banking and finance is expanding rapidly worldwide, its systemic importance for the stability of national, regional, and global financial system is also increasing rapidly. This study aims to explicate the short story of the Islamic Financial System (IFS) within the traditional financial system of Turkey as well as to reveal the implementation of Sukuk, which is recognized as one of the most important instruments of the IFS, and a model proposing for Turkey.

Chapter 19 focuses on the International competitiveness analysis of the Islamic financial services sector. Developing significantly in the recent years, the Islamic Financial Services industry has been constantly increasing its importance in the national economy. It is predicted that this progress in this industry will continue in the years ahead. Subjecting the industry to a global comparison is of great significance for the industry so that the level of this development, the basic variables and dynamics could be understood and contribution could be made to the sustainable competitive advantage of the industry and strategies could be developed. This study analyzes the international competitive level of the industry by employing Porter's diamond model. In line with the analysis, this study identified the competitive level of the industry and explained the basic characteristics of the competitive structure, and revealed macro level strategies required for its development to position itself in the regional and global competition.

Chapter 20 demonstrates ShamGen as a regional financial integration of Islamic countries. This chapter evaluates the project of ShamGen using SWOT analysis. In this chapter, it is advocated that once financial cooperation among the ShamGen countries is established, the trade and investment in the region would increase. Turkey as the seventeenth biggest economy in the world will be the leading economy in the group. Istanbul, as an international financial center, will be the center of finance for ShamGen. It is hoped that economic success of the process will bring peace and political stability to the region.

The roots of the 2008–2009 financial crisis and its reflections on capital markets have been prior to studies in literature. However, organizational competitiveness in banking and finance has not been sufficiently attached to managerial issues in finance yet. Therefore, it is important to develop an innovative and a strategic approach to managerial issues in banking and finance. In this regards, the impact of financial crisis investors' perceptions and institutional competitiveness has been assessed from an interdisciplinary perspective. The authors of the chapters in this book developed models for innovative solutions to managerial issues in banking and finance by assessing critical case studies. Finally, this book gathers colleagues and professionals across the globe from multicultural communities to design and implement innovative practices for the entire global society of banking and finance.

Ümit Hacioglu
Hasan Dincer

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Part I
Global Issues in Economics and Finance

Chapter 1
Market Prioritization Methods for Global Firms

Ulas Akkucuk

Abstract Advances in communication and information technologies, reduction in trade barriers, privatization, deregulation and opening of new markets have led to the expansion of trade and increased investment in new markets. One of the crucial decisions that global firms should take is the choice of markets to enter when there are many different alternatives present. The alternatives could be at the level of nations, regions or even cities. To make informed decisions, critical macroeconomic, demographic and cultural data elements must be available for analysis. The growth of global business in the last two to three decades has resulted in an explosion of data sources both commercial and syndicated. Using these data sources and the product/service specific characteristics firms may use various algorithms to rank order markets for suitability of entry. This chapter will try to outline the different methods for market prioritization utilizing the numerous global data sources available. Special considerations for global financial institutions will also be presented.

Keywords Global business · Market prioritization · Secondary data sources · Financial services firms

1.1 Introduction

Due to the integration of markets, cooperation between states, and increasing communications technologies cross-border trade has increased dramatically in the last few decades. Table 1.1 provides the data in merchandise imports and exports of the world's countries starting with the year 1990 and ending in 2012. In 22 years the trade volume has increased almost six fold. The rate of increase from the year

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Ü. Hacioglu and H. Dincer (ed.), *Managerial Issues in Finance and Banking*,
DOI: 10.1007/978-3-319-01387-9_1, © Springer International Publishing Switzerland 2014

Table 1.1 World import and export in merchandise from the year 1990 (in billions of dollars), (WTO 2013)

Years	World export	World import
1990	3449	3550
1991	3515	3632
1992	3766	3881
1993	3782	3875
1994	4326	4428
1995	5164	5283
1996	5403	5544
1997	5591	5737
1998	5501	5681
1999	5712	5921
2000	6456	6724
2001	6193	6483
2002	6494	6742
2003	7587	7867
2004	9219	9568
2005	10503	10866
2006	12125	12459
2007	14017	14325
2008	16154	16566
2009	12545	12776
2010	15289	15504
2011	18291	18487
2012	18323	18567

Source WTO (2013)

2000 and onwards has actually surpassed the increase from 1990 to 2000. The fluctuations also become more dramatic as one observes the drop from 2008 to 2009. All companies are influenced, one way or another, from the advent of globalization and many global firms are constantly looking for ways to expand their operations into new countries. These unexplored countries offer the opportunity to increase the company's profitability and return on investment. However, there are also risks of making bad decisions and not being able to account properly for the risks involved. It is also important to make a decision between alternative markets. At this stage information obtained from major global data sources coupled with a sound decision making framework may be of use to the global firm.

Market prioritization refers to a set of techniques that could be used to decide in a systematic way how to allocate resources among various countries or other geographic units. It may mean making the decision to enter or not enter a market or determine the level of investments in the alternative markets in question. Prioritization may also refer to allocating resources to various market segments. In this chapter we refer particularly to the country selection procedure.

The chapter will continue and explain the global data requirements in making market entry decisions and list the principal data sources available to global firms. We will then present some alternative prioritization methods that could be suitable in different contexts. The next section will deal with market size determination methods, a very important source of data to the prioritization models. Finally a section is dedicated to specific considerations faced by global financial firms in choosing between alternative markets.

1.2 Global Data Requirements and Data Sources

In order to make informed decisions it is important to collect secondary data about the countries the global firm wishes to invest in. The secondary data may be internal or external to the firm. External sources include government agencies, global organizations, trade unions or syndicated sources. A number of issues need to be addressed before the secondary data may be used to compare countries. Measurement units may differ across countries and the accuracy of sources may be questionable.

1.2.1 Global Data Requirements

The type of data that are generally required for a firm to make an entry decision span from demographic data and macroeconomic variables to infrastructure data and product market specific data. Data requirements can generally be classified under the following categories:

- Political, financial and legal data
  - Political risk, export and import restrictions
  - Exchange rates, devaluation, ability to repatriate revenue
  - Tax rates, environmental standards, product standards
- Market data
  - Demographic data, age distribution, population size
  - GNP, GNP per capita, income distribution
  - Geographic conditions, climate
  - Technology, educational level
  - Social and cultural data, languages, religions, traditions
- Infrastructure data
  - Transportation
  - Retail, distribution channels
  - Communication
  - Raw material needs

- Product market specific data
  - Industrial goods
  - Consumer goods, data on competition, substitute and complementary products

1.2.2 Global Data Sources

After determining which variables are needed in the model used for market entry decisions the firm needs to collect the data from the wide range of international data sources. Some of these data sets may be free of charge while others may require significant expenditures. Some of the global data sources are listed below:

- Organization for Economic Cooperation and Development (OECD)
- Heritage Foundation, known for the index of economic freedom (Heritage 2013)
- Country Watch, an information provider for corporations, government agencies needing up-to-date news and information on each of the recognized countries of the world, may provide 25 year forecasts of GNP of countries as an example (Countrywatch 2013)
- CIA World Factbook, provides information on the history, people, government, economy, geography, communications, transportation, military, and transnational issues for 267 world entities (CIA Factbook 2013)
- US Census Bureau
- Eurostat
- Local statistical agencies (such as Turkey's State Statistical Institute—TUIK)
- World Bank, world development indicators are provided on a number of topics such as financial markets (World Bank 2013)
- World Intellectual Property Organization (WIPO)
- United Nations (UN)
- Global syndicated sources, such as Nielsen Retail Measurement Services (RMS) (Nielsen 2013)
- University web sites, such as GlobalEdge maintained by Michigan State University (GlobalEdge 2013), the "country comparator" function of this web site, for instance, may be used for comparing countries across selected indicator variables
- Information Please (Infoplease), providing answers to all kinds of factual questions since 1938—first as a popular radio quiz show, then starting in 1947 as an annual almanac, and since 1998 on the Internet (Infoplease 2013)
- World Economic Forum, providing yearly reports on global competitiveness
- Country risk data, such as measured by Euromoney (Euromoney 2013)
- Euromonitor, provides country specific reports, and product specific reports (Euromonitor 2013)
- Nationmaster, a web site providing country specific data on many variables and comparison engines, it is featuring 9,934 variables, and 4,118 maps as of April 18, 2013 (Nationmaster 2013)

- World Trade Organization (WTO)
- Thomson Financial Services (Thomson Reuters, 2013)
- Online communities such as Trade Port, a repository of free information and resources for businesses seeking to conduct international trade to and from the US State of California, it is backed by an alliance of regional trade associations that assist California export and import businesses (Tradeport 2013)
- Academic publications, if a company wants to determine the cultural similarity of a nation to the home-country of operations, they may refer to, for instance, Hofstede's cultural dimensions (Hofstede 2001; Hofstede and Bond 1988), also online sources available (Hofstede 2013).

1.3 Country Ranking Methods

A crucial step for a company keen on developing a global expansion strategy is the selection of a list of potential target markets, and rank ordering these markets for a properly defined measure of suitability. Generally the companies have a vague idea about a large list of potential countries but would like to narrow down this list for further analysis. Companies would not want to waste time in a country which is not a suitable market for their products or services, and similarly would like to minimize the risk of ignoring a high potential country. We will discuss here a general screening procedure, regression based methods and cultural distance methods.

1.3.1 Macro Screening of the Countries

These methods involve the determination of a number of indicators (macroeconomic, demographic, cultural and etc.) and weights allocated to these indicators by the company managers. Then a straightforward weighted combination of the indicator values of a new country (or a set of countries) represents the suitability of the new country for investment. The following four steps form the basis of an initial screening of countries prior to a more thorough analysis, or actual field studies (Kotabe and Helsen 2011):

Selecting Indicators and Collecting Data: The company needs to determine which macroeconomic, social or political variables are needed for the analysis. Information on these indicator variables can be gathered from the publicly available sources (some listed in the previous section). While some of these variables may be highly correlated with each other, in some cases one country doing well on one variable will be performing poorly on another. In terms of population, for example, India may score very high, however, when it comes to GNP per capita India may be below many countries. Since the variables are mostly not perfectly correlated a rank order of the suitability of the countries would require the input from the next

Table 1.2 Possible weighting of macroeconomic, demographic, geographic and social cultural criteria

Criteria	Weight (%)
Gross national product	25
Income per capita	20
Number of internet users	15
Population size	10
Male to female ratio	5
Land area	20
Percentage of population following major religions	5

Source Author

step, i.e., the determination of the relative importance of the variables for the company.

Determining Importance of Country Indicators: The second step for the company is to assign weights to the variables selected in the previous step. This step depends mostly on the mission and vision of the company. Some companies might prefer a young population others may give a high importance to total population. Total GNP is important for some countries, while for others GNP per capita is more important. For some luxury goods marketers GNP per capita alone may not be a good indicator since the income distribution may be uneven. Generally the weights can be determined in any arbitrary fashion; however, using a constant sum scale is the most frequently used approach. In this approach the sum of the weights should be 100. More critical indicators should receive a weight close to 100 while the less critical ones should receive a weight close to 0. Table 1.2 gives an example with 7 indicators and weights of each indicator.

Assigning Ratings on the Countries in the Evaluation Pool for Each Indicator: A score should be assigned to the countries on the variables so together with the importance weights, a total score can be computed and the countries can be ranked. What is important here is that the variables should all be rated on the same scale. If the original scaling is unchanged, the variable with different scales may have an abnormal weight. For example GNP may be measured in thousands of dollars while male to female ratio is a number close to one. After multiplying with the weights the male female ratio will have no differentiating effect. Hence the variables should be rated on a similar scale, such as 0–100. The numerical values could be converted by assigning 100 to maximum value and 0 to minimum value (*min–max* normalization). Other methods may involve ranking the countries and assigning certain numerical values to the ranks. A simple three-level ranking system may be used assigning 100 to best value, 60 to the middle and 20 to the worst. Other alternatives may also exist.

Computing Overall Score for Each Country in The Analysis: The final step involves multiplying the weights with the country ratings and coming up with a composite score. For each indicator the product of the weights and ratings are computed and summed. The countries receiving the highest scores should be the more desirable destinations of investment for the company.

There are several possible actions that could be taken using the overall scores obtained in the four steps outlined above. Some companies may wish to determine a cutoff value below which the country will be deemed unsuitable for investment. Others may wish to do further analysis on the countries with the highest scores.

1.3.2 Regression Based Methods

An alternative country selection procedure can be used when the company has previous experience in some markets. Some performance measure (such as market share) needs to have been established as a result of the operations in the other countries. The actual values of the performance measure (or measures) and the indicator variable values in the markets where the operations have been going can be used as inputs to a multiple regression model. The weights of the indicator variables can be taken as the regression coefficients. In this method the weights are assigned in a quantitative way taking into account their influence on the performance variable, rather being judgmentally determined. After the weights are computed they can be used to compute an estimate of the performance in the potential markets, and the markets can be ranked accordingly.

1.3.3 Cultural Distance

While many different country selection methods have been proposed in the literature it has been observed that firms generally take into account cultural similarity and geographic distance rather than a weighted average of macroeconomic, demographic or market size related factors (Papadopoulos and Denis 1988; Erramilli 1991). One such cultural similarity measure can be computed using the dimensions of the Hofstede (Hofstede 2001; Hofstede and Bond 1988). Kogut and Singh computed the following measure to calculate the cultural distance from other countries to the US (Kogut and Singh 1988; Baumuller 2007):

$$CD_j = \sum_{i=1}^{4}\left[\left(\frac{\left(I_{ij}-I_{iu}\right)^2}{V_i}\right)/4\right]$$

Here CD_j is the cultural distance from US to another country j. I_{ij} is the score of the other country on the ith Hofstede dimension. Here subscript u stands for the US. The squared differences are corrected for the variance of each dimension (which may be different from one another, this measure prevents one dimension from having an extra weight if the variability is high). Since the original study needed the distance of US to other countries the formula was presented in such a fashion, in general the formula can be modified to include the distance from any country k to any country j as follows:

$$CD_{jk} = \sum_{i=1}^{4} \left[\left(\frac{(I_{ij} - I_{ik})^2}{V_i} \right) / 4 \right]$$

Some modifications of the above measure were used in the International Marketing literature. One such modification is presented below (Morsini et al. 1998; Sakarya et al. 2007); this one ignores the variance correction:

$$CD_{jk} = \sqrt{\sum_{i=1}^{4} (I_{ij} - I_{ik})^2}$$

It is worthwhile to point out that there is an additional fifth dimension (long term orientation-and also a sixth dimension indulgence versus restraint) now so that the formulas can be updated to include that dimension as well. Another aspect to note about the above formula is that it is simply the Euclidean distance between the countries based on the Hofstede dimension scores. Euclidean distance is a special case of the Minkowski p metric where p is two (Lattin, Carroll, and Green 2003). Other distance measures are possible by varying the value of p. Generalizing the total number of dimensions as l and making the distance measure more general we can come up with the following expression for the cultural distance between country j and country k using the pth norm of the Minkowski metric:

$$CD_{jk} = \sqrt[p]{\sum_{i=1}^{l} |I_{ij} - I_{ik}|^p}$$

Specifically if p is two then this becomes the straight line Euclidean distance. If p is one then the distance is basically the sum of the absolute value differences in the dimensions (sometimes referred to as the city-block, Manhattan distance or L_1 norm). As p gets larger and in the limit if it becomes equal to infinity then the distance would be the maximum absolute value difference in the dimensions.

The original Hofstede dimensions included Power Distance (PDI), Individualism (IDV), Masculinity (MAS), and Uncertainty Avoidance (UAI). Later Long Term Orientation (LTO) was added to this list. Very recently, Indulgence versus Restraint (IVR) joined the dimensions (Hofstede 2013). The scores for the five dimensions for a selection of countries are given in Table 1.3. For seven countries in the table, Table 1.4 also provides the Euclidean distance computed on the dimensions. The culturally closest countries seem to be France and Belgium while those furthest apart are Denmark and Portugal. Table 1.5 provides the City-block distances ($p = 1$) between the same countries so the two versions can be compared.

Table 1.3 Scores of 18 countries on the five dimensions of Hofstede

Country	PDI	IDV	MAS	UAI	LTO
Austria	11	55	79	70	31
Belgium	65	75	54	94	38
Denmark	18	74	16	23	46
Finland	33	63	26	59	41
France	68	71	43	86	39
Germany	35	67	66	65	31
Greece	60	35	57	112	–
Ireland	28	70	68	35	43
Italy	50	76	70	75	34
Netherlands	38	80	14	53	44
Portugal	63	69	31	104	30
Spain	57	51	42	86	19
Sweden	31	71	5	29	33
UK	65	89	66	35	25
USA	40	91	62	41	29
Japan	54	46	95	92	80
Hong Kong	68	25	57	29	96
Taiwan	58	17	45	69	87

Source Hofstede (2001, 2003); Keegan and Green (2011)

Table 1.4 Euclidean distances (cultural distances) between seven selected countries, highest and lowest values are shown in bold

Country	Austria	Belgium	Denmark	Finland	France	Germany	Portugal
Austria	0	68	83	60	72	30	80
Belgium		0	94	56	**15**	45	27
Denmark			0	42	85	69	**95**
Finland				0	48	42	56
France					0	46	24
Germany						0	59
Portugal							0

Table 1.5 City-block distances (cultural distances) between seven selected countries, highest and lowest values are shown in bold

Country	Austria	Belgium	Denmark	Finland	France	Germany	Portugal
Austria	0	130	151	104	133	54	149
Belgium		0	**165**	110	**27**	86	49
Denmark			0	77	150	131	162
Finland				0	89	62	97
France					0	89	46
Germany						0	105
Portugal							0

1.4 Market Size Determination Methods

Estimating the size of the market for a potential foreign market is a very important part of market selection in International Marketing. Some of the ranking methods explained in Sect. 1.3 may also use market size as an independent variable for a regression model to estimate performance in a foreign market. Early works in International Marketing have established that market size and market growth are important factors in determining the attractiveness of a foreign market (Stobaugh 1969; Davidson 1980). The International Marketing literature is abound in different market size estimation techniques. Here we will describe four approaches including the method of analogy, chain ratio method, demand estimation for emerging markets and an alternative data mining based approach.

1.4.1 Method of Analogy

In this method a comparable country and a comparable good/service should be determined. In the country to be compared the market size for both goods are known. In the new market, the market size for one of the goods is known whereas the other is not known. The steps of the methods would be as follows, considering a market size estimation of LCD TV's in country A:

- A country at the same level of economic development should be selected. Suppose countries A and B are similar to each other.
- A surrogate/proxy variable in Country B should be determined, suppose that the sales of DVD players are highly correlated with the sales of LCD TV's.
- The data on sales of LCD TV's and DVD players in Country B, and DVD players only in Country A should be collected
- Then the market size in Country A for LCD TV's can be calculated as follows:
  - $\textit{Demand For LCD in A} = \textit{Demand for DVD in A} \times \frac{\textit{Demand for LCD in B}}{\textit{Demand for DVD in B}}$
- An alternative version of the formula may correct for the fact that some countries could be at an earlier stage of development. Consider for example that Country A is at a development stage in 2013 as Country B was in 2000. Then the revised formula is:
  - $\textit{Demand For LCD in } A^{2013} = \textit{Demand for DVD in } A^{2013} \times \frac{\textit{Demand for LCD in } B^{2000}}{\textit{Demand for DVD in } B^{2000}}$
- The analogy method can also be applied using the respective country populations and GDP per capita values as follows:
  - $\textit{Demand for LCD in A} = \textit{Demand for LCD in B} \times \frac{\textit{Population A}}{\textit{Population B}} \times \frac{\textit{Per Capita income A}}{\textit{Per Capita income B}}$

1.4.2 Chain Ratio Method

The main aim of this method is to start with the population (or total demand) and multiply by some percentages in order to come up with the market demand. For example, the following values can be multiplied to find the demand for a new light beer (Kotler and Keller 2006):

- Population
- Personal discretionary income per capita
- Average percent of discretionary income spent on food
- Average percent of amount spent on food spent on beverages
- Average percent of amount spent on beverages spent on alcoholic beverages
- Average percent of amount spent on alcoholic beverages spent on beer
- Average percent of amount spent on beer spent on light beer

Another demonstrative use of this example in finding the possible market size of baby monitors in a developing country can be as follows:

- Population
- Urbanization percent
- Number of children/population
- Percentage of population above poverty limits (enough buying power to afford baby monitor)

1.4.3 A Nearest Neighbor (k-NN) Approach to Market Size Determination

A series of Data Mining techniques can also be utilized in order to determine market size for a potential market. *K* nearest neighbor technique is a supervised classification technique that can be used to classify a new observation given a data set for which the classifications are already known (Akkucuk 2011a; Giudici 2003; Larose 2005). The methods can also be used to estimate the value of a dependent variable in much the same way. To illustrate the first purpose let us consider that we have a number of countries in which the entry initiative has been deemed to be successful. We would like to evaluate a new country and we know some variables (macroeconomics, demographic, cultural, geographic or otherwise) which could be used to compute a distance function. The following steps could be used to determine whether the new country would be a success or failure. The target variable in general does not need to be binary; it may be, for example, the entry method taking on possible values such as Export, FDI, Joint Venture. The results of the method naturally depend on the choice of some parameters:

- Choose the number of nearest neighbors k
- In the learning set find the k nearest (closest in some distance measure to be defined—the distance measures can be computed on some variables such as macroeconomic, demographic, geographic, cultural or combinations of these) countries to the new country in question
- Use the simple voting rule to determine whether the new country will be a success or failure, or if the target variable is entry method, to determine if the new country will be entered using FDI, Export or Joint Venture.

In some cases the simple voting rule will not work out, there may be ties. Supposing that k is equal to three in the above example and one country in the list is FDI, the other Export and the other Joint Venture, the simple voting will be inconclusive. In such cases a weighted voting procedure can be used. The weight of each observation in the k nearest neighbor list will be computed as being proportional to the inverse of the squared distance between the new country and the countries in the nearest neighbor list. The weights can also be used in demand estimation as well. The weight of country i in the neighborhood set will be inversely proportional to the squared distance between the new country and the country i, computed as follows:

$$weight(i) = \frac{1}{d^2(new\ country, i)}$$

Instead of simple voting now the weights can be used. If we would like to estimate the demand for the new country using the weights and demand levels of the closest k countries we may use the following formula:

$$Demand(new\ country) = \frac{\sum_{i=1}^{k} (w_i \times demand_i)}{\sum_{i=1}^{k} w_i}$$

To give a simple example let us consider k is equal to 3 and that the distance from the new country to countries A, B and C respectively are 0.1, 0.2 and 0.5. The demands are 200, 150 and 300 respectively. The weights of A, B and C would be 100, 25 and 4. The estimated demand will be 193.41, due largely to the proximity to Country A the number is very close to the actual demand in Country A (200). To give an example to the estimation of a discrete target variable, suppose that the operations in Country A were successful and in the other two countries the operations were unsuccessful. Simple voting would not favor entering the new country but weighted voting would win by 100–29. Similarly if the target variable had three levels, and Country A was entered using Export strategy, Country B was entered using Joint Venture and finally Country C was entered using FDI, weighted voting again would prefer to enter the new country by Export (same as Country A). Simple voting would be inconclusive.

1.4.4 Demand Estimation in Emerging Markets

In a rapidly growing emerging market the fact that the GDP is lagging behind many developed economies may mean that there is achievable potential not yet captured in the current GDP and in the current population figures. The difference between the developed economies average GDP and the projected growth in the population together can be used to determine potential demand in an emerging market. Arnold and Quelch's (1998) proposal allows identification of business opportunities by prioritizing national-markets according to long-term market potential. Profit potential and market-entry opportunities are also assessed in relation to product or service adaptation, business partnerships, and distribution strategies. The approach is market-demand driven as opposed to being risk-oriented. It distinguishes between long-term market potential and potential for short to medium-term profit. The dynamic emerging market environment is captured by considering future market potential. Future demand is estimated with minimum demographic and economic data available for all countries as well as data specific to both product and country markets. Arnold and Quelch (1998) propose the following formula for assessing long-term emerging market potential:

$$Q = (P + NP) \times (DevGDP - AdjGDP)$$

In the above formula Q is the total market potential of the country being evaluated; P is the country's national population; NP is the new population (population to be added to the current population in the planning period); $DevGDP$ is the per capita GDP average in developed markets; and $AdjGDP$ is the GDP adjusted to Purchasing Power Parity (PPP) level. By relating national population to the difference between GDP per capita averages in developed markets and an emerging market, the formula tries to approximate the future market size of the emerging market being evaluated. Long-term growth opportunities offered by emerging markets as the fastest expanding markets are not revealed by traditional analysis. Incorporating long-term market potential as an additional criterion offsets this shortcoming (Sakarya et al. 2007).

1.5 Demand Estimation and Market Selection in Financial Markets

Financial services are different in some respects to the other consumer goods or electronics markets. Such companies include banks, insurance agencies, brokerage houses, accounting firms, and real estate agencies. The sector is highly environmentally sensitive. The use of some products within the portfolio of a global bank may not be acceptable according to the customs and traditions of the majority of the population of some countries, in some countries they may be completely banned by laws. The products may need to be adapted accordingly. The sector also

relies heavily on information systems infrastructure, due to the pervasive use of Internet banking and mobile banking. The possibility of a credit check using existing credit bureaus (such as Experian, Equifax and TransUnion in the USA) also gives the bank a competitive edge since otherwise the bank will have difficulty making credit decisions. Following are some examples of data needs by a Global Financial company making country selection decision, some of which are available in World Bank global indicators web site (World Bank 2013), more specifically, except the first three the others are presented by World Bank financial indicators web site, the measurement units are given as well:

- Number of Internet users
- Number of mobile telephone users
- Number of secure Internet servers in the country
- Bank capital to assets ratio
- Bank nonperforming loans to total gross loans
- Claims on central government (annual growth as % of broad money)
- Claims on other sectors of the domestic economy (annual growth as % of broad money)
- Credit depth of information index (given on a scale from 0 to 6 by World Bank)
- Deposit interest rate
- Domestic credit provided by banking sector (% of GDP)
- Foreign direct investment, net inflows (BoP, current US$)
- Interest rate spread (lending rate minus deposit rate)
- International migrant stock, total
- Lending interest rate
- Listed domestic companies
- Market capitalization of listed companies (current US$)
- Market capitalization of listed companies (% of GDP)
- Money and quasi money growth (annual %)
- Net migration
- Personal remittances, received (current US$)
- Portfolio equity, net inflows (BoP, current US$)
- Private credit bureau coverage (% of adults)
- Public credit registry coverage (% of adults)
- Real interest rate
- Risk premium on lending (lending rate minus Treasury bill rate)
- S&P Global Equity Indices (annual % change)
- Stocks traded, total value (% of GDP)
- Stocks traded, turnover ratio
- Strength of legal rights index (given on a scale from 0 to 10 by World Bank)
- Total reserves (including gold, current US$)

Demand estimation for the financial sector of a country involves the estimation of latent demand of the country. This in general is higher than the actual sales of the financial sector in that country. Savings habits of the people, for example a tendency to save in gold or foreign currency significantly reduces the size of the

market. The latent demand in such cases will be much higher than the actual demand. It is the job of the financial institution to try to stimulate the demand and convert the consumers' savings from traditional means to bank accounts. The same is true for individual pension instruments, insurance instruments (life, health, property) and real estate agencies. Latent demand estimation could make use of econometric methods taking as input the many macroeconomics variables about a country.

Outside sources have routine reports about the global financial sector. One such report is the 2013–2018 World Outlook for Financial Services prepared by Icon Group (Icon Group 2013). This econometric study covers the world outlook for financial services across over 200 countries of the world. For each year reported, estimates are given for the latent demand or Potential Industry Earnings (PIE), for the country in question. For the same variables the proportions to the global and regional values are also provided. These comparative benchmarks allow the global marketing managers to quickly gauge a country and compare it to others, with respect to the financial sector. Using econometric models which project fundamental economic characteristics within each country and across countries, latent demand estimates are calculated (Icon Group 2013). Using the data provided on the Global, Regional and Local levels global managers can evaluate which countries they would like to invest in and furthermore which cities within the country would have a greater share of that investment.

1.6 Conclusion

Global marketing managers are constantly faced with decisions about entering or exiting countries, choosing the modes of entry and making specific product decision in the foreign markets. To aid in making these decisions a large number of quantitative methods are available. The increasing number of data sources and improving analytical capabilities will generate newer country/market selection algorithms. The results of the models and the judgmental analyses/corrections of the managers will yield the best results in making international markets related decisions.

It is important to note that all models, especially those estimating market demand, may provide biased results. In some countries the demand can be overestimated, in some underestimated. It is therefore crucial to use more than one technique. The lower and upper end points of the estimates can be used as confidence intervals. The same discussion also goes for the data sources. It is not uncommon for two sources to disagree. Using multiple methods and multiple data sources it is possible to come up with different answers (Craig and Douglas 2005). One study revealed that the estimates using two different techniques computed the market demand to be five to thirteen times the actual trade audit results (Amine and Cavusgil 1986). This finding suggests that a company relying on estimates might have a difficult time meeting objectives set according to those estimates.

Another group of models (not discussed here) aiding in the country entry decision are referred to as "grouping" methods. These methods try to group similar countries with each other so that meaningful groups or clusters (with respect to the global market selection motives). Countries can be grouped according to data obtained from the secondary data sources listed in Sect. 2. One such example was given by Akkucuk (2011c) where the countries were grouped using competitiveness data from the World Economic Forum. Depending on the type of data collected, other multivariate techniques such as Multidimensional Scaling or Correspondence Analysis may also be helpful visual tools whereby managers may get a feeling of proximity between the countries on a visual graph. In one study the world patent application statistics in different technological fields were used to construct maps of the countries with various dimensionalities (Akkucuk 2011b).

In this article we have tried to outline the basics of some of the prominent market prioritization methods, although it would be far from an exhaustive list of the total number of techniques. In the ever changing global economic circumstances managers can make informed decisions with the help of decision support systems incorporating these methods. Although no one model can replace managerial intuition and experience, decision support systems can promise to give the managers fast quantitative results in comparing the multitude of emerging markets and many possible product/market/distribution combinations.

Acknowledgments I would like to thank the Society for the Study of Business and Finance, the editors and section editors of the "Managerial Issues in Finance and Banking" volume and the anonymous reviewers for the valuable feedback they provided during the preparation of the manuscript.

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Chapter 2
Performance of Inward and Outward U.S. Foreign Direct Investment during Recent Financial Crises

Lucyna Kornecki

Abstract Foreign direct investment (FDI) plays an extraordinary and growing role in the global markets and represents an integral part of the U.S. economy. This research has descriptive character and focuses on the latest trends in inward and outward U.S. foreign direct investment illustrating the impact of the recent financial crises on FDI performance in the United States. The study analyzes the US FDI stock contribution to the global FDI, performance of the inward and outward US FDI flow and stock, the US FDI flow and stock as a percentage of GDP and geographical distribution of inward and outward US FDI stock. The essential part of this research relates to inward and outward US FDI employment and the structure of inward and outward US FDI financial performance, which includes: equity, reinvested earnings and intercompany debt.

Keywords Crises · U.S. economy · FDI · Employment · Financial structure

2.1 Introduction

Globalization is a dynamic process of liberalization, openness, and international integration across a wide range of markets, from labour to goods and from services to capital and technology. Globalization is based upon the freedom to trade with the rest of the world and to capitalize on each country's comparative advantage, the freedom to invest where returns on capital are greatest (De la Dehesa 2006, p. 1). Globalization signifies a process of intensification of economic, political, and cultural interconnectedness among the various actors in the global system. In the

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Ü. Hacioglu and H. Dincer (ed.), *Managerial Issues in Finance and Banking*,
DOI: 10.1007/978-3-319-01387-9_2, © Springer International Publishing Switzerland 2014

economic arena it represents a process of integration of national economies with the global economy.

The ongoing globalization process has altered the economic landscape. Many products used to be produced locally using inputs drawn largely from the domestic economy. Further development of globalization and technology has facilitated the geographical fragmentation of production processes, resulting in the emergence of global value chains. Different parts of a firm's production processes can now be located in different parts of the world, according to the comparative advantages of the locations.

The International Monetary Fund defines foreign direct investment (FDI) as an investment that allows an investor to have a significant voice in the management of an enterprise operating outside the investor's own country. The phrase "significant voice" usually means ownership of 10 per cent or more of the ordinary shares or voting power (for an incorporated enterprise) or the equivalent (for an unincorporated enterprise). This may involve either creating an entirely new enterprise—a so-called greenfield investment—or, more typically, changing the ownership of existing enterprises, via mergers and acquisitions. Other types of financial transactions between related enterprises, such as reinvesting the earnings of the FDI enterprise, are also defined as FDI (http://www.conferenceboard.ca/hcp/details/economy/outward-fdi-performance.aspx).

The United States continues to be the leading destination for foreign direct investment (FDI) and the leading investor in other economies. A.T. Kearney's FDI Confidence Index measures investor sentiment on the basis of a survey of senior executives in the world's largest enterprises, and ranks present and future prospects for FDI flows to different economies with respect to the factors that drive corporate decisions to invest abroad. The FDI Confidence Index Report of 2010 ranked China and the United States as the most attractive FDI locations in the world, recording unprecedented levels of investor confidence. According to the ranking for 2011, however, although the United States remained a strong magnet for FDI in the world economy, China, India and Brazil occupied the top spots in terms of the Confidence Index (http://www.atkearney.com/gbpc/foreign-direct-investment-confidence-index).

The financial crisis, which began in summer 2007, has led to a progressive deterioration of the investment situation in the world economies. Various indicators during the first half of 2008 already suggested a decline in world growth prospects as well as in investors' confidence. This deteriorating climate began to leave its first negative marks in investment programs, including FDI, in early 2008. According to UNCTAD's 2008–2010 *World Investment Prospects Survey,* conducted April–June 2008, 40 % of the respondent companies already mentioned at that time that the financial instability had a "negative" or "very negative" impact on their investment (unctad.org/en/docs/wips2008_en.pdf).

This study has descriptive character and constitutes base for the further exploration of the importance of inward and outward US FDI in the global markets and in the U.S. economy. The goal of this research is to illustrate the impact of current financial crises on FDI performance in the United States. The basic

statistics related to US FDI flow and stock come from the UNCTAD's FDI/TNC and from the Bureau of Economic Analysis (BEA), a section of the U.S. Department of Commerce. BEA is responsible for collecting economic data related to FDI flows in the United States. Monitoring this data is very helpful in determining the impact of FDI on the economy's output and employment, but it is especially helpful in evaluating performance of the particular states and industry segments. BEA data offers, as well the most up-to-date view of the U.S. and global operations of U.S. multinationals.

2.2 Recent Financial Crises and US FDI

2.2.1 US FDI Contribution to the Global FDI Stock

The current recession, which began in December 2007, could rank as the longest U.S. economic downturn since the Great Depression. In addition to the severe economic downturn of the U.S. economy, global economic indicators have registered sharper declines than in the previous two global recessions of 1981 and 1990. The current global recession corresponded with reduction in flows and stock of inward and outward of global and US FDI (Ibarra-Caton and Mataloni 2013). In 2008 amid a sharpening financial and economic crisis, global and US FDI stock declined substantially. The US FDI contribution to the global inward and outward FDI stock is illustrated in Figs. 2.1 and 2.2.

After reaching pick in 2007, world inward FDI decline between 2007 and 2008 by 14 %, from US$ 17,901 billion to US$ 15,451 billion increasing farther to 20, 438 billion in 2011, while inward US FDI decline during this year by 30 % from US$ 3,551 billion to US$ 2,486 billion increasing to US$ 3,509 in 2011.

After reaching pick in 2007, World outward FDI declined by 15 % between 2007 and 2008 from US$ 19,273 billion to US$ 16,343 billion, while outward US FDI decline by 41 %, from US$ 5,275 billion to US$ 3,102 billion. In comparison, outward US FDI stock declined deeper than inward US FDI stock.

2.2.2 Geographical Distribution of Inward and Outward US FDI Stock

The U.S. hosts the largest stock of *inward FDI* among the world's economies and continues to be at the top as a destination for inward FDI. The inward US FDI stock grew from US$ 83 billion in 1980 to US$ 540 billion in 1990 to US$ 2,783 billion in 2000, reaching $3,509 billion in 2011 (Table 2.1). *During 2007 and 2008 inward US FDI stock decreased by 30 %, from US $ 3,551 billion to US$ 2,486 billion.* In 2011, US FDI stock exceeded by far the inward FDI stock of other

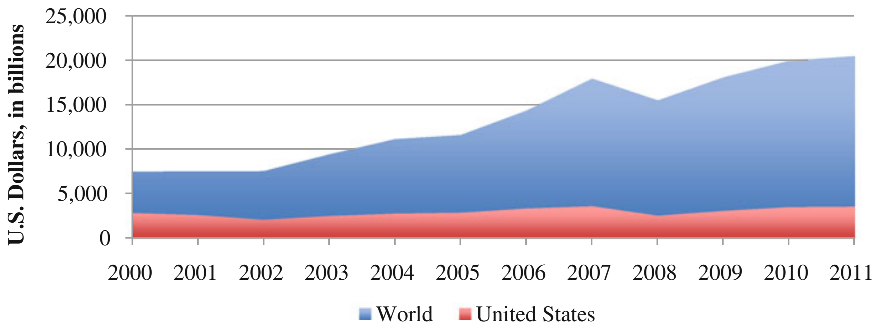

Fig. 2.1 Inward World FDI stock vs. US FDI stock, 2000–2011. *Source* Built based on data retrieved from UNCTAD's FDI/TNC database, available at: www.unctad.org/fdistatistics

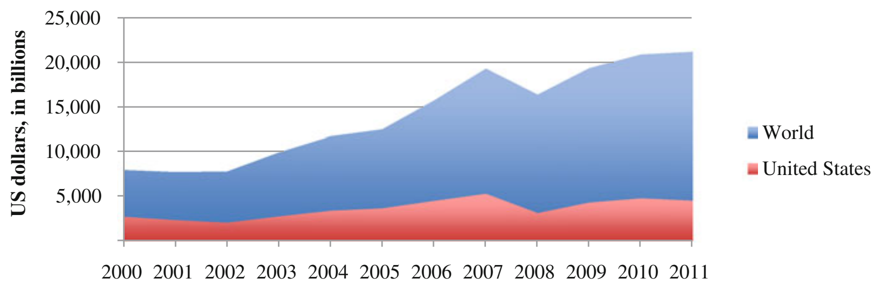

Fig. 2.2 Outward World FDI stock vs. US FDI stock, 2000–2011. *Source* Built based on data retrieved from UNCTAD's FDI/TNC database, available at: www.unctad.org/fdistatistics

large developed economies such as the United Kingdom (US$ 1,199 billion), Germany (US$ 714 billion) and the largest emerging market economy, China (US$ 712 billion).

The contribution of the United States to the world *outward FDI* stock is tremendous. In the last decade, on average between 2000 and 2011, US FDI stock represented 25 % of the total world stock, while the all European Union countries accounted for 51 % of the world FDI stock (www.unctad.org/fdistatistics). Based on Table 2.2, during 2007 and 2008 outward US FDI stock decreased by 41 %, from US $ 5,275 billion to US$ 3,102 billion. In 2011, outward US FDI stock (US$ 4,500 billion) exceeded by far the outward FDI stock of other large developed economies within the European Union, such as the United Kingdom (US$ 1,731 billion), Germany (US$ 1,442 billion), France (US$ 1,373 billion) and individuals contributors, such as: Hong Kong (US$ 1,046 billion), Japan (US$ 962 billion) and Canada (US$ 670 billion).

During the recent economic crisis, between 2007 and 2008 outward US FDI flows decreased by 32 % from US$ 394 billion to US$ 308 billion, decreasing further in 2009 to US$ 267 billion.

Table 2.1 Inward US FDI stock, 2000–2011 (US$ billion)

Economy	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
United States	2,783	2,560	2,022	2,455	2,717	2,818	3,293	3,551	2,486	3,027	3,451	3,509
Comparator economies												
United Kingdom	439	507	523	606	702	841	1,139	1,243	981	1,056	1,086	1199
Germany	272	272	298	395	512	476	591	695	668	677	674	714
China	193	203	217	228	245	272	293	327	378	473	579	711
Russia	32	53	71	97	122	180	266	491	216	382	423	457
Japan	50	50	78	90	97	101	108	133	203	200	215	226

Source UNCTAD's FDI/TNC database, available at: www.unctad.org/fdistatistics

Table 2.2 Outward US FDI stock, 2000–2011 (US$ billion)

Economy	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
World	7,953	7,719	7,786	9,917	11,695	12,465	15,697	19,273	16,343	19,326	20,865	21,169
United States	2,694	2,315	2,023	2,729	3,363	3,638	4,470	5,275	3,102	4,287	4,767	4,500
Comparator economies												
Canada	238	251	276	319	373	388	445	522	524	602	639	670
Hong Kong	388	352	310	340	403	472	677	1,011	762	832	936	1,046
Germany	542	618	696	831	925	928	1,081	1,332	1,327	1,412	1,437	1,442
France	926	798	639	947	1,154	1,232	1,610	1,795	1,268	1,583	1,580	1,373
Japan	278	300	304	336	371	387	450	543	680	741	831	962
United Kingdom	898	870	994	1,187	1,247	1,199	1,455	1,836	1,531	1,674	1,627	1,731

Source UNCTAD's FDI/TNC database, available at: www.unctad.org/fdistatistics

2.2.3 Inward US FDI Background and Literature

During the recent economic crisis, between 2008 and 2009, inward US FDI flows decreased by 50 %. This setback in FDI has particularly affected cross-border mergers and acquisitions (M&As), the value of which sharp decline as compared to the previous year's historic high. International greenfield investments have been less impacted to this point but a large number of projects have been cancelled or postponed. The value of M&As and greenfield investment in the United States by foreign MNEs picked up again in 2010, contributing to a rise in FDI flows from US$ 153 billion in 2009 to US$ 198 billion in 2010 and further to US$ 227 billion in 2011. Although not yet back at their pre-crisis level, FDI inflows in 2010 and 2011 accounted for 15 % of global inflows in both years, still by far the single largest share of any economy in the world (Kornecki 2013).

Foreign direct investment in the United States contribute immensely to the domestic output growth and employment. The empirical research results indicate the existence of a positive and significant relationship between FDI stock and output growth. The research used the regression analyzes and indicated that FDI stock in the U.S. economy shows a relatively higher rate of growth in comparison with that of domestic capital, and contributes about 23 % to GDP growth in comparison with domestic capital contributing 20 %. The model used a modified Cobb-Douglas production function based on a pooled cross section data for the U.S. economy in the period of time between 1981 and 2007, and included the impact of inputs such as labor, domestic capital, inward FDI stock, export and multifactor productivity on economic growth (Kornecki and Borodulin 2012). Goss, Wingender and Torau applied the Cobb-Douglas production function to data from 1988 to 1999 and found that foreign capital accounted for almost 16 % of overall U.S. productivity growth (Goss et al. 2007). FDI and U.S. economic growth, it is important for the U.S. economy to continue attracting foreign direct investment.

When discussing the policy context for FDI in the United States,, it is important to keep in mind that inward FDI contributes significantly to employment in the U.S. economy (Kornecki and Ekanayake 2012) Over the past 10 years, majority-owned U.S. affiliates of foreign companies employed 5–6 million workers and supported 2 million manufacturing jobs (Payne and Yu 2011).

Research investigated factors affecting the inward FDI flows in the United States using annual data for the period from 1997 to 2007 and identified several state-specific determinants of FDI. The result showed that, among the major determinants influencing FDI flows, the real per capita state income, real per capita state expenditure on education, state FDI related employment, state real research and development expenditure (R&D), and state capital expenditure are found to have a significant and positive impact on FDI inflows (Ekanayake and Kornecki 2011).

A number of organizations in the United States deal with IFDI promotion. The state and local economic development organizations include state, regional, city,

and county or local organizations. These refer to investment promotion agencies, economic development agencies, economic development corporations, industrial development corporations, or various other organizations. Many of these organizations are closely associated with local chambers of commerce, but generally are operated separately and play a key role in pursuing policies aimed at retaining existing activities by foreign companies and in implementing targeted investment promotion programs on promising activities (http://www.gdi-solutions.com/directory/invest_usa.htm).

"SelectUSA", established by the President and housed within the U.S. Department of Commerce, represents a Government-wide effort to encourage, facilitate and accelerate business investment in the United States, by both domestic and foreign firms—as a major engine of economic growth and job creation. It provides enhanced coordination with existing resources across all federal departments and agencies with operations relevant to business investment. It works in partnership with state, regional and local economic development organizations to promote and facilitate business investment overall in the United States (http://selectusa.commerce.gov/why-select-usa).

Over the past 5–10 years, these state and local economic development agencies have used the Internet to create search engines and databases that offer foreign as well as domestic investors useful information on matters such as business and personal tax structure, infrastructure and utilities, work force and training resources, population and demographics, business and industry profiles, financing and incentive programs, and available sites and buildings. These web-based resources have streamlined the location process by allowing foreign MNEs to conduct a great deal of research. The state development agencies have an established framework of financial incentives to influence the final business location decision. Typical state inducements may include low-interest loans, reduced income, sales, or property tax liability, and grants for training or infrastructure improvement (http://www.selectusa.commerce.gov/investment-incentives).

2.2.4 Outward US FDI Background and Literature

American direct investment abroad has grown sharply since the mid-1990s, raising questions about the effects of such investment on the U.S. economy. These questions seem pertinent since American multinational corporations lost shares of U.S. GDP over the last decade and their domestic employment had declined until the mid-1990s. Increased economic activity abroad relative to that in the United States increased overseas affiliate employment in some industries, including manufacturing (http://www.fas.org/sgp/crs/misc/RS21118.pdf).

Being globally engaged requires U.S. multinationals (MNEs) to establish operations abroad and also to expand and integrate these foreign activities with their U.S. parents. The idea that global expansion tends to "hollow out" U.S. operations is incorrect. Rather, the scale and scope of U.S. parent activities

increasingly depends on successful engagement abroad. Expansion by U.S. parents and their affiliates contributes to the productivity and average standard of living of all Americans (businessroundtable.org/studies-and-reports/how-u.s.-multinational…).

The United States is the largest investor abroad and the largest recipient of direct investment in the world. For some Americans, the national gains attributed to investing overseas are offset by such perceived losses as displaced U.S. workers and lower wages. Some observers believe U.S. firms invest abroad to avoid U.S. labor unions or high U.S. wages, however, 70 % of U.S. foreign direct investment is concentrated in high income developed countries. Most economists conclude that direct investment abroad does not lead to fewer jobs or lower incomes overall for Americans and that the majority of jobs lost among U.S. manufacturing firms over the past decade reflect a broad restructuring of U.S. manufacturing industries. (http://www.fas.org/sgp/crs/misc/RS21118.pdf).

The contribution U.S. multinational companies make to the American economy is increasingly being called into question. Critics claim that these companies have abandoned the United States, that they succeed only by exporting jobs, and that their domestic and international operations need to be rebalanced through changes in U.S. tax, trade and investment policy. Strong U.S. multinational companies that are able to compete effectively in foreign markets will be better positioned to help restore American economic growth. The ability of U.S. multinationals to stem domestic job losses and return to hiring more American workers depends on the health, vitality and competitiveness of their worldwide operations (businessroundtable.org/studies-and-reports/how-u.s.-multinational…).

United States Council for International Business (USCIB) reports (BR Business Roundtable, March 2010), that the U.S. multinationals are first and foremost American companies, and continue to enhance the nation's economy by their capital investment, research and development, and continued support of good-paying American jobs. The worldwide operations of U.S. multinationals are highly concentrated in America in their U.S. parents, not abroad in their foreign affiliates. The idea that U.S. multinationals have somehow "abandoned" the United States is not supported by the facts. They maintain a large presence in America relative to the overall U.S. economy and relative to the size of their foreign affiliates. Based on official government statistics and current research, this report addresses the following facts related to U.S. multinationals:

- International engagement drives the overall strength of U.S. multinational companies.
- Foreign-affiliate activity tends to complement, not substitute for, key parent activities in the United States such as employment, worker compensation and capital investment.
- U.S. parent companies perform large shares of America's productivity-enhancing activities that lead to high average compensation for American workers.

- All these productivity-enhancing activities contribute to larger-than-average paychecks for the millions of employees of U.S. multinationals.
- U.S. parents purchased a total of $6.03 trillion in intermediate inputs. Of this total, 88.9 %—or $5.36 trillion—was bought from other companies in the United States.
- The worldwide operations of U.S. multinational companies are highly concentrated in America in their U.S. parents, not abroad in their foreign affiliates.
- Foreign affiliates are located primarily in high-income countries that in many ways have economic structures similar to the United States, not in low-income countries (Slaughter 2010)

There are empirical studies done on outward US FDI determinants. Dunning's (1988) identified an array of location factors that improve a country's attractiveness to foreign investors. Location advantages are unique to the specific location in which the firm is currently operating or intends to operate. These advantages range from the availability of cheap labor, natural resources, skilled labor, and large and rapidly expanding local market, to the existence of stable economic and political systems. The presence of location advantages is a necessary condition for successful and profitable operation.

Some studies emphasize the importance of economic factors such as market size, market growth, inflation rates, and income levels (Root and Ahmed 1978; Grubert and Mutti 1991; Woodward and Rolfe 1993). These studies suggest that FDI tends to be attracted mostly to countries with large and expanding domestic markets. Other studies place emphasis on political risk (Nigh 1985; Fatehi-Sedeh and Safizade 1988; Oseghale 1993). While Cheng and Kwan (2000) suggest the primacy of the level of development of host country's infrastructure, Guisinger et al. (1985), Rolfe and White (1992), and Brewer (1993) emphasize the role of government policy in the process. Interestingly, these studies gave little or no considerations to the importance of a host country's institutional framework (Oseghale and Nwachukwu 2010).

Wheeler and Mody (1992) were among the first researchers to explore, empirically, the linkage between institutional framework and the location of US foreign affiliates. Using the first principal component of thirteen factors (e.g. bureaucratic red tape, political instability, corruption, quality of the legal system and so on), they found a statistically insignificant relationship between 'good' institutions and US FDI.

Stein and Daude (2002), using bilateral outward FDI stock for 20 source and 58 host countries, examined the effects of institutional variables on FDI location decisions. They employed three different sets of institutional variables. The first set is the governance indicators database developed by Kaufman et al. (1999). The database had data for six different governance indicators which are: Voice and Accountability, Political Stability and Lack of Violence, Government Effectiveness, Regulatory Quality, Rule of Law, and Control of Corruption.

2.3 Inward and Outward US FDI Flow and Stock Comparison

Inward foreign direct investment is an essential component of the U.S. economy, contributing to production, exports and high-paying jobs for the country's workers. As the world's largest economy, the United States is well positioned to participate in the increasingly competitive international environment for FDI that has emerged as both advanced and developing economies have recognized the value of such investment. The U.S. hosts the largest stock of IFDI among the world's economies, and continues to be at the top as a destination for inward FDI flows.

IFDI represents an integral part of the U.S. economy, with its stock growing from US$ 83 billion in 1980 to US$ 3.5 trillion in 2011. The United States, which had earlier been primarily a home for multinational enterprises (MNEs) rather than a host for affiliates of foreign MNEs, has become a preferred host country for FDI since the 1980 s. Foreign MNEs have contributed robust flows of FDI into diverse industries of the U.S. economy, and total FDI inflows reached US$ 227 billion in 2011, equivalent to 15 % of global inflows, the single largest share of any economy. US FDI flows, with a peak of US$ 314 billion in 2000 and another of US$ 306 billion in 2008, have been an important factor contributing to sustained economic growth in the United States.

The flow of international capital supported the U.S. economy in the 1980s and has been a key factor expanding economy. During the 1990s, the U.S. experienced extraordinary inflow of FDI corresponding with exceptionally high output growth (Goss and Wingender 2007). Between 2008 and 2009, during the recent financial and economic crisis, inflows decreased by 50 %, from US$ 306 billion to US$ 153 billion, but grew again to US$ 197 billion in 2010 and further to US$ 227 billion in 2011. The U.S. continues to be the leading destination for FDI flows with the biggest FDI inflows from China (US$ 123 billion), the United Kingdom (US$ 54 billion), and to Germany (US$ 40 billion). Between 2000 and 2011, the U.S. received the largest FDI inflows of any economy in the world (Kornecki 2013).

The recent financial and economic crises negatively impacted FDI flows to the United States and opened a period of major uncertainty. The effectiveness of government policy responses at both the national and international levels in addressing the financial crisis and its economic consequences will play a crucial role for creating favorable conditions for a rebound in FDI inflows. Unlocking the full potential of the future global inward FDI developments for the United States, as elsewhere, will depend on wise policymaking and institution building by governments and international organizations (Table 2.3).

Inward foreign direct investment is an essential component of the U.S. economy, contributing to production, exports and high-paying jobs for the country's workers. As the world's largest economy, the United States is well positioned to participate in the increasingly competitive international environment for FDI that has emerged as both advanced and developing economies have recognized the value of such investment. The U.S. hosts the largest stock of inward FDI among

Table 2.3 United States inward and outward FDI flow and stock, 2000–2011, US $billions

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Inward US FDI flow	314	159	75	53	136	105	237	216	306	153	198	227
Inward US FDI stock	2,783	2,560	2,022	2,455	2,717	2,818	3,293	3,551	2,486	3,027	3,451	3,509
Outward US FDI flow	143	125	135	129	295	15	224	394	308	267	304	397
Outward US FDI stock	2,694	2,315	2,023	2,729	3,363	3,638	4,470	5,275	3,102	4,287	4,767	4,500

Source UNCTAD's FDI/TNC database, available at: www.unctad.org/fdistatistics

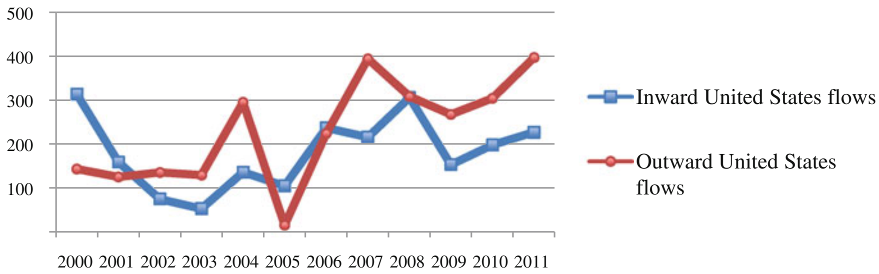

Fig. 2.3 Inward and outward US FDI flow, 2000–2011 in US $ billion. *Source* UNCTAD's FDI/TNC database, available at: www.unctad.org/fdistatistics

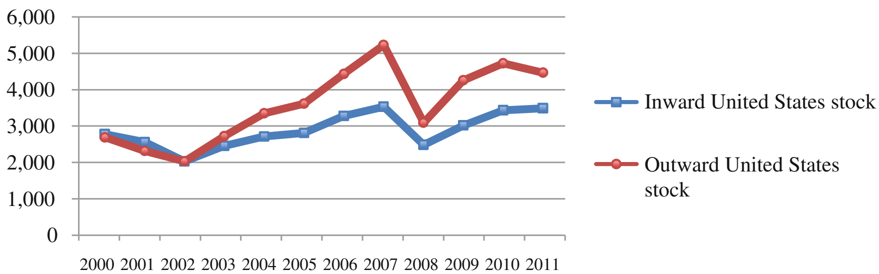

Fig. 2.4 Inward and outward US FDI stock, 2000–2011. *Source* UNCTAD's FDI/TNC database, available at: www.unctad.org/fdistatistics

the world's economies, and continues to be at the top as a destination for inward FDI flows. During 2007 and 2008 inward US FDI stock decreased by 30 %, from US $ 3,551 billion to US$ 2,486 billion (Figs. 2.3 and 2.4).

The contribution of the United States to the world outward FDI stock is tremendous. During the recent economic crisis, between 2007 and 2008 outward US FDI flows decreased by 32 % from US$ 394 billion to US$ 308 billion, decreasing further in 2009 to US$ 267 billion by 14 %. The outward US FDI stock decreased by 41 %, from US $ 5,275 billion to US$ 3,102 billion between 2007 and 2008.

Outward US FDI flow outperformed inward US FDI, during analyzed period of time except 2005, which indicates that American stock abroad exceeds foreign stock in the United Sates. There was large decline in outward US FDI flows in 2005 mainly due to increase in distributed profits of foreign affiliates of United States-based companies. This fact led to a large decline in reinvested earnings of foreign affiliates, which has been the main mode of investment by United States firms abroad in previous years. The American Jobs Creation Act of 2004 also contributed to this decline, as it allowed repatriated earnings of United States foreign affiliates to be taxed at a lower rate than the normal one, leading to a one-off fall in reinvested earnings

2.4 Inward and Outward US FDI Flow and Stock as a Percentage of GDP

The inward US FDI stock as a percentage of GDP climbed up to 6 % during 1980s and up to 10 % during 1990s reaching a peak of 28 % in 2000 declining to 25 % in 2007. During 2007 and 2008 US FDI stock as a percentage of GDP declined to 17 %, increasing to 23 % in 2011. This relatively high percentage of the FDI stock in GDP indicates important role of the inward FDI in the U.S. economy (Kornecki 2013).

The highest US FDI flow as a percentage of GDP was in 2000 (3 % of GDP), declining after 2001 economic recession reaching the bottom in 2003, then increasing to 2 % between 2006 and 2008 to fell dawn to 1 % in 2009 and coming back to 2 % in 2011 (Table 2.4)

The outward US FDI stock as a percentage of GNP declined during 2001 economic recession from 27 to 19 % in 2002, to increase 37.3 % in 2007 and declined to 21 % during current recession to increase further to 29.4 % in 2011. Outward FDI flows as a percentage of GNP declined during 2001 economic recession from 1.4 to 1 %, with ups and downs reaching the peak of 2.78 % in 2007, to decline during recent economic recession to 1.9 % reaching 2.6 % in 2011 (Table 2.5).

2.5 Sectoral Distribution of Inward and Outward US FDI

2.5.1 Sectoral Distribution of Inward US FDI

While, over the period 2000–2011 as a whole and in most years, the services sector accounted for the largest IFDI flows, the manufacturing sector overtook services in 2005, 2007, 2010, and 2011, with inflows to the sector peaking in 2007 at US$ 103 billion, accounting for 48 % of total flows. Within services, financial services represented the largest recipient category in most years between 2000 and 2011, but were overtaken by wholesale trade in 2002, 2005, 2007, and 2011.

The most of US FDI flows reached manufacturing industry. The manufacturing industry accounted, between 2000 and 2011 (on average), for 36 % of total FDI flows, followed by the finance (16 %) and the whole sale (10 %). The average is based on data in Table 2.6.

2.5.2 Sectoral Distribution of Outward U.S. FDI

The services sector, led by holding companies, finance and wholesale trade industries, is the largest recipient of U.S. outward FDI flows, growing from $91

Table 2.4 Inward US FDI flow and stock as a percentage of GDP, 2000–2011

	2000 (%)	2001 (%)	2002 (%)	2003 (%)	2004 (%)	2005 (%)	2006 (%)	2007 (%)	2008 (%)	2009 (%)	2010 (%)	2011 (%)
US FDI flow as % GDP	3	2	1	0	1	1	2	2	2	1	1	2
US FDI stock as % of GDP	28	25	19	22	23	22	25	25	17	22	24	23
GDP	100	100	100	100	100	100	100	100	100	100	100	100

Source United States Department of Commerce, Bureau of Economic Analysis, FDI database, available at www.bea.gov/international, and UNCTAD's FDI/TNC database, available at: www.unctad.org/fdistatistics

Table 2.5 Outward US FDI flow and stock as % GNP, 2000–2011 (in UD$ billions)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
GNP	9,989	10,338	10,691	11,211	11,945	12,720	13,450	14,152	14,460	14,117	14,708	15,328
Outward US FDI flow	143	125	135	129	295	15	224	394	308	267	304	397
Outward US FDI flow % of GNP	1.4 %	1 %	1 %	1 %	2 %	0.12 %	1.7 %	2.8 %	2 %	1.9 %	2 %	2.6 %
Outward US FDI stock	2,694	2,315	2,023	2,729	3,363	3,638	4,470	5,275	3,102	4,287	4,767	4,500
Outward US FDI stock % of GNP	27 %	22 %	19 %	24 %	28 %	28.6 %	33 %	37 %	21 %	30 %	32 %	29 %

Source United States Department of Commerce, Bureau of Economic Analysis, FDI database, available at www.bea.gov/international

Table 2.6 Sectoral distribution of inward US FDI, 2000–2010 (US$ billions)

Sector/industry	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
All sectors	**314**	**160**	**75**	**53**	**136**	**105**	**237**	**216**	**306**	**144**	**198**
Services	**139**	**95**	**27**	**22**	**101**	**30**	**106**	**64**	**169**	**54**	**84**
Wholesale trade	16	6	9	−5	27	20	21	32	33	12	30
Retail trade	4	6	0.3	4	1	0.1	3	−2	7	4	1
Depository institutions	6	6	2	4	18	9	14	−1	25	17	9
Finance	51	18	8	20	32	4	38	10	95	29	39
Real estate	3	−2	2	−4	3	1	0	8	−5	−1	0
Manufacturing	**105**	**51**	**26**	**18**	**21**	**56**	**99**	**103**	**77**	**53**	**86**
Other industries	129	74	27	16	36	15	63	67	74	31	33

Source United States Department of Commerce, Bureau of Economic Analysis, FDI database, available at www.bea.gov/international

billion (64 % of total) in 2000 to $311 billion, accounted for 78 % of total outward US FDI flows in 2011. Within outward US FDI flows, manufacturing sector grew from $ 43 billion (30 % of total) in 2000 to $ 59 billion (15 % of total) in 2011.

Within services, holding companies represent the largest recipient category in most years during 2000–2011, but were overtaken by financial services and wholesale trade in 2005. Financial services also attracted considerable foreign direct investment in 2011 at $37 billion, up from $25 billion in 2010. Wholesale trade investment doubled between 2010 and 2011, accounting for 6 % of total investment.

The most of outward US FDI flows reached service industry. This industry accounted, between 2000 and 2011 (on average) for 76 % of total FDI flows, followed by the manufacturing industry (19 %) and other industries (5 %). The average is based on data in Table 2.7.

2.6 Inward and Outward US FDI Employment Comparison

The FDI-related employment are widely used as a measure of inward FDI effectiveness (Bode and Nunnenkamp 2007). Foreign companies and their U.S. subsidiaries generate enormous economic benefits for the American economy and bring billions of investment dollars into the United States, create thousands of in- sourced American jobs, and highlight the importance of the U.S. market for foreign companies. This calls on the U.S. policy makers to formulate policies that are conducive to increasing the amount of foreign direct investment in the economy. Foreign companies and their U.S. subsidiaries generate enormous economic benefits for the American economy and create thousands of in- sourced American jobs, and highlight the importance of the U.S. market for foreign companies.

Table 2.7 Sectoral distribution of outward US FDI flow, 2000–2011 (US$ billion)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
All sectors	**143**	**125**	**135**	**129**	**295**	**15**	**224**	**394**	**308**	**267**	**304**	**397**
Services	**30.1**	**45.2**	**45.9**	**50.3**	**117.2**	**−66.4**	**97.5**	**153.6**	**118.6**	**140.3**	**175.7**	**207.6**
Holding companies												
Services	**60.4**	**36.7**	**43.9**	**44.2**	**106.4**	**28.9**	**68.4**	**164.1**	**131.4**	**69.7**	**70.6**	**99.1**
Finance	22	3	38	20	51	13	26	82	58	47	25	37
Wholesale trade	12	16	3	12	19	13	15	13	32	13	12	24
Information	17	−3	−1	4	−0.36	3	4	9	8	9	8	12
Real estate	−1	0.88	7	−3	9	9	11	18	4	6	9	12
Manufacturing	**43**	**26**	**32**	**31**	**63**	**28**	**42**	**72**	**36**	**39**	**46**	**59**
Mining	2.2	15.6	6.7	3.8	18.2	12	21.8	19.9	25.6	12.1	13	24.8
Other industries	17.7	21.32	3.4	10.9	17.96	3.4	6.7	26.5	25.8	0.6	15.3	20.6

Source United States Department of Commerce, Bureau of Economic Analysis, FDI database, available at www.bea.gov/international

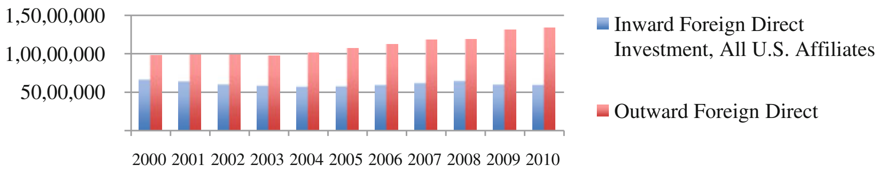

Fig. 2.5 Inward and outward US FDI employment, 2000–2010 (thousands of employees). *Source* United States Department of Commerce, Bureau of Economic Analysis, FDI database, available at www.bea.gov/international

The state development agencies have an established framework of financial incentives to influence the final business location decision. Typical state inducements may include: low-interest loans, reduced income, sales, or property tax liability and grants for training or infrastructure improvement (http://www.areadevelopment.com/LocationUSA/). Each state has adopted a unique strategy to attract FDI as they compete for foreign investors. The leading states in foreign direct investment employment, in manufacturing, are: California, Texas, Ohio, Pennsylvania, Illinois, North Carolina, New York, New Jersey (Fig. 2.2). The southern U.S. states has become more aggressive in recruiting foreign investment by providing incentives to attract investments and communicating the unique advantages they offer to foreign companies. Many southern states have been successful in improving their economies and providing new employment opportunities by offering the incentives attracting foreign capital (Borstorff, Collum and Newton 2007).

Many foreign investors choose the southern part of the U.S. as a desirable location for their FDI. Southern states invite large industrial employers in order to continue the evolution from an agricultural economy to a manufacturing economy. Tennessee, Alabama, Georgia, Kentucky, South Carolina and Texas have welcomed foreign automakers with numerous incentives. Currently, more than 300 foreign-based manufacturers from more than 30 nations operate in Alabama. Out of these foreign-based companies, three are major automobile manufacturers; Honda, Hyundai, and Mercedes (Borstorff, Collum and Newton 2007) (Fig. 2.5).

Outward US FDI employment outperformed inward US FDI employment in each year, between 2000 and 2011 (Table 2.8), which indicates that all U.S. foreign affiliates create more jobs abroad then all U.S. affiliates in the country. Additionally outward US FDI contribution to total U.S. employment is much higher than inward US FDI (Table 2.9).

Lipsey discuses the FDI as a particular form of the flow of capital across national borders, from home countries to host countries, measured in Balance of Payments Statistics. Those flows give rise to a particular form of stocks of capital in host countries, namely the value of home country investment in entities, typically corporations, controlled by a home country owner, or in which a home country owner holds a certain share of voting rights (Lipsey 2001).

Table 2.8 Inward and outward US FDI employment, 2000–2010 (thousands of employees)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Total U.S employment	165,370	165,510	165,063	166,019	169,026	172,551	176,124	179,899	179,644	174,225.7	173,626.7
Inward FDI all U.S. Affiliates	6,524.6	6,268.3	5,925.1	5,713.2	5,617.1	5,665.5	5,803.1	6,088.7	6,324.7	5,979.1	5,802.2
Outward FDI, all U.S. Foreign Affiliates	9,713	9,803.6	9,776	9,657.5	10,068.4	10,621.7	11,149.9	11,731.9	11,801.2	13,029.3	13,255.8

Source United States Department of Commerce, Bureau of Economic Analysis, FDI database, available at www.bea.gov/international

Table 2.9 Inward and outward US FDI employment, as a percentage of total U.S. employment, 2000–2010

	2000 (%)	2001 (%)	2002 (%)	2003 (%)	2004 (%)	2005 (%)	2006 (%)	2007 (%)	2008 (%)	2009 (%)	2010 (%)
Total U.S. employment	100	100	100	100	100	100	100	100	100	100	100
Inward FDI, All U.S. Affiliates	4	4	4	3	3	3	3	3	4	3	3
Outward FDI, All U.S. Foreign Affiliates	6	6	6	6	6	6	6	7	7	7	8

Source United States Department of Commerce, Bureau of Economic Analysis, FDI database (www.bea.gov/international)

U.S. direct investment abroad is defined as ownership by a U.S. investor of at least 10 % of a foreign business. The direct investor is known as a U.S. parent, and the U.S.-owned foreign business is known as a foreign affiliate. The combined global operations of a U.S. parent company and its foreign affiliates constitute a U.S. MNC (http://www.bea.gov/about/pdf/international_usdia.pdf).

Americans believe that U.S. direct investment abroad, directly or indirectly, shifts some jobs to low wage countries. They argue that such shifts reduce employment in the United States and increase imports, thereby affecting negatively both U.S. employment and economic growth. Economists generally believe that firms invest abroad because those firms possess some special process or product knowledge or because they possess special managerial abilities which give them an advantage over other firms. On the whole, U.S. firms invest abroad to serve the foreign local market, rather than to produce goods to export back to the United States, although some firms do establish overseas operations to replace U.S. exports or production, or to gain access to raw materials, cheap labor, or other markets (http://www.fas.org/sgp/crs/misc/RS21118.pdf).

There are instances when firms shift activities abroad to take advantage of lower labor costs. However, it is clear from the data that the majority of U.S. direct investment abroad is in developed countries where wages, markets, industries, and consumers' tastes are similar to those in the United States. U.S. direct investment in these developed countries is oriented toward serving the markets where the affiliates are located and they tend, in the aggregate, to boost exports from the United States. In addition, foreign firms have been pouring record amounts of money into the United States to acquire existing U.S. firms, to expand existing subsidiaries, or to establish "greenfield" or new investments (http://www.fas.org/sgp/crs/misc/RS21118.pdf).

2.7 Inward and Outward US FDI Financial Performance Comparison

2.7.1 Inward US FDI Financial Performance

Flows of FDI comprise capital provided either directly or through other related enterprises by a foreign direct investor to an enterprise. These flows have three components: equity capital, reinvested earnings and intra-comp any loans. Equity capital is the foreign direct investor's purchase of shares of an enterprise in a country other than its own. Reinvested earnings comprise the direct investor's share (in proportion to direct equity participation) of earnings not distributed as dividends by affiliates, or earnings not remitted to the direct investor. Intra-company loans or intra-company debt transactions refer to short-or long-term borrowing and lending of funds between direct investors (parent enterprises) and affiliate enterprises.

Among the components of inward US FDI flows (equity investment, reinvested earnings, intra-company loans) between 2000 and 2011 on average, equity investment is the one that is related most directly to long-term international investment strategies and constitute 75 % of capital inflows, while reinvested earnings and intercompany debts constitute accordingly 15 % and 10 % (Table 2.10—calculation base) of the total FDI inflows.

Foreign direct investment financial flows were US$ 227 billion in 2011, up from US$ 198 billion in 2010 and consisted of US$ 93 billion in net equity investment, US$ 80 billion in reinvested earnings, and US$ 53 billion in net intercompany debt investment inflows (Table 2.11).

During the recent financial crises the inward US FDI equity declined from US$ 256 billion in 2008 to US$ 127 billion in 2009 declining further to US$ 93 in 2011. Net equity investment was the largest component in 2011, but it was lower than in 2010 (US$ 132 billion) and it was at its lowest level since 2005 (US$ 71 billion). The US FDI reinvested earnings declined between 2008 and 2009 from US$ 35 billion to US$ 15 billion and return back to pre-crises level of US$ 60 billion in 2010 increasing farther to US$ 80 billion in 2011. Borrowing transactions between U.S. affiliates and foreign parent groups decreased between 2007 and 2010 from US$ 31 billion to US$ 7 billion in 2007 to increase again in 2010 to almost pre-crises level of US$ 53 billion in 2011 (Barefoot and Ibarra 2011). In the last 2 years reinvested earning as a percentage of total FDI income increased from 43 to 53 %. Unfortunately, US FDI equity as a percentage of US FDI flows declined from 84 to 41 % between 2008 and 2011

2.7.2 Outward US FDI Financial Performance

The outward US FDI equity, during the recent financial crises started to declined from US$ 201 billion in 2007 to US$ 127 billion in 2008 and to US$ 18 billion in 2009. Upward trend started in 2010 with increase to US$ 41 in 2010 and to US$ 53 in 2011 (Table 2.11). Equity capital flows for new investments experienced a sharp decline during the current recession. The pronounced decline in equity capital flows for new investment coincided with a worldwide decline in global merger and acquisition activity. According to Thompson Reuters, global merger and acquisition activity fell by 40 %. The share of reinvested earnings trended upward through 2008, indicating that parent firms were still choosing to invest in their foreign affiliates rather than remit their earnings to the United States. Despite weak economic conditions, U.S. multinationals have continued to expand their investments in newly emerging markets at a more rapid rate than in advanced economies. The outward US FDI reinvested earnings declined between 2008 and 2009 from US$ 212 billion to US$ 207 billion and increased beyond the pre-crises level of US$ 292 billion in 2010 (by 14 %) increasing farther to US$ 326 billion in 2011(by 18 %) based on Tables 2.11 and 2.12.

Table 2.10 The structure of inward US FDI by Financial Components (2000–2011), US$ billion

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
FDI inflows	314	159	75	53	136	105	237	216	306	153	198	227
Equity	260	141	105	93	93	71	115	142	256	127	132	93
Reinvst. earnings	−8	−41	−8	4	39	34	63	43	35	15	60	80
Intercomp. Debt	62	60	−23	−44	4	0.2	59	31	15	2	7	53
FDI income	48	4	32	61	88	110	145	121	126	98	138	152
Reinvest. earnings % of FDI income	−16 %	−1062 %	−25 %	7 %	45 %	31 %	44 %	35 %	28 %	15 %	43 %	53 %
Equity % of US FDI flows	83 %	88 %	140 %	176 %	68 %	67 %	49 %	66 %	84 %	83 %	66 %	41 %

Source United States Department of Commerce, Bureau of Economic Analysis, FDI database (www.bea.gov/international)

Table 2.11 The structure of outward FDI Components (2000–2010), US$ billions

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Capital outflows	143	125	135	129	295	15	224	394	308	267	304	397
Equity	78	61	43	35	133	62	49	201	127	18	41	53
Intercompany debt	−12	12	26	−7	20	−15	−22	−17	−31	42	−29	18
Reinvested earnings	77	52	66	101	142	−32	197	210	212	207	292	326
Direct investment income	134	110	125	165	228	272	304	350	393	335	421	458

Source United States Department of Commerce, Bureau of Economic Analysis, FDI database (www.bea.gov/international)

Table 2.12 The structure of outward FDI Components (2000–2010), as a percentage of outward US FDI

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Capital outflows	100	100	100	100	100	100	100	100	100	100	100	100
Equity	55	49	32	27	45	413	22	51	41	7	13	13
Intercompany debt	−8	10	19	−5	7	−100	−10	−4	−10	16	−10	5
Reinvested earnings	54	42	49	78	48	−213	88	53	69	−18	96	82

Source United States Department of Commerce, Bureau of Economic Analysis, FDI database, available at www.bea.gov/international

Reinvestment is not only different from new equity and inter-company debt flows in terms of its share of total US FDI, it is the only component which originates in the host country and thus, does not involve cross-border transfer of funds (Lundan 2006). Furthermore, an analysis of the correlation between individual components of FDI reveals the existence of very low inter-component correlation (ranging from −0.089 to 0.23). The weak correlation between the components suggests that they are independent of each other. This finding corroborates that of Salorio and Brewer (1998). The further study examined the effect of the quality of host country institutions on reinvestment decisions by United States multinationals. Six indicators of quality of institutions were used as measures of the quality of host country institutions. The six indicators are Voice and Accountability, Political Stability and Lack of Violence, Government Effectiveness, Regulatory Quality, Rule of Law, and Control of Corruption. These indicators have been found, by Kaufmann et al. (1999) to be most important in assessing the overall quality of a country's institutions. The statistical analysis reveals that the quality of host county institutions has a statistically significant effect on reinvestment decisions by US multinationals (Oseghale and Nwachukwu 2010).

Intercompany debt flows—loans between parent firms and affiliates—are a very small component of outward US FDI and are extremely volatile; they change direction frequently because the loans, which are often for the purpose of providing short term financing for intra-firm trade, tend to be repaid soon after they are created (Ibarra-Caton and Mataloni 2013).

2.8 Conclusions

The recent economic crises negatively impacted world FDI flows in 2008 and 2009 and opened a period of major uncertainty. The effectiveness of government policy responses at both the national and international levels in addressing the financial crisis and its economic aftermath will play a crucial role for creating favorable conditions for a continued recovery of FDI inflows into the United States. Public policies will obviously play a major role in the implementation of favorable conditions for such a recovery. Structural reforms aimed at ensuring more stability in the world financial system, a renewed commitment to an open environment for FDI and the implementation of policies aimed at favoring investment and innovation are key issues in this respect (https://wpqr1.adb.org/…/0918BE1C4C9148EC48257567000D8869/…).

The U.S. hosts the largest stock of inward FDI among the world's economies and continues to be at the top as a destination for inward FDI. Foreign direct investment in the United States contribute immensely to the domestic output growth and employment. During the recent economic crisis, between 2008 and 2009, inward US FDI flows decreased by 50 %, from US$ 306 billion to US$ 153 billion. This setback in FDI has particularly affected cross-border mergers and acquisitions (M&As), the value of which sharp decline as compared to the previous year's historic high. During 2007 and 2008 inward US FDI stock decreased by 30 %, from US $ 3,551 billion to US$ 2,486 billion.

The United States is the largest recipient of direct investment and the largest investor abroad the in the world. Often, the national gains attributed to Americans investing overseas are offset by such perceived losses as displaced U.S. workers and lower wages. Some observers believe U.S. firms invest abroad to avoid U.S. labor unions or high U.S. wages, however, 70 % of U.S. foreign direct investment is concentrated in high income developed countries. Most economists conclude that direct investment abroad does not lead to fewer jobs or lower incomes overall for Americans and that the majority of jobs lost among U.S. manufacturing firms over the past decade reflect a broad restructuring of U.S. manufacturing industries (http://www.fas.org/sgp/crs/misc/RS21118.pdf).

The contribution of the United States to the world outward FDI stock is tremendous, however this research confirmed, that outward US FDI stock outperformed inward US FDI stock between 2002 and 2011, which indicates that American stock abroad exceeds foreign stock in the United Sates. In the last decade, on average between 2000 and 2011, US FDI stock represented 25 % of the

total world stock. The outward US FDI stock decreased by 41 %, from US $ 5,275 billion to US$ 3,102 billion between 2007 and 2008. During the recent economic crisis, between 2007 and 2008 outward US FDI flows decreased by 32 % from US$ 394 billion to US$ 308 billion, decreasing further in 2009 to US$ 267 billion.

The most of US FDI flows reached manufacturing industry. This industry accounted, between 2000 and 2011 (on average) about 36 % of total FDI flows, followed by the finance about 16 % and the whole sale about 10 % of the total inward US FDI flows. The leading states in FDI employment in manufacturing are California, Texas, Ohio, Pennsylvania, Illinois, North Carolina, New York, New Jersey. The most of outward US FDI flows reached service industry. This industry accounted, between 2000 and 2011 (on average) about 76 % of total FDI flows, followed by the manufacturing industry (19 %) and remaining other industries (5 %).

Outward Inward FDI represents an integral part of the U.S. economy. Most of the foreign investment in the United States comes from the European developed economies. These investments are predominately in the manufacturing sector and accounts for very high percentage of foreign direct investment in the United States. U.S. affiliates of foreign companies in the manufacturing industry is the largest contributor of FDI employment in the U.S. economy. It is known that foreign companies investing in the United States not only provide jobs, but offer relatively high-paying jobs what constitutes important factor influencing to high FDI employment and contributing to employment in the U.S. economy. Between 2000 and 2011, outward US FDI employment outperformed inward US FDI employment, which indicates that all U.S. foreign affiliates create more jobs abroad then all U.S. affiliates in the country.

During the recent financial crises the inward US FDI equity declined from US$ 256 billion in 2008 to US$ 127 billion in 2009 declining further to US$ 93 in 2011. The equity investment was the largest component in 2011, but it was lower than in 2010 (US$ 132 billion) and it was at its lowest level since 2005 (US$ 71 billion). The inward US FDI reinvested earnings declined between 2008 and 2009 from US$ 35 billion to US$ 15 billion and return back to pre-crises level of US$ 60 billion in 2010 increasing farther to US$ 80 billion in 2011.

The outward US FDI equity capital for new investments experienced a sharp decline during the current recession. The pronounced decline in equity capital for new investment coincided with a worldwide decline in global merger and acquisition activity. The share of reinvested earnings trended upward through 2008, indicating that parent firms were still choosing to invest in their foreign affiliates rather than remit their earnings to the United States. Despite weak economic conditions, U.S. multinationals have continued to expand their investments in newly emerging markets at a more rapid rate than in advanced economies. The outward US FDI reinvested earnings declined between 2008 and 2009 from US$ 212 billion to US$ 207 billion and increased beyond the pre-crises level of US$ 292 billion in 2010 increasing farther to US$ 326 billion in 2011 (Tables 2.11 and 2.12).

For dealing effectively with the financial crisis and its economic aftermath, as well as benefiting from the positive contributions of FDI to output growth and employment, it is important that policymakers maintain an overall favorable business and investment climate. In order to promote foreign investment, the United States has entered into a number of international investment agreements, including bilateral investment treaties (BITs) and double taxation treaties (DTTs). The total number of BITs concluded by the United States as of June 1, 2012 was 48, and the total number of DTTs concluded as of June 1, 2011 was 164 (http://archive.unctad.org/Templates/Page.asp?intItemID=4505&lang=1).

For over 70 years, the United States has negotiated bilateral tax treaties with its trading partners to facilitate economic flows and investments between the treaty partners, eliminate double taxation, and provide certainty to taxpayers where overlapping taxing jurisdictions can cause confusion. The major focus of these treaties is to provide clear rules as to which taxing authority has the authority to tax income that has some connection to entities or persons in both the United States and the country with which a treaty was negotiated. Some of the other key features of these treaties include prevention of income tax evasion, avoiding double taxation, reducing barriers to cross border investment, and avoidance of discriminatory tax treatment (http://www.ofii.org/docs/Background_on_Tax_Treaties.pdf).

There are several priorities being pursued by the U.S. Government to attract foreign companies. In addition to an ongoing review of trade, tax and regulatory policies and legislation to assure competitiveness in a rapidly evolving global marketplace, strategies with a focus on technology, innovation, education, and supporting infrastructure are being implemented to assure that the country can find its place in an increasingly competitive environment.

As far as outward US FDI, based on the United States Council for International Business (USCIB) reports the U.S. multinationals are first and foremost American companies, and continue to enhance the nation's economy by their capital investment, research and development, and continued support of good-paying American jobs. The worldwide operations of U.S. multinationals are highly concentrated in America in their U.S. parents, not abroad in their foreign affiliates. The idea that U.S. multinationals have somehow "abandoned" the United States is not supported by the facts.

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Chapter 3
The Evolution of Globalization Process and Its Implications

Fulya Kivilcim

Abstract This study aims to present a thorough understanding of the process of globalization and analyze the current effects and changes of globalization on Turkey. In accordance with this viewpoint, the first, second and third parts of the study explain the concept and the development of globalization, its dimensions, various aspects are addressed, and the relations between globalization and Turkey are demonstrated. The last part handles the effect of the process of globalization on Turkey, and presents the fact that Turkey, as a nation state, is influenced by this process in a way that it even threatens Turkey's power of sovereignty. The last part also shows how Turkey should follow a path in order to avoid any harm caused by the global order and make use of any opportunity appearing under present circumstances.

Keywords Globalization · Dimensions of globalization · Turkey

3.1 Introduction

When compared to previous periods, it is seen that the past half century poses differences due to the developments in communications and transportation technology. The elapsed time has caused changes in societies' perception levels and skills in defining-evaluating the world, again depending on communication and transportation technology. As seen here the elapsed time has been subject to a societal transformation/change. Thereby, the notion of globalization, via the trans-border exchange dimensions developed and the contrast between far and near was eliminated. The plainest definition of the notion of globalization can be expressed

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Ü. Hacioglu and H. Dincer (ed.), *Managerial Issues in Finance and Banking*,
DOI: 10.1007/978-3-319-01387-9_3, © Springer International Publishing Switzerland 2014

by ruling out the distance between far and near venues, thereby the rapprochement of countries and people and their being in economic and social exchange.

The important element in the definition of globalization is that locally taken decisions have the power to surpass the limits of the policies pursued, reach other nations and affect them. Especially when the past thirty years are taken into consideration; history of mankind has felt such power of capitalism with all its dimensions and as a requirement of the conditions generated by the era being lived in, it will be continue to be felt more strongly in the years to come.

3.2 The Fundamentals of Globalization

Despite the richness in literature and interest by academic environments in the matter of "globalization", a key notion describing an old process (Ellwood 2002, p. 13), albeit a new word and used in the explanation of the world's change process, there is no common definition. Moreover, it is seen that there is a very debatable situation concerning its definition (Aydemir and Kaya 2007, p. 261). The reasons for this debatable situation however is rather due to differences in political and social views, the areas of interest of those analyzing globalization, the predication on some dimensions of globalization while ignoring some of its dimensions generally in the efforts to define globalization; additionally globalization is given a meaning in developed countries and developing countries with a different attitude (Aslan 2005, p. 5). It is also seen that globalization as a dynamic process makes the definition more difficult, i.e. globalization still being an ongoing and unfinalized current issue also causes the continuation of debates on its definition and the continuous birth of new globalization definitions. Another reason why globalization is still a debatable notion is based on the fact that that there is no consensus among researchers as to which societal processes forms its essence. Additionally, it is also stated that with respect to globalization, it is a notion concealing solid facts and argued that especially the negative aspects of globalization are not visible (Timur 2004, p. 11).

Different and contravening attitudes towards definitions make a definition of globalization which everyone would agree on almost impossible. The difference in the definition of globalization, which is a very complex, multi-dimensional and dynamic process, is nowadays the focal point of globalization studies. According to Zengingönül, the common characteristic of definitions on globalization is that 'they can't agree on a common point' (Zengingönül 2004, p. 12). In this study, common notions used in the context of globalization are taken into consideration to reach a definition.

Globalization is seen as an economic notion by most researchers. For example, Aktan and Şen define globalization as the integration of world economies by means of trade, financial flows, technological change and the mobility of information and labor (Aktan and Şen 1999, p. 2). Another definition seeing globalization from an economic viewpoint however is as follows: "It is pointed out that

an integration process in being undergone with the increase in international exchange and interdependence in economic relations in today's world and such trend is named as globalization" (Aslan 2005, p. 5). The common point of those defining globalization from an economic viewpoint is the issue of 'the integration of world economies and the adoption of a common economic life across the world'. However, seeing globalization merely from an economic viewpoint makes it difficult to understand. This is because it is seen that globalization is not merely an economic process and also the social, cultural and political aspects of this process are also important.

Each era is mentioned by a notion explaining itself. The era we live in, however, is represented by the notion of "globalization". Globalization is a highly debatable notion implying a world in which values, ideas and knowledge both differentiate and become subjective and standardized (Ekşi 2004, p. 94). With its different dimensions, globalization can affect the notion of security. The process of globalization has nowadays come to threaten the nation state. New, non-state actors arising within this process restrict the nation states' understanding of sovereignty.

In addition to the different debates made on the notion of globalization, it is an undisputable fact that this notion is a phenomenon of the last twenty years. Since 1980s and especially with the end of the cold war analyses on global economy, global actors and global policies started to come on the agenda more frequently. As the phrase goes, the notion of 'global' came to be brought in front of each fact and present debates then came to be continued over globalization.

Although a definitive and structural agreement can't be reached on the notion of globalization, it is a process explaining transformations in the world in the last decade. Revolutionary innovations especially in communication technologies are the sole element supporting globalization. This is because if it weren't for the facility provided by technology, a global economy or social world would not be mentioned today. Thanks to technological innovations (internet, telecommunications and several similar innovations related to the information technologies sector) distances have ceased to form such an obstacle.

"Globalization is defined as the new millennium's political, economic and social notion and affects all countries as an inevitable notion. In as much as there are those adopting the globalization trend, there are also fractions standing strongly against this trend." (Kalpaklioglu and Aktas 2004, p. 43). Opinions for and against the transformative effect of globalization on the world system are shaped by both ends of the political and ideological scale.

Some common values in globalization and the economic, political, social and cultural areas spread across the world by surpassing local and national boundaries. In the economic fields, the economic system adopted in both developed and developing countries and economic policies applied accordingly show increasing similarities. Together with the collapse of real socialism, the liberal economic order, i.e. free market economy is increasingly globalizing and views on the delimitation of states gains in importance (Kalpaklioglu and Aktas 2004, p. 46).

As can be understood from the evaluations above, the notion of globalization is one of the most debated issues of recent years. The main reason for this situation can be explained as the global system showing its impact nearly in all areas. Including debates and analyses on globalization it has of course a nature far exceeding the limits of this debate.

3.3 Historical Development of Globalization

The West has endeavoured in overseas discoveries after 1490 with the significant developments in the maritime field. According to Oran, the requirement causing this dispersion was the wish of Western Europe's newly dithering Absolute Monarchies that confiscated noble metals and goods in overseas countries. Again, according to the author, this was also the beginning of the Mercantilism policy, which peaked in the sixteenth and eighteenth centuries (Oran 2001, p. 5). Noam Chomsky also sees the Westerners' discovery of America as a result of these explorations as the conquest of America by a foreign culture and the start of globalization. This process, according to some, has caused wide spread colonization with the Westerners' discovery of the Cape of Good Hope, the birth of capitalism with capital accumulation and industrialization and has continued into present globalization (Atasoy 2005, p.151).

As a consequence of this initial Western expansion arising from developments in maritime affairs, the economic system of Western Europe came to be determined as an economic system based on colonial economies. During this period, the classical colonial economy was functioning, whereby the raw material and intermediary goods provided by colonies were turned into final products at the center and were resold to peripheral countries. This process was a period during which intense labor and capital flows were experienced and thereby the foundations of the world economy's integration were laid down (Oran 2001, p. 5).

Fiedman stated that what came to the foreground within this period from 1492 with Columbus' discovery of America until 1800s was the power countries had (man power, horse power, and steam power) (Yilmaz 2006, p. 194). In short, the First Globalization wave, which the World Bank states to have materialized between years 1870–1914 is the result of an intense accumulation. This accumulation, however, has caused developments preponderantly in maritime affairs, the development of railways, communication becoming cheaper with innovations of the telegram and telephone, the emergence of markets such as in Canada, Argentina, Australia, New Zealand, Russia and China and consequently the very rapid development and enhancement of the world economy. The greatest share in these developments and the enhancement of foreign trade belonged to England and France. Some authors, however, link the increase in economic relations between countries within the 1870–1914 periods during which time globalization materialized to capitalism. Accordingly, 'capitalism' which emerged and started to develop in the period between 1870 and 1914 and formed the foundation of the

Western economic system has been an important tool in the manifestation of globalization (Aktan and Şen 1999, p. 2). In this sense, authors who see globalization as the expansion of the West also agree with this view.

As a result, the main dynamics of globalization were 'change' and 'expansion', while their justification was economy. During the first period of globalization, maritime developments, innovation of the telegram and developments in railroads, gave the West the opportunity to expand its political, military and commercial influence in overseas countries they hadn't reached yet (Oran 2001, p. 5). Moreover, during this new period, the intensification of competition arose in international commerce, which brought about expertise in production. According to Yılmaz, development in the technological field had reached advanced levels and caused the ties connecting nations and societies to one another to increase. Consequently, similar to first technological development's dissolution of traditional society and leading to the modern industrial society, new technological developments had also dissolved the industrial society and caused a new post-modern society and a second globalization wave (Yilmaz 2006, p. 130).

The second phase of globalization coincided with post 1870 which was the West's second expansion. The opportunities ensuring this expansion, however, are according to Oran were the immense technological opportunities generated by the industrial revolution which had given rise to a very great imbalance between the West and other regions of the world; i.e. the industrial revolution was behind these expansions (Oran 2001, p. 6). This globalization was going to affect social life very positively (Atasoy 2005, p. 155). According to Fiedman; while steam engines were initially ensuring the spread of marine and rail transport, telegrams, telephones, PC, satellite, optical wires eliminated the distance problem in maritime transport and communications consecutively (Yilmaz 2006, p. 194).

In fact, second phase of globalization "was a response to new and certain economic and financial pressures arising within Europe". "By the end of the 19th century, capitalism had encountered the obligation to restructure. The second expansion ensured this and gave the system the opportunity to reproduce itself. Therefore, this brand new type of the notion which was until then mentioned as 'colonialism' was given a new name: Imperialism." Consequently, Imperialism, which was the second Western expansion, had strongly settled into these overseas territories and had, according to Oran, inseminated its own infrastructure with strong roots as opposed to the first phase of globalization (Oran 2001, p. 8).

Between 1914 and 1945 there was a period during which globalization, or the second part of globalization had stagnated. The outbreak of World War I in 1914, the Great Depression in 1929 and the start of World War II thereafter slowed down the process of globalization considerably (Aktan and Şen 1999, p. 10). In other words, wars and pursuant depressions hindered the continuity of globalization and exposed different globalization periods.

After the stagnation period with two great wars and depressions, the second part of globalization continued on its advancement. The pursuant period is also seen by math researchers as the revival of the capitalist economy. However, the impact of problems leading to stagnation was negative. In the post-World War II era, Europe

had immense power losses and was devastated economically. Aslan summarizes the globalization process which restarted after World War II as follows: "While the production capacity of Europe was ravaged during World War II era, the US, as the world's leading economic and social force put neo-liberalization tendencies to the foreground. Thus the effort to develop international cooperation intensified and efforts to establish international organizations to guide the world economy within this scope was initiated. As it is known, during the 1944 Bretton Woods Conference, decisions to establish the IMF and the International Bank for Reconstruction and Development (IBRD) and diminishing regulations obstructing international commerce were taken" (Aslan 2005, p. 8).

It is seen that in the post-World War II period, most countries subjected the international circulation of capital to strict control and the IMF and the World Bank were designed to provide opportunities for international trade and investments in an environment where the circulation of private capital was restricted; thereafter, restrictions in capital circulation were eliminated in course of time, international capital movements gained pace in early 1980s during Reagan and M. Thatcher periods, especially in early 1990s with the collapse of the Soviet Union financial markets in a real sense started to become global. In fact, with the acceleration of the globalization process during this period, the importance of international organizations such as IMF, the World Bank, GATT and the Organization for Economic Cooperation and Development (OECD) were great. Such international entities nearly all of which were established in the second half of 1940s were formed under the auspices of the US and according to Aktan and Şen with the contribution of these entities a new wave of globalization was formed in the 1950s and 1960s. "Another turning point in terms of the second phase of globalization, however, manifested in the 1970s: In August 1971, with the collapse of the Bretton Woods System, the fixed exchange rate system was abandoned and developed countries foremost the USA, Germany, England and Japan successively eliminated the restrictions in capital movements. The elimination of restrictions in capital movements in these countries gained extraordinary pace with financial globalization (Aktan and Şen 1999, p. 11).

Another reason why globalization gained momentum after the 1970s was accelerated technology and the impacts of increasing production in markets' external expansion. Therefore, after mid-1970s countries by conforming to this market logic started to act in line with the requirements of commercial liberalization. According to Aslan; "While external market rule based on technological supremacy especially in developed economies in the post 1945 period took growth under guarantee for a long time by demand in domestic markets and "Keynesian" policies to keep purchasing power high, the change in the circumstances after 1970 also brought political change. Due to developments such as the power of Japan being already felt in world markets and increases in oil prices these economies came to defend the thought that neither keeping purchasing power in domestic markets high nor leaving developing economies a certain autonomy to protect their domestic markets could any longer guarantee growth as before. For them, it was necessary to bring external markets closer and make them more usable and this

was doable with a neo-liberal understanding and by means of globalization (Aslan 2005, p. 10). (Not sure where the ends).

Bulutoğlu, however, who studied globalization during this period compares the global period led in the nineteenth century by England and the twentieth century by the USA and he states that this process developed the commerce in goods and services with international capital movements; which is now being called globalization instead of the free movement of commerce, capital and man power that the present development is the continuation of nineteenth century free goods, capital and labor movement, that innovation is merely in internet an communications technology and that the flow of labor in the nineteenth century was even more than current labor mobility (Bulutoglu 2005, p. 467).

The third part of globalization is the product of globalization accumulations and the previous period, which formed the dynamics of the pursuant periods. However, globalization is not a single process, at the same time it is a series of processes manifesting simultaneously, at various levels and irregularly. In other words, the history of globalization has a structure bearing differentiations between processes within itself which however blends the accumulations of one another. In this sense the third phase of globalization is a continuation, followed and resulting from the first and second parts of globalizations and it also has certain distinctions from others bearing certain differences. With respect to the history of globalization, 1980s and its aftermath is the period during which the third part of globalization is being undergone. It is a period very much different from others, complex and multi-dimensional. The fast developments undergone are a wide scale ranging from technology to communications, human life to environment.

Globalization after 1980, basically witnessed the following developments and came into focus: “Activities of companies focusing on the industrial field, fast market changes, stunning developments in product and production technologies and the instigation of competition.” In the post 1990 period, however, this process peaked with the economic and political collapse of former Eastern Bloc countries. These countries dominated by the planned economy started approaching Western countries economically and politically in course of time (Aktan and Şen 1999, p. 12). Most authors argue that especially after 1990, the globalization wave is based on the environment available due to the elimination of bipolar military balance in the world.

The means of the third part globalization are science and technology as researchers can reach a common understanding. Therefore, its period is also named as the Information Age. Oran explains the transition into third part of globalization around the following three events occurring with ten year intervals (Oran 2001, p. 9).

Rule of multinational companies over the world economy beginning from the 70s;

The Communication Revolution generated by the West by putting in place technological innovations such as optical cables, communication satellites, computer and the internet in 80s and 90s, As a result of the dissolution of the Soviet

Union in the 90s, the balance of power's elimination and the re-emergence of the West as the single power elite.

One of the basic dynamics of globalization is communication, one of the main symbols of which is the internet. Internet, which is a revolution in the field of communications is currently used widely and cheaply all across the world. Internet, by forming the World Wide Web (www) connecting billions of people, private entities and states to one another, plays a very important role in the realization of globalization (Aktan and Sen 1999, p. 12).

An important element in globalizations has always been developments in transportation. Alongside innovations in communications, important developments in transportation during all three globalization phases had reinforced each other and consequently globalization had arisen. Another characteristic of the third phase of globalization, however, is the developments in the transportation sector to the extent of eliminating geographical obstacles. In fact, advancing railways and maritime transportation were supplemented by air transportation during this period and transportation had now become both cheap and convenient. No doubt this has great contributions to the formation of a 'global structure'. Therefore, some authors link the current globalization era to these developments (Atasoy 2005, p. 156).

3.4 Dimensions of Globalization

3.4.1 The Political Dimension of Globalization

One of the paradigm debates on the state's political and economic effectiveness in the international system is rooted in an old tradition facing Grotius with Hobbes and De Jure Pacis ac Belli with Leviathan in the seventeenth century. Although Grotius, who was a Dutch lawyer emphasized the roles of individuals and international formations in the international area had ideas concerning the development of inter-state relations. This view of Grotius, though, was criticized by Hobbes who saw international relations as power and conflict focused. According to Hobbes, national interests were related to the notion of national security inevitably (Badie 2001).

The winner of this debate, however, as may be guessed, was the English Hobbes. Symbolically Leviathan was published three years after the institutionalization of the sovereignty paradigm by the Peace of Westphalia. As of this date, the international order came to be seen as the order of sovereign territorial entities. Although the process which started with Westphalia invalidated Grotius' views it had brought him to the role of the mere protester against order. This is because the view adopted by Grotius was non-conforming with the nineteenth century international system attaching priority to inter-state relations and seeing the basic principle of international regulations as the balancing of state powers

(Badie 2001). The same periods were also those of economic relations shaped by mercantilist policies.

The contradiction of Grotius' ideas he had developed around the axes of society, individual, international cooperation and moral norms with Hobbes' state, security and national interest based thoughts caused current debates being made on issues such as the role of the state in the international system, the development of free commerce, international cooperation and integration to be finalized in favor of Hobbes' ideas. As of this period, liberal policies were to be adopted; despite efforts for cooperation basically the determining element is the state. During this process it is also observed that the realist theory is more dominant.

According to realism, the state is the unique and most essential actor of the international system. Since states are rational actors, national security is the most important target. The notion of the individual within the concept of international relations is centered on the state and the international order has fallen much behind the priority issues of realism. While the relation of realism to society and the individual defines the characteristics of the state centered system, it has been shaped with a pessimistic attitude to the human nature it analyzes. Similar to the daily behavior of individuals who are naturally evil, seeking their own interests and ambitious, the roles of states in the international system are also specified around their own interests (Morgenthau 1965, pp. 24–38; Griffts 1999, pp. 1–4).

In this context, especially until 1980s international relations theories have been analyzed on state and system basis. However, starting with the 1970s both transformations in the international system (such as the gaining in prominence of international institutions and multi-national companies) and the coming into focus of different theories to explain the changes being undergone (neo-liberalism, neo-marxism, pluralism, feminist theory and the like) carried the notions of the individual and society to the agenda of international relations (Aydın and Erhan 2004). Thereby, the basic issues of debate on the international system were again placed on the agenda albeit in a different way.

In the framework of international relations and the international political economy, what partially overcomes the ambiguities of the present systemic paradigm debate on the nature of the international system, the role of the state and its relation with society and renders the basic issues of this debate ineffective is globalization. The world order has undergone transformation by two traits rooted in the globalization process. Firstly, globalization has eliminated distances and made it ceased to be a political source. Arguing by complex communication opportunities, the new world order is no longer regional. They turn into relations directly between individuals, arguing by the international flow which can't be controlled by the state and exceeding boundaries. Thereby individuals, international organizations, civil society and formations such as multi-national companies are the potential international actors (Badie 2001).

Secondly; public interest is no longer a sovereign interest: meeting the needs in a global order hint at a global context instead of a national mobilization. The environment, economic and social tension, shelter, the standing of women and human rights has come to be related with international politics instead of states'

internal politics. Moreover, the new actors of the international system (such as regional integrations, supra-national structures, NGOs) challenge states' exertion of absolute power and politics lose its hierarchical position proposed by realism. Therefore, after the cold war the basic debate was related to the multiplicity of actors and differences. In light of the evaluations made up to this point, it is a fact that the world is undergoing a process of transformation. The frequently repeated name of the relevant process is globalization. In order to debate the issue on firmer grounds, it will be useful to examine the definitions and analyses about globalization.

The notion of globalization reflecting the basic trait of today's world, brings about certain debates in different fields to the extent it expresses the rapid integration and assimilation process recently being undergone in the economic, political, social and cultural areas. Although there are quite a few discussion topics on the political dimension of globalization its impact on the nation state and international integrations basically continue in the axis of inter-state cooperation's new dimensions.

Those analyzing the political dimension of globalization will see that the political dimension is directly linked to other dimensions of globalization as well. Especially those analyzing the impacts of political globalization will notice that technological developments ensure the elements underlying the impacts of political globalization. Accordingly, as a result of technological and scientific developments, 'limits' in communication between people have been eliminated, become closer and easier, while relations have well intensified; consequently people have started to become more dependent on one another. It is inevitable for this situation to affect the political area. In other words, it is obvious that political globalization has a close relationship with technological globalization (Somçag 2005).

Understanding globalization's political dimension is especially important with respect to companies' clarification of their international activities. Although globalization generates internationalization or global markets, in the end companies pursue their international activities with the boundaries of a certain nation state and by taking its political dynamics into consideration. At the same time the political impact of globalization on the notion of the state and the rules of the international political system, define the advantages and disadvantages for companies' cooperation in the international area.

While basic values such as democracy, human rights, liberty and the protection of the environment gained universal traits alongside globalization, the nation state also was, as were all ruling means at every level, under the intense pressure of strong trends such as democratization, localization, transparency, participation, flexibility and accountability. Within this framework, strategies such as the down-sizing of the state, privatization, political reforms, transformation of socio-economic policies have become the basic policies of countries (Köse 2003).

Upon the above evaluations, neo liberal policies are emphasized. Nation states are expected to adapt to the new process being undergone and harmonize their economic and political structures to the global system. Similar to the realist paradigm this situation however questions,, the basic theory of international relations

which sees the nation state as the main actor and the sovereignty of the state (Badie 2001).

The sovereign problem of the nation state is a debated issue especially in the context of globalization. One of the most debated issues in the process of globalization is on supra-national structures and the ruling power and sovereignty of the nation state. It is possible to say that developments occurring upon the obtainment of an international characteristic of labor force and production, foremost being capital by surpassing national boundaries have weakened the intervention power of the nation state. Accordingly, a circumstance implying the weakening the economic power of the nation state occurs. Nevertheless, the process of globalization diminishes the states' functions of being welfare states (Yildiz 2005, p. 38).

The sovereign problem of nation states or its manipulative monopoly in international economic and political relations with other actors such as multinational companies are in particular related to cooperation or integrated processes in the international arena. In particular, states shape their national and international policies according to the tendencies of globalization to the extent international capital movements in the global economy and companies' international investments become attractive for states (especially for developing countries). Alongside states being influenced by the political dimension of globalization for the purpose of global competition, the cultural dimension of the process is equally important.

3.4.2 The Cultural Dimension of Globalization

The cultural aspect of globalization can be explained by the constant increase in societies' communication and mutual exchange. Additionally, overall identity structures such as citizen identity are being replaced by different ethnical, religious, social and political identities.

Additionally, the process of societies becoming similar to one another with factors such as consumption and popular culture is the case. Facts such as the presence of t-shirts bearing the US flag nearly everywhere in the world, English becoming a global language, listening to the same music show that globalization also in a cultural sense is being undergone (Köse 2003; Saglam 2007).

Now this and similar conditions are proofs that globalization has started to show itself in a social and cultural sense. Enterprises also determine their own purposes and policies under these conditions. For example, marketing activities have to take these cultural elements into consideration.

In particular global enterprises face both a uniform consumer mass and a diversifying consumer mass. Speaking of becoming uniform, there is a consumer mass which follows up on trends and what is fashionable in the world, having the same tastes especially by means of technology. Additionally, both product variants, impact of competition and policies focusing on customer satisfaction have also created a consumer mass which can have different tastes from one another, is

selective or attaches importance to details. In this context, the marketing process of enterprises define their policies within these two main trends.

3.4.3 The Technological and Communicative Dimension of Globalization

The notion of the "global economy" is becoming a widely used notion both by the public and in the academic field, foremost being in the US. However, although the notion of global economy is being used frequently, new debates also come to the agenda. The points at which the debates on this issue intensify most are as follows: Does the tendency which occurred in the economy recently have a special significance? What will the consequences of global economy be with respect to economic ethics? What will the basic social values be? Will all models provided by global economy cause inequalities to increase or benefits to be eliminated in the social policy field by isolating certain section of society? Discussions in the recent period have focused on the need to examine and define disadvantages with the development of the communication technology (Senkal 2005, pp. 224–225).

In a capitalist economy, two problems must be solved for the system to survive. The first among these two is the anarchical nature of markets determining prices. The second one, however, is establishing sufficient control on the use of labor force in order to guarantee that a value is added to production, thereby ensuring that as many capitalists as possible will reap profits.

The most important characteristic differentiating globalization from previous periods is the spread of production with globalization by global capitalism with the new technologies it uses at an unprecedented pace and level (Saribay 2000). Thereby, there is the need to define technology which is a different dimension of globalization. The process defined as global economy is a digital economy. Digitalization technique means converting all kinds of voice, text, document, music, images, moving objects, virtual conference through digital cameras and all kinds of data into computer bytes comprised of 0s and 1s and later send these elsewhere by mean of telecommunications technology. These codes are deciphered again very close to their original at the point where they have been sent and provided for the use of the receiver (Bayraç 2006).

The foreign trade theory of the capitalist economy, though, is the elimination of obstacles before commerce. From the viewpoint of the classical theory based on the development and support of foreign trade, there are important obstacles before international commerce. These obstacles forming dependency incur significant costs. If costs fall, this may cause international goods and services to be much cheaper than national goods and services. Moreover, with the market gaining an international trait, the mobilization of labor is realized and deepened with respect to the production of technology (Senkal 2005, pp. 224–225).

3.4.4 The Economic Dimension of Globalization

According to the view frequently expressed by many thinkers is that globalization derives its power and rule from the functioning of the economy, i.e. economic laws. According to this view, the first dimension of globalization is economy. The idea that challenges against power, and global and political and other relations we may call supra-structural such as world hegemony after overcoming of basic survival challenges by mankind have brought about globalizations is within the preponderant field of though (Saglam 2007).

Economic globalization expresses in general the integration of country economies, i.e. the integration of the world in a single market. In other words, economic globalization is expressed as the development of economic relations between countries, intensification and spread of mutual interactions at a world scale as a result of the increase in the mobilization of goods, capital and labor between countries (Fischer 2003).

One of the most important developments undergone in the process of economic globalization is the increase in interdependence, cooperation and similarity between countries due to intensified commercial activities. The more commercial ties increase, the more national relations change, international preferences develop, spread or even become obligatory (Aslan 2005). In fact, some developments have had great roles in the international spread, i.e. globalization of trade.

At the start of these developments, there was the efforts at liberalization of international trade at universal dimensions by the elimination of customs tariffs and quotas within the framework of GATT established in 1947 (Presently GATT is replaced by WTO). Additionally, technological (communications) developments of course have important effects. Alongside these developments, costs for transportation have decreased and the international market has come to be more easily followed up (Seyidoglu 2003, p. 189).

Şenatalar states that globalization is not an entirely independent and self-functioning process and that it has accelerated after the policies of developed countries, foremost being the US and international entities, foremost being IMF, General Agreement on Tariffs and Trade (GATT) and then the World Trade Organization (WTO) (Senatalar 2002, p. 11). As expressed before, globalization is a multi-dimensional process. In as much as globalization has a social, political and a cultural aspect, it also has an economic dimension with preponderant aspects (Seyidoglu 2003, p. 189).

The notion of capitalism can sometimes be used in expression and definition of the assimilation processes of world societies and the emergence of a single global culture accordingly; while it can be used in the expression and definition process of societies and identities' own differences. In fact, both these qualities are very much the globalization process itself; globalizing cultural structures and their differences, simultaneity, cohesion and complementariness of cultural practices bringing locality and partiality" (Keyman and Sarıbay 1998).

Approaches towards globalization are divided into three. The first among these approaches is the anti-globalization (traditionalist) which argues that globalization weakens and destroys the nation state and nationalism, places nations under the hegemony of international capital. The second approach however is the approach with extreme supporters of globalization arguing that globalization is an inevitable consequence for the future of the world and supporting the necessity of the global new world order. The third and last approach towards globalization however is the approach comprised by the supporters of moderate globalization, predicating on the standing of the nation state against globalization, pursuing a careful approach as regards standing for or against globalization and refusing the theses of both other approaches (Bozkurt 2001).

3.5 Conclusion

The matter which first attracts attention is the impact of globalization on Turkey, which is starting to be examined, is that Turkey is affected by all of the above mentioned dimensions at a very high level compared to many countries in the world. A fundamental reason of this situation is caused by Turkey's geo-strategic standing. Being situated at a point where the West and East, North and South meet, at the center of Eurasia, Turkey is widely exposed to the influences of globalization. Another reason why Turkey is affected strongly by the process of globalization; however, is the characteristics of people it inhabits within its geography (Bayar 2008).

The process of globalization whereby free market forces free themselves of the control of nation states has transformed into a market mechanism process directing and shaping economy in the international arena. As a consequence, national economies have become more fragile and crisis prone and many countries, also Turkey, have been affected by these circumstances (Ener 2006). This unique geo-strategic standing of Turkey also brings about important results in the field of the economy. This state especially shows itself in the field of energy. Turkey, which is neighboring the richest regions of the world in terms of energy resources, provides the shortest and lowest cost route economically in terms of the oil and natural gas reserves' transport in the East–West route. The realization of the East–West Energy Corridor Project with the contributions of Turkey will reap economic consequences not only regionally but also globally (Bayar 2008). Again, it is seen that with the economic transformation undergone in Turkey after 1980 the import substituting policies pursued by then were abandoned and an open policy understanding has started to be pursued. When one looks into the reflection of globalization's political dimension on Turkey, it is seen that an approach within the framework of universal values has been pursued in the functioning of notions such as democracy, rule of law and human rights. Moreover, Turkey's search for solutions merely by national policies in issues such as combating terrorism, disarmament, illegal migration, corruption, human trafficking being insufficient,

providing solutions for present matters within the frameworks of regional and international cooperation under international policies has gained importance.

The matter which must lastly and essentially be mentioned is that Turkey must not only be affected by globalization but also be able to contribute to the process in order to avoid the negative impacts of the globalization storm and win through. It must pursue a commonplace policy in foreign policy which has a peaceful and reconciliatory identity albeit protecting regional interests, participating in global organization but not attaching its fate solely thereto, which trumps well its advantages due to its geo-strategic standing, attaches importance to democracy and human rights in domestic politics, performs developments in these issues not because of foreign powers pressure but for its people and country, predicates of quality, efficiency and competition in economy, takes and applies measures to use its equities and rich natural sources, young and entrepreneurial labor force instead of foreign capital and loans and which additionally does not compromise its national culture despite adopting global cultural elements, develops both universal and national cultural elements and has a strategic vision respecting its history.

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Chapter 4
Globalization and Social Media Strategies by Financial Institutions Worldwide

Nurdan Oncel Taskiran and Nursel Bolat

Abstract The objective of this research is to investigate financial institutions on social media; their strategies and the ways they deal with customers in the light of the process of globalisation. The objective material is ING Bank and its Facebook site within the process of its institutional expansion worldwide. On four continents, Asia, Europe, North America and Australia; four countries Australia, Canada, India and Turkey are investigated comparatively. For almost ten years, social media using among banking companies has had a remarkable rise especially on Facebook. ING Bank, which was awarded “the most successful effective banking management” in Eastern Europe in 2012, is one of them. The research investigates how far the bank achieves this success online; the discourses between the bank and its customers on Facebook pages. Discourse analysis and semiological analysis are applied to four categories —advertisements, feedbacks, surveys and social activities on Facebook pages in four countries of an international bank within a three month’s period.

Keywords: Globalisation · Banking · Discourse · Social media · Facebook

4.1 Introduction

Being a social media accountant is very favourable nowadays and is a sign of being up to date and proficient in the digital age. It is a must and vital for entrepreneurs, especially for those who are competitors in social media. We have already known that the world is not a small village anymore, thanks to digitalism

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Ü. Hacioglu and H. Dincer (ed.), *Managerial Issues in Finance and Banking*,
DOI: 10.1007/978-3-319-01387-9_4, © Springer International Publishing Switzerland 2014

and the age of speed. Social media, in other words, Facebook, Twitter, Instagram, Blogs, etc. facilitate this speed twice as fast and enable people or institutions to communicate as 'fast as light.' The first popular social media site is Facebook, where news, a photo, an opinion or a suggestion for action is shared, and then almost hundreds or more see it, like it or hate it instantly. People in pursuit of making money, discovered how fruitful social media has become and how earnings would be duplicated via advertisements on the social media pages. Many entrepreneurs in various fields have already attempted to take their places on social media. However, banking was not the first to get involved with social media. ING Bank is one of the more assertive banks with its registered quality in the field of global banking.

ING Bank has many offices around the world; four of them are in Australia, Canada, India and Turkey. The objective of the research is to investigate how ING Global Banking manages social media affairs and how it gets into contact with its customers and what kind of strategies it developed on Facebook. This is an empirical study in which discourse and semiological analyses and the significance of the subject matter is that ING Bank was awarded as "the most successful effective banking management" in Eastern Europe in 2012, with the products and services it provided to global customers. This investigation relates to the ways it deals with its global customers on social media and from that point it is worth investigation. The research is limited to a three month time span: December 2012, January 2013, and February 2013.

Through a quick investigation on the social media, it can simply be recognised that ING banking is one of those whose global banking affairs expanded from America to Australia; Asia to Europe in the world. ING Banking seems well updated with Facebook and has taken its place among Facebook accountants, which is very popular for instant communication among people and private organizations for public announcements or civil public institutions especially governmental or political propagandas all around the world just like an epidemic. Beforehand, it would be beneficiary to learn more about some terms or concepts like globalism, social media, Facebook and the relationship among them.

4.2 Globalism

Ino Rossi points out that the increasing and deepening interaction among different cultures and traditional conflicts. To him, globalism is a process manifested within the social layers of a society itself. These conflicts are motivated by social interest in a society. Gradually, it is accompanied by multi-cultural affairs and information technology as well (Ceylan 2011: 37). What bears a major significance here is its strict observation over intercultural behaviours of people. Countries are in hard rivalry to acquire the capital, which is a principal element of production, on their side. Thanks to ICT developments and globalism, economic and social substratums have to face a radical change (Soros 2003: 2).

One of the crucial points with globalization is some critical thoughts about its eliminating effects on traditional values. It is an inevitable process which can be denied conversely. Globalism establishes a threat against cultural values and identities (Stiglitz 2006: 273). Functionally, globalism was established under intense competition which enables it to set its own separate values. In other words, traditional culture might get harmed.

Some researchers evaluated globalism prior to its political cultural and ideological aspects (Ertürk 2010: 25). One of the factors of its fast expansion lies in the developments of Information Communication Technologies (ICT). Data improvements and ICT developments especially on the internet phenomena affected financial markets directly and inevitably (Ceylan 2011: 52). The undeniable impact of ICT during the 1980's, almost extinguished the concept of "distance" on earth. Within its ideological respect, globalism exists on a dialectical base (Ertürk 2010: 26–27). The Expansion of globalism is not estimated as limited only with the developments of technology and ideology, but also economically. Globalism has an active role on the global integration of expansion and improvement of economic, political, and social systems of countries (Ertürk 2010: 28).

4.3 Social Media: Facebook Phenomena

The internet has become an ubiquitous tool for users ranging from professional careers to casual housewives and being online has prompted curiosity and speculation about the interaction between this technology and individual variables (Mitchell et al. 2011). Therefore, the equilibrium between the counterparts is highly considerable. On Facebook, there is a heterogeneous population on each social level, some are disguised, some fake, and some not. Institutions with a good image and profound vision for the future have to be on good terms with online social media users.

According to Marshall, social media means one or more people connected each other with social activities (Marshall 1999: 4). Thanks to ICT and globalisation, today we have a different sort of media which is called "networking society". Today individuals are surrounded with nets which provide them immense facilities. On the other side, users who are always in front of computer screens, lead to an unsocial life. Social networks can be defined as individual web pages that enable people sharing some fruitful information around and making socialization possible for those who would like to have interactive relationships (Özmen et al. 2011). Contents are bound to people and can be determined independently. In other words, social media eliminates time and space boundaries and develops a kind of communicational system in which mobile sharing based on "discussion". Social media platforms are mainly established on the basis of "communication and "sharing" (Erkul 2009: 8).

Facebook is a networking system which provides people to people interaction and sharing, joining other groups, writing about a subject and expressing his/her

opinion on open access platforms online (Gonzales and Vodicka 2010). Facebook was created by a Harvard University student Mark Zuckerberg to keep in touch with other Harvard students over the Internet and get to know each other better. By the time, Facebook became so popular that is was soon opened to other colleges. By the end of the following year, it was also open to high schools. The year after that, it was opened to the general Internet public. According to the statistics, Facebook has reached 1 billion users in the world and day by day it is increasing. At present, most institutions, companies have Facebook accounts and make their business via online transactions. As a conclusion, explosive innovation, thanks to the growth of ICT, particularly the provision of useful services, largely are unchanged. Socialising, commerce, information finding, entertainment and travel have all undergone profound structural transformations (Shah 2012).

4.4 Globalism and the Importance of Banking

Another aspect in this new world of technology has been the emergence of cross border activities in the financial sector. Global ownership and activities have already come into prominence and the expansion of the ICT at top speed also caused an increase in cross- border capital flows. The major advantages of globalization are easy access to foreign securities thanks to the technological revolutions and the rapid increasing importance of institutional investors and in addition to the diversification of the portfolio (Şener 2012). Along with the technology, the financial sector has been expanding all around and brought services to some daily business. People have benefited from the services of online banking transactions.

> Internet users are now broadly representative of large swathes of the population, with far fewer groups remaining unconnected to the Internet—the elderly, low-educated and disabled being the main examples. From the point of view of public service delivery, it is of course highly important to encourage these groups to get online, to ensure equality of access to the opportunities available there (Shah 2012).

People, in the information society, should be provided with technological services by governmental subsidiaries as a need of cross-border relations.

4.5 Global Banking and Social Media Relations

Establishing groups in the social media are closely related with a social capital idea which is defined as people's social networks and mutual trust that they can draw upon in order to solve common problems. Social capital is very important for improving group social participation (e.g. perceived membership and influence (Tsai et al. 2012).

> Social media consists of tools that enable open online exchange of information through conversation and interaction. Unlike traditional Internet and communication technologies (ICTs), social media manage the content of the conversation or interaction as an information artefact in the online environment (Yates and Paquette 2011).

Banking hosts seem quite beneficial for costumers who are ready to interact online from a social capital point of view.

Social media online systems exposed on banking institutions generally is integration of some new units. Additionally, it also provided standardization of information flow system, improvement of efficiency, recurrence of the same transactions and more work in less time.

Moreover, it decreased labor costs in management, improved efficiency and distribution of management responsibilities and globalization, as well (Işın 2006).

4.6 Banking on Social Media

These days' computers, mobile phones and the Internet serve as central means of communication, social interaction and entertainment, and the popularity of new technology has played a prominent role in the rise of different online networks (Näsi et al. 2011) among the social media sites, Facebook is the first and the most prevalent one. On networking, people have the opportunity of expressing themselves. Therefore, instant availability and having an account on social media is essential for the information society. Social networks gained a lot of respect from many institutions as a source of information and feedback for social networks where most people react negatively or positively but independently. Similarly, Facebook users actively use and follow online banking events or ask questions, provide feedback about transactions or bank officials.

Research demonstrates that 44 % of global customers use social networks in order to get individual banking information. Turkey is categorized as one of the leading countries. Generally, 78 % of customers use social media with the purpose of using banking products and services and 53 % as feedback they experienced (Elhadef and Hatipoglu 2012: 7). Facebook, as the most preferred social site in Turkey, provides an environment on which users evaluate products, experiences, feedback, services, opinions, actions, etc. as favourable or unfavourable independently. As a conclusion to globalisation, Facebook gained a number of banking hosts as new accountants and their customers as well. ING Bank is one of them that participated and established a remarkable position among counterparts.

4.7 General Outlook on ING Bank Facebook Pages

On examining four web pages of ING Bank Global Offices on Facebook, an apparent similarity about the visual frame is remarkable. The orange colour in the background and the lion image on it together are the components of an official ING

Bank logo. Each Facebook Time Tunnel page of ING Bank includes many themes under different titles within Time Tunnel windows. According to their contents, these windows can be classified into seven sections:

Contents relating to ING Bank advertisements, announcements and campaigns and videos relating to products and services,
Customers' Questions &ING Bank Answers; Customers' feedbacks (positive and negative)
Contents relating to ING social (responsibility) activities,
Surveys and contests relating to product and service.

Contents tend to be mostly focused on advertisements, announcements, campaigns and feedback.

4.8 Conclusion

Within the framework of globalisation, financial institutions in a way have been granted to keep in touch with their customers instantly and have an opportunity to be on good terms with them, with the privileges provided by the online world. Networking systems are now very prevalent, apart from the banking web sites, people using social media have easy access to interactive problems on the same site, and therefore social media user banks are mostly current and available. People could ask and complain in any way they like. They communicate with signs as an expression of admire or hate. Therefore, financial institutions have the opportunity of restoring themselves, in the way customers prefer and make a worldwide site that is trustable and efficiently fast.

On a three month's observation, ING Bank Facebook pages seem to include vernacular events as well as banking affairs in accompaniment with pictures in attractive colours. Administrators of pages seem to be supporting the famous PR approach: "think globally, act locally"; which the pages include various kind of announcements, photos, advertisements relating to credit card campaigns, local and universal activities, news, videos, customers' feedbacks, surveys or contests, etc. Before the argument, it would be fruitful for customers to be categorized into two: really involved with financial affairs or probably have plans for the future visit the page just for fun. Recent research shows different kinds of usage like social media for functional benefits, social benefits, psychological and hedonic benefits and it also reveals that the *use of social media is both pleasing and fun for them; Individuals who participate in collaborative environments by expressing opinions and sharing tourist experiences are proud of doing so* (Parra-López et al. 2011).

Finally, four offices on four different continents seem to be applying the same strategies for the social media Facebook users. Let's have a look at how they manage to realise this:

The contents of advertising videos or written announcements are naturally composed of the advertisements everyday watched or met on the media. They are nothing but just repetitions; sometimes there are temporary ones like Valentine's Day Celebration or Australian Cleaning up Day. Facebook pages can be assumed as the smartest way to keep such archives at hand. On the other side, most people who have enough time are affected readily by means of some enticing tricks such as surveys, contests or awards. These are highly attractive means for social media accountants.

The bank could easily attract people and they can read or watch almost everything on the page including complaints, appraisals or any news they would like to hear or read. There are also people really involved with the banking business, as well. The major aim here is to attract people to events as much as possible and persuade them to apply for a credit card or housing loan and reach the customer via Facebook events or emphatic pictures or cute images of a lion logo. There are also nice pictures from real life, working or saluting personnel or contest winners. Today, where advertising has had a major impact on consumers, companies do their best to go ahead. One of the advertising strategies in this way is using a celebrity in an advertisement. ING Bank Global seems to neglect this; there is only a Turkish celebrity, Acun Ilıcalı who performs with a puppet lion in ING Bank Turkey advertisement and videos on Facebook page. There was no any other celebrity performing in the Bank's videos or ads during these three months.

As for feedback, banking personnel who are in charge with finding solutions for the problems written by the customers on Facebook page are almost right. If they had reviewed the page once, they would have got all the answers and wouldn't need to ask the same question again and again on the page sufficient information is given mostly. Sometimes people complain about the slow response time of getting a reply. What most complaints revealed here is related primarily with customer service's rudeness or responding too slow for replies. Secondly comes about the banking processes and interactions and procedures. When people write up with a rightful tone, ING personnel replies in a "copy—paste" structure, with only the names changing. They kindly direct them to another link which the customer gives his ID or problem details, which they seem as if they could provide a solution. A few of them seem to achieve a happy ending.

Some customers are not fully satisfied with the service they receive so they question how ING Bank's was awarded a prize of "the most successful effective banking management" in Eastern Europe in 2012. They even supported each other online. Online social support plays a critical role in a virtual group, which is inherently regarded as an innovative form of a social network linking people, organizations, and knowledge (Tsai et al. 2012).

Another strategy ING Bank applies to online customers especially who is aggressive and rude against the banking proceedings is not replying at all. Especially messages including accusations or insults they do not reply. Sometimes customers are right and the Bank is not fair all the time. They often have errors during interactions or transactions or they are late in doing some transactions or replying or compensating soon; so this causes some financial penalties by the ING

Bank. However, they might not know what the missing thing is or they are too confused and overloaded the whole day. On the other hand, the Bank employs many young people for the future and provides employment resources. However, this situation might have been caused by lack of experience. Replying customers' questions on a fixed format might sometimes cause misinformation and change the course of dialogue in a wrong way, as well. Customers should be treated as do gooders.

> Treating an organization's publics well goes far beyond the tactical and behavioural decisions made when incorporating reciprocity, responsibility, and reporting into the public relations programming. The final stewardship strategy—relationship nurturing—requires that organizations engage in extra efforts to ensure that these relationships are nurtured carefully and consistently. It is vital that practitioners let stakeholders know on a regular basis that they are important to organizations, that organizations respect and care about them, and they appreciate their involvement (Waters 2011).

On the other side, there are many people supporting and following the events or activities taken over by ING Bank. Besides, there are ING personnel who cordially support their employer on any event as well.

Surveys are striking points for customers, but not all the time. That's why a percentage of participation is lower than others. ING Bank should search for or create more attractive contests, concerts or events appealing different classes of society. A major reason for this is low participation must be correlated with the products of the Bank. Unless a customer has a credit card or has an online interaction via smart media, such as mobiles or iPads, nobody seems to acquire the opportunity of joining a contest, which is not fair on one hand.

This research also reveals how far interested a global Bank in social activities. It is clear that they pay much attention to social events like Mother's Day, New Year, Republic Days, and Celebrity Birthdays beyond themselves. Turkish, Indian, Canadian and Australian ING Facebook pages are good examples for this phenomenon. They provide not only their services and products but involve with local and universal events as well. On ING Direct Australia Facebook page "Australian Clean-up Day" is induced with nice scenery of people cleaning up around, which recalls "Think global, act local" approach again which is one of the most successively applied approaches in Public Relations Field. India is a diverse country from a religious point of view but prevalent belief is Islam. By this respect ING Vysa Bank celebrates the sacred day of Islam on its Facebook page, whereas the other ING Bank Facebook pages do not. ING Vysa Bank Facebook page directly appeals to Islamic customers in order to make them feel at home, as their own Islamic Bank. Other pages also celebrate and participate in universal events like New Year and X-mas but, it is inexcusable for ING Vysa Bank neglecting to celebrate a universal day like Christmas!

As a conclusion, it can be assumed that ING Bank social media management strategies are almost the same with each other in different continents. It also implies institutional identity and institutional unity of ING Bank worldwide. Here

it deserves being voted for the most successful Bank rate in the field of "Private Banks and Banking" in 2012.

In the age of digital convergence, social media will lead societies for further steps to learn and teach each other gradually on the way to all kinds of literacy via commercial enterprises like banking business, which has been vital for everyone, anytime, anywhere in the world. Consequently, as a whole, ING Bank is a good candidate for social media global leadership and could be the best anytime, in case it recovers the deficiencies pointed out on Facebook pages by its customers.

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Chapter 5
Economic Approach to Consumption in the Process of Global Crisis: 2007–2009 Period

Serkan Dilek

Abstract According to the micro theory, the household's consumption of goods is strongly related to income. Consumption of some goods may not change as in the proportion of income change. Consumers generally increase luxury consumption, decrease necessary goods' consumption while their incomes increase. At least, it is true in the micro theory. The global crisis, which started in the USA and spread into other parts of the world, can have significant effects on consumption of households. The aim of this study is to research consumption habits of rich and poor Turkish citizens after the start of the global crisis. At first, I want to describe movements of consumptions by studying related literature and at last study Turkish data that was published by TUIK.

Keywords Consumption · Engel law · Necessary and luxury goods

5.1 Introduction

Statistician and economist Ernst Engel studied on the movements and relationships between income and consumption of goods. He revealed income elasticities of some good items. He computed the percentage of incomes spent on each item at different income levels (Ahcihoca and Ertek 2000: 2; Dilek and Çolakoğlu 2011: 1223). The rules known as Engel's laws are:

Percentage spent on food decreases as income rises, Percentage spent on housing stays about the same, Percentage spent on clothing stays the same or increases, Percentage spent on luxury goods increases (Dilek and Çolakoğlu 2011: 1223; Loeb 1955: 20).

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Ü. Hacioglu and H. Dincer (ed.), *Managerial Issues in Finance and Banking*,
DOI: 10.1007/978-3-319-01387-9_5, © Springer International Publishing Switzerland 2014

By using these laws, economists draw Engel's curve which shows the relationship between a consumer's income and expenditure that is spent for related goods. At any point on Engel's Curve, we can calculate the sensitivity of a good's quantity demanded to changes in consumer's income by using income elasticities of demand (Özer et al. 2010: 232). Mathematically, we divide the change in quantity consumed to consumer's income to calculate the income elasticity. Income elasticities need not to be positive. They can be negative, too. In other words, there are some goods that decreases in demand when consumer income increases. These types of goods are called inferior goods in economic literature (Bulmuş 2003: 77; Dilek 2011: 80).

Many emprical studies have been done to reveal consumption patterns of consumers since the last decade of the 18th century (Özer et al. 2010: 232). Barigozzi et al. (2012), studied household consumption-expenditure share distributions by using data of Italian households in the period of 1989–2004. In this study, it was found that the household budget share distributions were stable over time for each category. Han and Ogaki (1997), examined the long-run relationship of consumption and income in the United States. Shamim and Ahmad (2007) analyzes the household consumption patterns of Pakistan society by using Household Integrated Expenditure Survey of Pakistan for the years of 2001–2002 and estimated Engel's curves. Their study, that comprises of 18 commodity groups, showed that consumption of food and non-food items is affected by changes in expenditure and household size. Dilek and Çolakoğlu (2011) examined the consumption patterns of university pupils after the 2007 Global Crisis. They found that expenditures of Turkish University pupils decreased by the effect of the crisis. Also, the decrease in luxury consumption was higher than the decrease in food consumption.

In 2007 a global crisis started in the US financial markets. Because of globalization, it's effects were not limited with several countries and it spread all over the world in a short time. Economists generally agree that today's crises are more risky and damaging then the crises before because it can spread around the world easily (Feldstain 2002: 2; Dilek and Çolakoglu 2011: 1221). Because of the global crisis effect, Turkish GDP per capita rose 4.7 % in 2007, 0.7 % in 2008, but falls 4.8 % in 2009 (www.hazine.org.tr).

In this study, the effects of global crisis to consumption shares of Turkish households are investigated. "Household Budget Survey Consumption Expenditures" for years of 2007–2009, that was published by TUIK, are used to reach the aim of this study.

5.2 Consumption of Rich and Poor

As it was mentioned before, the consumption of the rich and poor are different. The share of food in total expenditure of the poor are generally higher than the rich.

Table 5.1 Percentage of composition of belgium workmen's family budgets 1857

	Family type		
	1 (On relief)	2 (Poor but independent)	3 (Comfortable)
Food	70.9	67.4	62.4
Clothing (include cleaning)	11.7	13.2	14
Housing	8.7	8.3	9
Heat and light	5.6	5.5	5.4
Tools and work supplies	0.6	1.2	2.3
Education, Religion, etc.	0.4	1.1	1.2
Taxes	0.2	0.5	0.9
Health, recreation, insurance etc.	1.7	2.8	4.3
Personal services	0.2	0.2	0.4
Total	100	100	100

Source Loeb (1955: 21); Stigler(1954: 98)

Engel's results stand on Table 5.1. He divided Belgium workmen according to their budget. The third group is richer or having higher budget than second and first group. The third group's share of food expenditure is lower than the share of food expenditure of other groups while opposite for clothing, housing, tools and work supplies, education, religion, taxes, health and recreation etc., personal services. Food is necessary and it contributes to a large proportion of consumption in households. While they become richer they don't increase their food consumption as much as the increase in their income. However, rich workers increase their share of clothing, housing, education, religion, health and recreation consumption in their budget. After these results, Engel published rules which are known with his name.

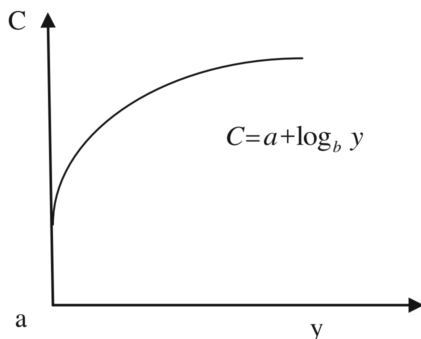
5.2.1 Necessity of Goods

Some goods are needed for living. Though consumers do not have enough income, they still are ready to purchase those certain types of goods. For instance, households need water, food, heating, housing, etc… so consumers can not decrease consumption of these goods to a critical quantity. Consumption is free from income. Thus, some goods are not very important for living such as luxury and cultural goods are in this group.

Consumers spend their income for necessary goods first. If they meet their necessary needs, then they will start to spend on luxury or cultural needs. In other words, expenditure for luxury or cultural goods strongly depend on a consumer's income.

Consumption for necessary goods can be defined by mathematical term (1)

$$C = a + \log_b y$$



Graph 1 Consumption for necessary goods, *source* similar but not the same graph of Mukherjee et al. (2003: 76)

In this term C denotes consumption and y denotes income. Also a and b are positive coefficients (a, b > 0). Consumers must purchase basic foods and necessary goods, they must live in a house. Therefore, they can not live without spending less than a, that is for basic foods, housing etc. This has mortal importance for consumer. Also, the second part $\log_b y$ says that consumption increases less than increases in income. As a consumer's income increases, the substitution effect reveals that consumers start to eat caviar instead of macaroni and live in a better locations. For instance, they sell their house where ever it is and buy a new house in luxurious locations such as Tarabya, Etiler, Ulus etc. Some of the necessary goods are inferior goods that can be defined as goods which are consumed less when consumers have more income.

The consumption function is shown in Graph 1. In the vertical axis, we have consumption and in the horizontal axis we have income. As it is seen, when consumers have no income they spend on necessary goods. After that, as income increases, the consumption curve starts to increase in a slower velocity. Generally, Engel's curve for necessary goods starts from the origin; however, even consumers don't have income they have to buy necessary goods. They can borrow or the government can subsidize them. if they don't meet their compulsory needs, they will not live.

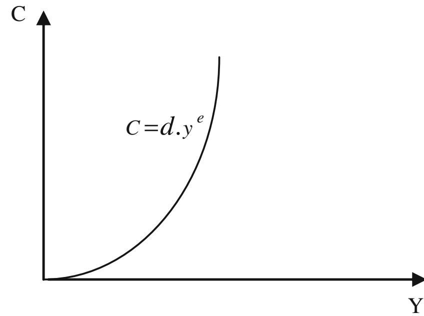
It is obvious that when income increases the share of necessary goods' consumption decreases. Generally, the shape of Engel curves are linked to income elasticities of demand. Income Elasticities of demand is defined as responsiveness of demand to changes in income (Mankiw 1997: 96).

Luxury and Cultural Goods: They have different nature than necessary goods. Consumers can live without spending on cultural or luxury goods. However, if they start on earning more they will start to spend on cultural and luxury goods. In mathematically, the consumption is defined by (2).

$$C = d.y^e \qquad e \geq 1$$

Again, C denotes consumption and y denotes income. This term also shows that as income increases consumption increase faster then the increase in income.

Consumption for luxury and cultural goods are shown by Graph 2.



Graph 2 Consumption for luxury and cultural goods, *source* Mukherjee et al. (2003: 76)

As it is seen in Graph 2, consumers will not spend for luxury and cultural goods if they don't have income. Thus, as their income increases their consumption increases much more than the increase in their income. So, the share of luxury and cultural goods in total consumption increases as consumer's income increases. This fact is strongly related with the consumption of necessary goods. We have seen that consumers will pay less for necessary goods when their income increases. Therefore, they have more money for the consumption of luxury and cultural goods. Shortly, when consumer's income rises the share of necessary goods in total consumption decreases and the share of luxury and cultural goods increases. This is the reason why the richer part of society pay more for luxury and cultural goods.

5.2.2 Household Consumption In Turkey

In this part we investigate the consumption of households in Turkey by using TUIK sources. TUIK listed the income of household from the least amount to most amount and formed a quintile by dividing the number of the households in five equal parts. So, number 1 represent the poorest part of Turkish citizens while number 5 represent the richest part of Turkish citizens. Also, TUIK divided consumption expenditures into 12 parts. These types are (i) foods and non-alcoholic beverages, (ii) alcoholic beverages and cigarette and tobacco, (iii) clothing and footwear, (iv) Housing, electricity, water, gas and other fuels, (v) Furnishing, housing equipment and maintenance of the house, (vi) Health, (vii) Transportation, (viii) Communication, (ix) Entertainment and culture, (x) Educational services, (xi) Restaurants and hotels, (xii) Miscellaneous goods and services.

In the first group these types of consumption are in 3 groups. These groups are (a) necessary goods, (b) Cultural and Luxury goods (c) Others. I do not include Miscellaneous Goods and services to my analyze (Table 5.2).

Necessary Goods: Necessary goods are goods that are necessary for living. People can not live without eating, drinking or housing. Also, if they have problems with their health they must spend for some medicines or health services. Because of all these factors, (i) Food and non-alcoholic beverages, (ii) Housing,

Table 5.2 Necessary goods, cultural and luxury goods

Necessary goods	Cultural and luxury goods	Others
(1) Foods and non-alcoholic beverages (2) Housing, electricity, water, gas and other fuels, (3) Health	(1) Furnishing, housing equipment and maintenance of the house (2) Transportation (3) Communication (4) Entertainment and culture (5) Educational services (6) Restaurants and hotels	(1) Alcoholic beverages and cigarette and tobacco (2) Clothing and footwear

Table 5.3 Consumption expenditures for necessary goods

Quintiles ordered by income	Foods and non-alcoholic Beverages			Housing, electricity, water, gas and other fuels			Health		
	2007	2008	2009	2007	2008	2009	2007	2008	2009
1	34.8	33.7	34	28.7	30.7	29.7	3	1.8	2.2
2	29.2	27.3	28.3	32.1	32.1	31.7	2.2	1.7	2.1
3	26	25.2	25.4	31	31	30.4	2.3	1.8	1.6
4	22.6	22.2	22.5	30.8	29.6	28.6	2.2	1.8	1.9
5	18.3	17.2	17.4	25.6	26.2	25.3	2.4	2.1	1.9

Source TUIK (2010: 5, 2011a: 4, b: 5)

electricity, water, gas and other fuels, (iii) Health is necessary for people. Though Engel's law says that consumption of housing stays about the same as income increases the consumption of housing may have different characteristics than he says. Because one of the consumption items firstly should be considered by consumer is housing. People have problems in living without housing or heating. Therefore, housing should be classified as necessary goods. Consumption patterns of Turkish households for necessary goods after 2007 crisis is given in Table 5.3.

As it is seen in Table 5.3, the share of necessary good's consumption in richer citizen's budget is less than poorer ones. One exception is in 2008 data for health;however, this consumption is strongly linked with health problems of people. Though, the poorest part (quintile 1) spent more than the richest (quintile 5) we can not say that health is not a necessary good. Most probably in 2008, richer ones had more problems about their health. When we set up the lienar regression model, it is seen that independent variable "income" can explain 97.5 % (R square) of dependent variable, "share of foods and non-alcoholic beverages consumption in budget". This score is very high for R-square. The linear regression equation is $C_f = 37{,}777 - 3{,}890Y$ while y represents income and C_f represents share of foods and non-alcoholic beverages consumption in budget. However, the linear regression model is not meaningful for share of housing, electricity, water, gas and other fuels items. Because income only explains 44, 2 % (R square) of dependent variable "share of housing, electricity, water, gas and other fuels in budget". Thus, linear regression model is not meaningful for health items because of 3.3 % (R square). But it is obvious that data (only 3 years) is not enough for reliable the regression model.

In Table 5.4, I added the three consumption items.

Table 5.4 Consumption expenditures for total necessary goods

Quintiles ordered by income	2007	2008	2009
1	72.6	66.2	65.9
2	63.5	61.1	62.1
3	59.3	58	57.4
4	55.6	53.6	53
5	46.3	45.5	44.6

Source TUIK (2010: 5, 2011a: 4, b: 5)

We have three important results from Table 5.4. Firstly, the share of necessary goods on a consumer's budget is very high, higher than 50 %. Secondly, Table 5.4 confirms that as the consumer's income rises, the share of consumption expenditures for total necessary goods on consumer's budget decreases. Thirdly, the share of necessary goods on a budget has decreased since 2007. The reason of the first result is very simple, people generally focus on important needs for their lives. After they meet their important needs they start to consider about their other needs. The reason of second one was explained before. The reason of third one should be discussed by economists. We can set up a linear regression model for consumption expenditures of total necessary goods. Income can explain 93,8 % (R square) of dependent variable, "share of total necessary goods in budget". This score is high enough for linear regression model. The linear regression equation is $C_N = 73{,}757 - 5{,}370Y$ while y represents income and C_N represents share of total necessary goods consumption in budget. Also this equation shows that as income increases, the share of total necessary goods decreases.

Cultural and Luxury Goods: Cultural goods are goods that are consumed because of the culture of society in which a consumer lives. Luxury goods are goods that increases with the increase in income. They have a higher income elasticity of demand. Sahalia et al. (2004): 2959 defined luxury goods as goods which have a low marginal utility even at very low consumption levels. In this category, I added (a) furnishings, housing equipment and maintenance of the house, (b) Transportation, (c) Communication, (d) Entertainment and culture, (e) Educational services, (f) Restaurants and hotels (Table 5.5).

All of these consumption expenditures show the same characteristics. As income increases the share of them in the budget increases. There is no exception in whole. Poorer households consider purchasing necessary goods instead of furnishings, transportation, communication or other luxury and cultural goods. However, if they get more money, they will purchase luxury furnishers for their house, use their cars instead of buses, use telephones or mobile phones, read more books, go to cinemas or theatres, consider about educational programmes, and go to restaurants rather than eating at home.

Linear regression models for furnishings, housing equipment and maintenance of the house (R square: 57, 1 %) are not reliable. We can set up a linear regression model for consumption expenditures of Transportation. Income can explain 85, 8 %

Table 5.5 Consumption expenditures for luxury and cultural goods

Quintiles ordered by income	Furnishing, housing equipment and maintenance of the house			Transportation			Communication		
	2007	2008	2009	2007	2008	2009	2007	2008	2009
1	5.6	5.2	5.1	5.9	7.6	7.5	3.6	3.7	3.5
2	5.7	5.6	6	7.9	10.7	9.2	4.1	4.1	3.7
3	5.3	5.9	6.2	9.4	11	11.3	4.4	4.4	4
4	6.1	5.9	6.1	11.2	14.3	13.9	4.8	4.6	4.5
5	6.2	5.9	6.5	14.4	18.3	17.7	4.8	4.5	4.6
	Entertainment and Culture			Educational Services			Restaurants and Hotels		
1	1.2	1.2	1.6	0.5	0.7	0.7	2.8	2.7	3.1
2	1.4	1.9	1.6	1	0.9	0.7	3.5	3.7	4.1
3	1.7	2	2.2	1.7	1.5	1.2	4.1	4.1	4.7
4	2	2.6	2.8	1.8	1.7	1.6	4.3	4.5	5.2
5	2.8	3.2	3.3	4.4	3	3.1	5.7	5.1	6.2

Source TUIK (2010: 5, 2011a: 4, b: 5)

(R square) of dependent variable, “share of transportation in budget”. This score is high enough for the linear regression model. The linear regression equation is $C_T = 4{,}313 + 2{,}347Y$ while y represents income and C_T represents share of transportation consumption in budget. Also it shows that as income increases, the share of transportation in budget increases. The similar relation is true for communication (R square: 85.2 % and regression equation: $C_C = 3{,}4 + 0{,}273Y$, C_c: share of communication consumption in budget, y: income), entertainment (R square: 85.1 % and regression equation: $C_E = 0{,}790 + 0{,}437Y$, C_E: share of entertainment consumption in budget, y: income), education (R square: 0,772 % and regression equation: $C_{edu} = -0{,}337 + 0{,}657Y$, C_{edu}: share of education consumption in budget, y: income), Restaurants and Hotels (R square: 87.1 % and regression equation: $C_R = 3{,}4 + 0{,}273Y$, C_R: share of Restaurants and Hotels consumption in budget, y: income). All of these regression models show that as income increases the share of these consumptions related expenditures increase, in other words there is a positive relationship between dependent and independent variables.

Total consumption expenditures for luxury and cultural goods are given in Table 5.6. It is obvious that the richer citizens pay a lot for consumption of luxury and cultural goods. Another interesting result is that the share of luxury and cultural goods in consumer’s budget has increased since 2007.

We can set up linear regression model for consumption expenditures of total Luxury and Cultural goods. Income can explain 93.8 % (R square) of dependent variable, “share of total luxury and cultural goods in budget”. This score is high enough for the linear regression model. The linear regression equation is $C_{LC} = 15{,}670 - 4{,}570Y$ while y represents income and C_{LC} represents share of total necessary goods consumption in budget. As income increases the share of cultural and luxury goods in budget increases.

Table 5.6 Consumption expenditures for total luxury and cultural goods

Quintiles ordered by income	2007	2008	2009
1	19.6	21.1	21.5
2	23.6	26.9	25.3
3	26.6	28.9	29.6
4	30.2	33.6	34.1
5	38.3	40	41.4

Source TUIK (2010: 5, 2011a: 4, b: 5)

Table 5.7 Consumption expenditures for alcoholic beverages and cigarettes, clothing and footwear

Quintiles ordered by income	Alcoholic beverages and cigarettes			Clothing and footwear		
	2007	2008	2009	2007	2008	2009
1	5.7	5.2	4.1	4.9	4.5	4.4
2	5	4.7	5.5	4.7	4.3	4.5
3	4.9	4.4	4.7	5.6	5	4.7
4	4.2	3.6	4.7	5.7	5.3	4.8
5	3.5	3	4.1	6.9	6.3	5.8

Source TUIK (2010: 5, 2011a: 4, b: 5)

Third group of goods are others including alcoholic beverages and cigarettes and tobacco, clothing and footwear. They have different characteristics then the former groups. At first, alcoholic beverages and cigarettes are goods for addicted people. Addicted consumers drink or smoke the same alcoholic beverages. Rich and poor consumers purchase, the same brand of cigarettes and alcohol, so they pay the same. If their income increases the share of expenditure for alcoholic beverages and cigarettes decreases. It can be seen that this is true for Turkey between 2007–2009 term from Table 5.7. Another different consumption item is clothing and footwear. At first, it can be thought that clothing and footwear is a necessary good, but not luxury goods. However, today brands have weight in clothing consumption. As people get richer they become ready to pay more for brands. When they have limited income they just wear cheaper clothes and footwear. But if they earn more money, they start to purchase more expensive clothes and footwear that have popular brands. Therefore, as their income rises the consumption expenditure for clothes and footwear increase, too. So, the share of expenditures for clothes and footwear increase. Table 5.7 confirms this proposition. In addition to this, people can not live if they don't wear clothes or shoes. Thus, clothing and footwear are also necessary goods. Shortly, clothing and footwear are both luxury and necessary goods.

The share of alcoholic beverages and cigarette consumption in a consumer's budget decreases as income of consumers increase in 2007 and 2008. However, it did not obey this rule in 2009. The share of clothing and footwear in a consumer's budget increases as income of the consumer increases, so it shows the same characteristics of luxury goods.

5.3 Conclusion

Consumers generally consider their necessary needs first, then they think about about other needs including luxury and cultural needs. After Engel's study many emprical studies have been carried out and it is seen that different goods have different income elasticities of demand. Also, the global crisis has had effects in Turkey as all other countries in the world. A crisis has significant effects on a households' budget and income.

The aim of this study is to research about consumption patterns of consumers after the crisis. After the crisis, the characteristics are not much different than the propositions of the study. As income of consumer rises the share of necessary good's consumption decreases and the share of luxury and cultural good's consumption increases. Another solution is that the share of necessary good's consumption have decreased while the share of luxury and cultural good's consumption have increased since 2007. This solution should be discussed in further studies.

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Chapter 6
The Changing Role of the Central Bank of the Republic of Turkey and Its Financial Implications on Turkish Economy

Secil Senel

Abstract Central banks are extremely important institutions responsible from the coinage, monetary policy applications and healthy operations of the economies. The policies applied by Central Banks and their ongoing corporate structures cannot be disassociated from the political, social and the whole economic developments of the countries in which they are located. The concept of the central bank, which has been in development since the twentieth century first appeared in Turkey in the 1930s. In this chapter the monetary policies of the Central Bank and their effects on the Turkish economy are discussed in periods by examining the concept of the Central Bank of Turkey and its aims.

Keywords Finance · Central banking · Institutions · Policy · Economy

6.1 Introduction

The central banks which represent the monetary authority and organize the monetary structure were usually known as banks of issue or national banks until the twentieth century. The development of the identity of banks as central banks started with the necessity of the organizing the export of paper notes and the need of the state for short term loans (www.tcmb.gov.tr).

The structural differentiation between the functions of the central banks and other banks brings the necessity to define "Central Bank" by keeping this function in mind. (Serdengeçti 2004, p. 3) Central Banks are usually seem like the bank of banks, the coordinator of the banking and monetary structure (Telman 2001, p. 31).

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Ü. Hacioglu and H. Dincer (ed.), *Managerial Issues in Finance and Banking*,

DOI: 10.1007/978-3-319-01387-9_6, © Springer International Publishing Switzerland 2014

The development of the central banks started mainly in the twentieth century. Especially the financial need created by the First World War, high inflation and the sudden rise in the economic growth increased the need for the central banks (Oktar 1996, p. 26). The first bank which has the qualities of the central banks is the Swedish State Bank (Riskbank) founded in 1668. Following the world's oldest bank of issue, the Swedish State Bank, the bank of England which is an example of the world central banking founded in 1694 (Zarakolu 1989, p. 5).

Although the idea of founding a central bank in Turkey was brought forward in the time of Committee of Union and Progress; the Central Bank Of Turkish Republic founded in 1931. Having the right of being a bank of issue, it has been authorized to carry out specific monetary and loan actions. The Law of Central Bank has been changed in the direction of being in conformance with the requirements of that time.

The central bank, in addition to its classical functions as working as a state bank and creating money as a governmental body; is also a part of the financial system as an institute which formulates and applies the monetary and loan policies by using specific instruments which effect the direction and use of the sources, cost, level and the state of funds (Aydın 1980, p. 25). The task of the central banks changes according to the level of development, size and the banking system of a country. The first and foremost task of the central bank, without question, is to create the price stabilization in a country (Tokgöz 1995, pp. 5–12).

The main task of the central bank is to preserve the domestic and foreign value of the money. While preserving the domestic value of the money means the preserving of the purchasing power of domestic market; the preserving of foreign value means preserving the value of the money against foreign money. (Capie et al. 2003, p. 4) The responsibility and duties within the scope of aforementioned Central Bank main functions, modelling of the world economies, improvements in the information technologies and new situations arising have affected the functions of the central banks (Erçel 1999, p. 12). Central banks meet the requirements of the governments and commercial banks by safe keeping the assets of the commercial banks, lending money to commercial banks when needed and accumulating assets for the treasury (Allen 2003, p. 101).

The main function of the central bank is to manage the money supply of the economy by making monetary and loan policies and applying them in accordance with the economic and social goals. While dealing with the liquidation problem of the economy; it tries to affect the money supply by making use of the rediscount rates, open market operations and deposit provisions tools. Thus it is a key institution being active mainly in the monetary market of the finance market. As a key institution in the money market, it is in a close relationship with other financial intermediaries, Commercial Banks, Liquidity management instruments and fund offering entities and users (Aydın 1980, p. 25).

Funding sources of the central bank consists of bank notes currently in use, asset reserves together with the partnership capital and retained earnings and the capital usages consist of gold, foreign currency, advances, rediscount actions and state bonds and bills. Since the central bank sources have a short term

characteristic, this situation impels the central bank towards making an investment to the short term capital markets, in other words money market. Thus the central bank is more an instrument of money market than capital markets and the effects of the central banks to the capital market occur indirectly rather than directly, in other words by way of financial intermediaries.

The direct effect of the central bank to the capital market is carried out by investing in treasury bills and open market actions and depositing the asset reserves gained from the banks into middle and long term loans. Its indirect effect is carried out especially by affecting rate of interest, money supply and macro conditions in which the intermediaries work together and the volume and conditions of the capital flow to the banks from the central bank and also affecting the activities of financial intermediaries in the capital market (Aydın 1980, p. 27). Central banks have the power and the inspection instruments which can return profit but the main goal of them is not gaining profit. They release banknotes which has no interest yield and which the public wants to keep as it is a legal currency for every kind of special and public debt and thus they lend money without interest.

In case of occurring an economic recession or depression, the central bank weakens the elements which bring down the economy by releasing additional money or loan to the system. In the case that the economic revival is too much, the central bank slows the growth by withdrawing money and loan from the market. The central banks are in a situation in which they inspect the money stock, interest rates and loan conditions themselves since they have the monopoly situation on the coinage and commercial bank reserves (Allen 2003, p. 101).

6.2 From a Historical Perspective: Policies and Implications of CBTR on Economy

The thought of founding a state bank first came into light at the time of the Ottoman Empire and continued intensely later, at the time when Turkish Republic founded. The idea of founding a national central bank first came into the agenda in İzmir Economy Congress held in 1923 (Tekeli and Ilkin 1997, p. 246).

The first evidence of the idea to found a central bank appeared in the government program which had been read on 5th of November 1927 in the Turkish Grand National Assembly. Together with the background information which has been made by the foreign and domestic consultants CBRT has been founded on accordance with the Central Bank of the Turkish Republic Law numbered 1715 which has been accepted by TBMM on 11 June 1930 (Kazgan and Koraltürk 2000, p. 93). CBRT has been founded as an anonymous company which has the privilege of coinage (Parasız 1997, p. 220). The coinage privilege of CBRT which was for 30 years when it was first established later extended with an amendment made in 1955 up to 1999 and then extended indefinitely with a second amendment.

(www.tcmb.gov.tr/a) With the foundation of CBRT the system of reserve in the coinage has stopped to be used and instead of gold standard, the bank note system which has compulsory circulation has been adopted (Özdemir 1987, p. 7). Since CBRT has the authorization of printing bank notes and collecting the state deposits it has not been directed to collecting private deposits. Thus, it has not been made to compete with other banks and the superior bank status of CBRT has been preserved (www.tcmb.gov.tr/a).

6.2.1 The Period of 1932–1950

Since the economy of Turkey is largely depending on agriculture; while the economy and inflation fluctuate, the exchange rates followed a steady route. While the coinage carried out in a limited amount in the first half of 1930s; in the second half of the 1930s the volume of bank notes issued has increased considerably due to the effect of 2nd World War. The main monetary policy instrument in this period is the rediscount rates which were determined by CBRT itself (Karluk 1996, p. 212). In these years the authority to determine the deposit and loan interest limits and compulsory reserves is not in the hands of CBRT and these reserves were allowed to be used by the banks (Hiç 1994, p. 429).

1940s are the years in which the negative effects of the 2nd World War have been felt and the start of tendency to the usage of the central bank sources aimed at public finance needs has begun. In this period the Central Bank in Turkey was active towards the deficit financing of the public rather than managing an independent monetary policy under this tendency. Thus the general price levels in the period of 1938–1948 have increased more than threefold (Serdengeçti 2004, p. 12).

6.2.2 The Period of 1950–1960

It may be said that this period is a milestone for CBRT. The financing of the economic growth and the budget deficits of the period with the sources of the CBRT caused the inflation to soar. The maximum interest rate to be applied by the banks to the lending actions and the maximum interest rates to be paid to deposit have been decreased. The principle of Amortization and Loans fund depositing on account of the CBRT has accepted and thus, the %20 of the total gathered deposit to be transferred to the public sector finances has become clearer. The idea of compulsory reserves to be extended as loan by CBRT has been accepted (Karluk 1996, p. 212). Another characteristic of the period is the raise of the negative real interest rate provided to the public enterprises by CBRT. Losses arising from the Agricultural Products Office price regulations have been compensated with the CBRT loans (Karluk, 1996, p. 213).

6.2.3 The Period of 1960–1970

In this period which the planned economy mentality became prominent, it could be said that the monetary policy was applied within the scope of development plans and the monetary control was provided by CBRT. In the 1960s the monetary policy was managed by compulsory reserve policies, selective loans and effective usage of rediscount loan interests. Also it can be seen in this period the debts of the public to the CBRT turn into long term non-performing loans (Hiç 1994, p. 154). With the law dated 12.05.1961 and numbered 301, the obligation of the compulsory reserves to be deposited to CBRT has been accepted. Thus the effectiveness of the application of compulsory reserves and the monetary control ability of the CBRT has been improved. Work has been done towards blocking the compulsory reserves deposited to Amortization and Loan fund in CBRT and bringing a control mechanism property to the compulsory reserves (Hiç 1994, p. 155).

The tendency of the having the monetary policies in the central banks revealed itself for CBRT as well and it has been started giving place in the development programs to restructure the duty and authorities of the Central Bank according to changing economic conditions (Dogruel and Dogruel 2005, p. 57).

6.2.4 The Period of 1970–1980

With the 1211 numbered law it has been aimed that the CBRT to be equipped with the required monetary instruments and to become an institute which plays an active part in the development of the Country’s economy.

All of the authorities which belong to the Bank Loans Organizing Committee have been transferred to CBRT. For the determination of the highest interest rates in the loans and deposits, authorization has been granted to CBRT via Higher Planning Council by the Council of Ministers. In order to regulate the money supply in the market, the authorization of carrying out the open market actions which is faster and more effective method than the rediscount mechanism has been given to the bank for the first time with this law (Hiç 1994, p. 432).

6.2.5 The Period of 1980–1990

Turkey has entered into a new economic era with the Decisions of 24 January 1980 and the CBRT monetary policy has changed a great deal depending upon these decisions. CBRT, while applying its loan policy; enabled the aim of using the loan system on accordance with the development plan and programs in such a way that it will make the management more appropriate by raising the shares of export

loans and investment loans in the private loans, raising the loan share of the private section by gradually lowering the share of the public loans in CBRT loans due to the not using the application of open financing (Önder 2005, p. 153).

The banks are set free to determine the interest rates of the loans they provide and to apply to the term deposits, the method of interest cap determination of the CBRT has been discontinued. Fixed exchange rate policy has been devalued on 25 January 1980 as 1TL = 70 US Dollars and a change has been made for the daily single exchange method rather than the multiple exchange rate method. The exchange rates started to be determined daily by the CBRT.

Since January 1986, a principle consisting of the necessity to transfer %20 of the foreign currency and effectives gained from the export to CBRT and in exchange for the foreign currency accounts opened in these banks a necessary %20 compulsory reserves to be made in CBRT has been brought forward (Dogruel and Dogruel 2005, p. 58).

In 1986, CBRT has started to try to make monetary aims without announcing to the public which is a pretty important policy change (Uygur 2001, p. 12). CBRT has aimed to control the TL reserves of the banking section for both following a more efficient interest policy and by the way of controlling the liabilities of the banks to control the money supply in a roundabout way (Dogruel and Dogruel 2005, p. 58). Since the middle of the 1980s the autonomy of monetary policy application using the market instruments has been given to CBRT and Eximbank, which enables CBRT to transfer its duty of encouraging the foreign trade and improving the export has been founded (Akgüç 1992, p. 19).

In 1988, the system of determining the foreign currency exchange rates in market conditions has been taken up and Directorate of Foreign Currency and Effective Markets have been founded. Another innovation is due to the limitation of the tender interests by the Treasury the lower than expected sales rate of the State Domestic Deed of Loan, the banks are set free to determine the interest rates they apply to their deposits in order to prevent the demand for the foreign currency since September 1988.

In this period the monetary policies of the CBRT has transformed into a more indirect instrument rather than direct instrument. Also the application of middle and long term rediscount has been discontinued since 1 January 1990 (www.tcmb.gov.tr.).

6.2.6 The Period of 1990–2000

With the 1990 monetary program, the central bank set some goals for total balance size, total domestic liabilities, total domestic assets and Central Bank money by limiting the expansion of the loans and wanted to take this under supervision (Kesriyeli 1997, p. 17). In 1993; a large proportion of the CBRT loans have been strengthened and activated in the CBRT balance starting with the short term advance provided to the Treasury.

Since there was no proper ground for foreign debts, in the first months of 1994 a leap in the loans provided to the public by CBRT has been noticed. On the other hand in the same period the reserve money has increased a little and the domestic assets are increased together with the foreign currency liabilities. CBRT tried to keep the stability by using the foreign currency reserves. However 1994 crisis occurred in the over-valued Turkish Lira (Karluk 1996, p. 236). After the crisis, the precautions taken on 5 April 1994 were aimed to raise the banking sector supervision and independent role of the CBRT and to lower the public deficits and to enable the permanent economic stability. The announcement of exchange rates which carry the indicator attributes of the exchange rates formed in free market by CBRT have started. According to the Stand-by agreement with IMF the compliance of CBRT to some goals similar to domestic assets, official reserves has made compulsory (Dogruel and Dogruel 2005,p. 71).

When looked at the monetary policies applied in 1995 it can be seen that the policy which started to be applied previous year was still in use. 1995 has become a year for CBRT in which the application of direct monetary policy instruments was discontinued and indirect monetary policy instruments were started to be used (www.tcmb.gov.tr). It has been the priority of the CBRT to lower the foreign exchange rate fluctuations to a minimum while keeping the reserve money within the limits which is one of the main goals of the 1996 year monetary policy (www.tcmb.gov.tr).

In the monetary policy of 1997 it has been aimed to prevent the sudden price movements in the market and to decrease the uncertainties in the market. As the main policy variable, money has been chosen. Acting with the view of together with the control of the reserve money, other monetary quantities can be controlled as well.

In 1997 with a protocol between the CBRT and Treasury, Treasury has given up the usage of the short term advance account. In the monetary policy of 1998 the reserve money has been chosen as the goal again. With the reserve money increase staying at a determined target range, the struggle with the inflation has become more important. CBRT, whose balance had begun to decrease, has been completely liquidized throughout the year for the medium term rediscount loans (www.tcmb.gov.tr). The monetary policy of 1999 has been determined to create stability in the money markets and in compliance with the goals of keeping the inflation under control, just like the one in 1998 (Şahin 2007, p. 474). The buying and selling interferences of CBRT are for achieving the basket of currency exchange rate goal. In order to prevent the liquidation problem due to the exogenous shocks, the interest rates set free and work towards keeping the value of Turkish Lira within the determined rate policy scope has been carried out.

In 1999 CBRT has started two new applications. First one is the daily limit application for the needs of daily occurred urgent fund needs to be met and the obstructions in the payment system to be resolved. The second one is the allocation of the Futures Limit for gaining the Futures a depth and regularity except for the borrowing limits left for the Interbank operations.

6.2.7 *From 2000 to the Present*

As a result of the economic crisis of 2001 the floating rate regime has been started. A structural transformation has begun in the economy after the crisis. The main goal was the creating the required structure in order to present the inflation targeting regime which is a modern monetary policy strategy and started in 2006. CBRT has directed its monetary policy works within the scope of inflation targeting regime and stated that the end target is to use inflation targeting regime since the year 2000 (TCMB 2006, p. 16).

Thus, since it would be hard to make an assumption about the next term inflation when the preconditions of the inflation targeting regime and when the inflation is very high and unstable; is has been decided to start using the inflation targeting only when the inflation target is lowered to a certain degree and then to start the usage of inflation targeting regime. During the period which is called implicit inflation targeting, along with the inflation targeting, monetary indicators have also been set an aim for (Akgüç 1992, p. 29).

From the date of 1 January 2006, CBRT has changed from implicit inflation targeting to open economy inflation targeting. With the inflation targeting regime Turkey has gained important acquisitions. The most important of which are: breaking the chronic high inflation process and the approach of inflationist pricing, the trust to the domestic currency regained due to reverse dollarization, decrease of the financial domination and the disciplining of the public debts and the increase process of the general economy due to the loaning the fundable resources which transferred to the public debt, to the private sector (TCMB 2006, p. 24).

6.3 Conclusion

With this work the activity of the Central Bank on the Turkish economy by certain periods has been stressed and is has been seen that the Central Bank which has an independent auditory structure, is one of the invariables of the economy and with the interventions it directs the economy. CBRT is a very active institution in the economy of Turkey having regulatory, directing and auditory power. CBRT is an institution which has been equipped with important authorities in the centre of the financial system and controls the sourcing.

As a result the Central Bank of which legal duty is to create the price stability will go on to its applications about activating monetary policies and liquidation management just as it has done until now and will do in the future. Within this scope according to the unexpected changes in the money markets and occurring needs, it will intervene the market with the applications of monetary policies in liquidation strategies.

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Part II
Risk Management and Auditing

Chapter 7
Financial Risk Management and Hedge Accounting

Ali Kablan

Abstract In recent years enterprises have met many risks as a result of rapid developments in business life. Minimizing the losses in investments which are made by enterprises or the financial risks that are taken in case of borrowing in an environment which has intense competitive conditions has become an important necessity. One of the most basic ways to deal with these risks is the use of derivative instruments. It is well known that derivative instruments are the tools which are used by enterprises in order to reduce or cut the financial risks which affect the financial structure of enterprises in a negative way. In the study IAS 39 Financial Instruments: Cash accounting and Measuring Standard which are subject to derivative instruments, have been examined and this study includes also hedge accounting.

Keywords Derivative instruments · Financial risk · Hedge accounting

7.1 Introduction

Both developed and developing countries are concerned with the developments in the international financial markets. Financial risk management has gained importance with the tendency of globalization in the world's economy, technological developments, rates of interest, foreign exchange rates and sudden changes which occur in the price of products. Bretton Woods system, founded in 1944 and based on a fixed exchange rate system, operated until the middle of 1960s but it was abolished by the industrialized countries' money which was left to float freely on March 1973. With the end of Bretton Woods, fluctuations in exchange rates

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Ü. Hacioglu and H. Dincer (ed.), *Managerial Issues in Finance and Banking*,
DOI: 10.1007/978-3-319-01387-9_7, © Springer International Publishing Switzerland 2014

exposed enterprises to risk of exchange rates (Chambers 2007, p. 1). Correspondingly, changes in interest rates in the international money market have brought forward the problem of high interest rate risk (Kaygusuzoğlu 2011, p. 138). As a result of these developments derivative instruments have begun to be used in order to calm the markets at the macro level and implement an effective policy of minimizing the risks which arise from the uncertainty of the future at enterprise level.

7.2 Derivative Instruments

Derivative instruments have emerged because of the demand for products which cut or reduce the risks that the enterprises have met. The first derivative instruments that appeared on the market were forwards, futures, options and swap agreements (Selvi 2000, p. 6). Derivative instruments are the agreements done between two parties. In these agreements, one party accepts to pay cash to the other party at a particular date or at any time corresponding to the one party that gets financial instruments, products or money (Turkkan 1999, p. 5). Derivative instruments can affect the risks which enterprises are exposed to. By using derivative products it is possible to get rid of unwanted risks and change the direction of the risk which is taken.

Derivative instruments: It is used to describe wide variety of products which take their value and price from another financial instrument that they are connected (Loader 2005, p. 11). On one hand derivative instrument agreements reduce the transaction cost in the markets where the investment and transaction are made, on the other hand it facilitates hedging and increases the depth of the markets. Forward transaction agreements: It is over the counter (OTC) market transaction which put an obligation to buy or sell a property on the agreed price in a specified future date over the counter market (OTC) is a disorganized market. A future agreement has the same aim and feature as a forward agreement. The main difference between them is that future agreements have standards and they are traded in stock markets.

The difference of option agreements from future and forward agreements is that option agreements provide a right to buyer and do not leave the buyer under obligations in accordance with the product which is bought or sold. The said right is obtained by paying an option premium (Turkish Derivatives Exchange 2008, p. 215). Swaps which change the floating and fixed cash between the parties and provides risk management of exchange rate and interest rate is an agreement (Chambers 2007, p. 2). In swaps the exchange of financial instruments or money on a specified rate on a specific date in the future is possible (Selvi 2000, p. 22). A swap agreement is an exchange transaction which is based primarily on economist David Ricardo's theory of comparative advantages and in which the parties can reduce the credit cost by changing the interest or foreign exchange rate (Tenker 1999, p. 376). In a swap agreement, the real debts do not change and both

parties pay their debts on time. Change is made on hypothetical capital. (Sevilengül 1999, p. 279)The intended usage of derivative products can be divided into three groups. These are (i) hedging (ii) speculation (iii) arbitrage. Derivative market investor types are the protectionists who want to reduce or cut the risk, the speculators who take risk in order to make profits, the market makers who build liquidity by trading and arbitrager who are trying to make profits from price imbalances.

7.3 Financial Risk Management

Today financial risk not only determines the profitability of the enterprises but it also decides whether the enterprises exist or not. Exchange rates can cause unexpected changes in interest rates, commodity prices and can pose risks that cannot be ignored. From now on it is not enough for enterprises to have the most advanced manufacturing technology, to find cheapest labour or to install the best marketing system (Müminoğlu 1994, p. 7). In the cases where financial risk is not managed well, the enterprise encounters bankruptcy. Developing and changing circumstances have shown that undertaking the risk alone was not enough in order to talk about successful enterprise, it has been possible to get real success if the risk has been managed well and this understanding has been sloganized by this statement "manage and undertake the risk" (Sayılgan 1995, p. 323). In short, financial risk management includes eliminating and avoiding the financial risk.

7.4 IAS Standard No. 39, "Accounting and Valuate Financial Instruments"

IASC Standard No. 39, "it is intended to valuate and account for Financial Instruments". The purpose of this standard is to put necessary principles forward in order to account, valuate and explain the related information about financial instruments that are placed in the enterprises' financial statements.

When we look at the scope of this standard: note payables, shares, loans, trade receivables, trade payable, interest rate swaps, forward agreements, and option agreements are within the scope of this standard. However subsidiaries, affiliates, financial leasing transactions, long- term assets and insurance contracts are not within the scope of this Standard.

This standard requires classifying financial assets according to purposes from the date of purchase and evaluating those with different methods depending on this classification. In accordance with IAS 39 (2005), financial assets are classified into four main groups:

Table 7.1 Valuation methods of financial assets and income/expense recognition principles

Financial assets	Method of valuation	The place where the change, in book value, is recognized
The trade purpose	Fair value	Income statement
Hold on until the forward date	Discounting value	Premium and discount are displayed in income statement
The credit and receivables which is collected directly	Discounting value	Premium and discount are displayed in income statement
Purchase	Fair value	Equity

Table 7.2 Valuation methods of financial liabilities and income/expense recognition principles

Financial assets	Method of valuation	The place where the change, in book value, is recognized
The trade purpose	Fair value	Income statement
Hold on until the forward date	Discounting value	Premium and discount are displayed in income statement
The credit and receivables which is collected directly	Discounting value	Premium and discount are displayed in income statement
Purchase	Fair value	Equity

- *Held for trading financial assets: These types of assets consist of valuables which are obtained with the aim of making a profit by selling them in short-term price changes.*
- *Held for fixed day financial assets: the financial assets which have a specific fixed date, intention and opportunity are held in this group.*
- *The loans and receivables resulting from enterprise's transactions: The financial assets in this group consist of credits which have been allowed to be used.*
- *The financial assets which are ready for sale: The assets which have not been classified in the stated three classes are within this class.*

According to IAS 39 including derivative instruments all financial assets and obligations take part in the balance sheet. Cost value, the first record value in balance sheet, consists of the fair value price which is paid or received in order to have asset or liability. In the next valuations they will be valuated as indicated in the following chart (Tables 7.1, 7.2).

7.4.1 Hedge Accounting

In accordance with IAS 39, enterprises may apply "hedge accounting" in order to protect themselves from risks for derivative instruments in case of fulfilling the criteria for "hedge accounting" (IAS-39, 71th article). The main objective of "hedge accounting" technique includes: reflecting the loss or income which are

resulted from changes on the fair value of the hedging instrument (derivative) on income charts, ensuring synchronization between periods or periods where the loss or income which are resulted from changes on the fair value of the element (risk factor) which is hedged.

In other words; if the valuation results of the hedged item are reflected on the income statements in a specific period, the valuation results of derivative instruments which are applied for hedging activity are reflected on income statements on the same time. What is expected as a result is meeting the loss which is resulted from risk by the derivative instruments' incomes which are applied for hedging (Tenker 1999, p. 81). From this perspective if "Hedge Accounting" is not applied, it can cause floating in profits from period to period and the losses and incomes belong to hedged item and the hedging instrument can be reported in income statement at different time spans (Hernandez and Francisco 2003, p. 82). Floating of profit from time to time may shade the hedging strategy of enterprise and lead to emergence of serious tax related problems (Kawaller and Teets 2004, p. 140). The application of "Hedge Accounting" is able to prevent these fluctuations largely.

7.4.2 Criteria for Applying Hedge Accounting

According to IAS-39 enterprises should provide five criteria below together completely in order to apply "hedge accounting".

a. In the beginning of hedging risk management's objective and strategy, the cause of applying hedge transaction by enterprise and the hedging relationship, must be based on a formal document and on a formal definition,
b. Hedging transaction is expected to be very effective in balancing the flow of cash or the fair value attributable to the hedged risk and to be consistent with documented risk management strategy which is related to hedging relationship (the accepted event rate range is between 80 and 125 %),
c. For the cash flow hedge transactions, the probability of emergence of approximate transaction which is included in hedging transaction must be high and the changes in cash flow must have quality of affecting loss or profit,
d. The effectiveness of hedging transaction must be measured in a reliable way,
e. The hedging transaction must be valuated continuously and it must be determined during the all financial reporting periods effectively which it is defined in.

In order to apply "Hedge Accounting" the whole criteria of "Hedge Accounting" should be completed. If one of this criteria item is not completed, the derivative instrument contracts which are supported, "having trade objective", are reported and valuated as financial instruments. The results of the valuation are reflected in the period of "Income Statement".

7.5 Reflecting the Derivative Instrument Contracts and the Types of Hedging in Financial Statements

According to IAS 39, as a financial asset or liability derivative product contracts must be reported on the balance sheet (IAS-39, 14th article) and be valuated according to "Fair Value" (IAS-39, 43th article). How to report the results of the valuation show differences according to purposes which products are partied.

According to IAS 39, financial transactions are divided into two parts as transactions for hedge objective and transaction for non-hedge objective. According to the standard hedging transactions are divided into three parts as shown below:

- Hedge transaction for fair value,
- Hedge transaction for cash flow,
- Hedge transaction for protecting the net investment in foreign countries from exchange risk.

Hedge transaction for the fair value: an asset or a liability or parts of them which can be determined and the net income which undertaken and reported against risk which is resulted from changes in fair value are hedge transactions which affects net income.

For example;

- The foreign currency forward or swap contracts which are made in order to hedge investment or debt denominated in foreign currencies.
- The interest rate swap contracts which are made for hedging the credits which are given in fixed interest rate.

Whereas in the hedge transactions for cash flow are:

a. The asset or liability which is exposed to risk (the total of a debt which is variable or a part of its interest payment) or with a transaction which can be predicted (the trade which is foreseen) and can be related,
b. And the net income which can affect the risk resulted from changes in cash flow.

For example;

- Hedging the foreign currency risk which is related to a contract out of balance sheet and which an airline company is undertaken for buying a plane in a fixed price with foreign currency,
- The swap contract which is used for converting variable interest rate debt to fixed rate debt.

When we look at accounting transactions for hedging according to IAS 39 briefly:

7.5.1 Hedge Accounting Transactions in Fair Value

The loss or income emerged as a result of change in fair value of derivative instrument contracts, being a party of them in order to avoid from commitments such as off—balance sheet debt or asset of an enterprise and value variations in fair value, are reported in income statement on valuation day (IAS-39, 89th article). Thus, the loss or income which is belonged to the changes in fair value of the item which is hedged and the loss or income which is belonged to variations in fair value of hedging item can be reflected on income statement at the same time.

a. The derivative instrument which is a hedging item is displayed in fair value,
b. The item which is hedged is displayed in fair value,
c. The loss or profit is displayed in income statement.

The example for protecting fair value: Assuming that we have fixed income securities in our asset and want to protect this portfolio against interest rate changes;

- 1st year: Assuming that we buy debenture bond worth 100 TL, accepting that debenture bond is ready for.
- At the end of 1st year: Assuming that the fair value of debenture bond is 110 TL. (10 TL increase will be associated with self-capital because the debenture bond, a value, is ready for sale)
- 2nd year: Assuming that we buy derivative instrument for protecting the fair value of debenture bond.
- At the end of 2nd year: Assuming that the derivative instrument made 5 TL profit and debenture bond made 5 TL losses.

Showing the stated information on financial statements;
The income at the end of the first year:

Assets	Balance sheet		Liabilities
Debenture bond	110	Capital	100
		Deferred income[a]	10
Total	110	Total	110

[a] The income is reported in equity because the debenture bond is accepted to be ready to be sold

End of the second year:

Assets	Balance sheet		Liabilities
Debenture bond	105	Capital	100
Derivative instrument	5	Deferred income[a]	10
Total	110	Total	110

[a] This amount is held until the debenture bond is sold

The deferred income is held in equity because the debenture bond is accepted as a value which is ready for sale; the income based on derivative instrument will be displayed in income chart of the period because it applies fair value protection.

Income statement	
Derivative instrument income	5
Decrease in fair value of bond	– 5
Net loss/profit	0

7.5.2 Accounting Hedging Transactions for Cash Flow

The effective part of loss or income which is resulted from changes in fair value of derivative instrument contract applied for avoiding from cash flow risk that is resulted from debt and assets of owner of enterprise or transactions likely to happen in the future are not reported in the income chart at valuation day but they are deferred by being reported (IAS-39, 95th article). The deferred loss or income, the assets owned by enterprise, the cash flow which is resulted from transactions that have high probability to occur in the future and the period or periods which are affected by cash flow are reported in income chart. Thus, the income or loss that are resulted from changes in the fair value of the item which is hedged and the income or loss which is resulted from changes in fair value of hedging instrument are reflected in income chart at the same period. The ineffective part of gain or loss which is resulted from valuation is transferred to income statement directly.

a. The derivative instrument as a hedge item is shown with its fair value,
b. The profit or loss which is emerged is shown in equity.

The example of cash flow protection: The purchasing of an airplane from a foreign aircraft company by an airline company one year later or the purchasing of natural gas by an electric company or transactions like these can be the example for cash flow protection.

Consider that we will purchase a good in forward as in our example;

- When we foresee purchasing goods worth 30.000$ on March 2013,
- Signing a forward contract for that and accordingly; the exchange rate forward contract is: 1TL = $ 1,
- Considering the exchange rate forward contract is 1:05 TL = 1 $ on 31.12.2012,
- And assuming that it is 1.10TL = 1$ on March 31, 2013; The transactions will be reflected in financial statements as follows;

On 31.12.2012;

Assets	Balance sheet		Liabilities
Other assets		Capital	
Derivative instrument	1.500	Deferred income[a]	1.500
Total	1.500	Total	1.500

Because of increase in value of dollar we take advantage by signing a forward contact in the valuation that is made at the end of period. This advantage will be reported in equity group because it applies cash flow protection. 30.000 $ * (1.05TL – 1TL) = 1.500 TL

Because of applying cash flow protection, there is no transaction which will be reflected in income statement at the end of this year.

On 31.03.2013;

Assets	Balance sheet		Liabilities
Other assets		Capital	
Derivative instrument	3.000	Deferred income	3.000
Total	3.000	Total	3.000

Because of increase in value of dollar we take advantage by signing a forward contact in the valuation that is made at the end of period. This advantage will be reported in equity group because it applies cash flow protection. 30.000 $ * (1.05TL − 1TL) = 1.500 TL

*Because the cash flow protection is applied in the income which is gained, they will be reported in equity. There is no transaction that will be reflected in income statement at the end of this year.

On 31.03.2013;

- When we assume that our company buys good which costs 33.000 TL,
- To get in debt at this amount,
- To associate derivative instrument, at fair value in active, with cost of good,
- To reflect deferred income in income statement of outcome period;

Assets	Balance sheet		Liabilities
Other assets		Capital	
Derivative instrument	0	Deferred income	0
Trade goods	33.000	Suppliers	33.000
Total	33.000	Total	33.000

Our enterprise bought a good 33.000 TL on 31/03/2013. The deferred income which was held under self-sources was transferred to end term account and the derivative instrument was associated with cost of good in fair value.

Income statement	
Income of derivative instrument	3.000
Net profit/loss	3.000

Table 7.3 The valuation degrees of derivative instrument contracts and reporting the gain or loss resulted from valuation process in financial statements

The objective for being a party to derivative instrument	Criteria for valuation	Valuating loss or gain
I Having objective for hedge		
A Hedge for changes in fair value	Fair value	Transferred to income statement period
B Hadge for changes in cash flow	Fair value	Effective portion: deferred and followed in equity in balance sheet Ineffective portion: transferred to income statement of period
C Hedge net investment in foreign countries from the degree changes in exchange rate	Fair value	Effective portion: deferred and followed in equity in balance sheet Ineffective portion: transferred to income statement of period
II Trade objective (speculative)	Fair value	Transferred to income statement of period

7.5.3 Accounting of Hedge Transactions for Protecting Net Investment from Risk of Rate of Exchange in Foreign Countries

Transactions for protecting net investment from risk of exchange rate in foreign countries and including transactions for protecting accounted monetary items, a part of net investment, from financial risk are accounted the same as transaction for protecting from cash flow risk. The degree of change in an exchange rate which is a part of hedging instrument, the effective portion of gain or loss and the gain or loss (IAS-21 (2003), 32nd and 48th article) which is belonged to the item that is the reason of applying hedge are deferred until the dispose of date of investment and are reported in equity in balance sheet but they are not reflected in income statement. At the date of dispose of investment the whole deferred gains or losses are removed from equity and transferred to income statement. The ineffective portion of the gain or loss which is emerged as a result of the valuation is directly transferred to the income statement (Table 7.3).

7.6 Conclusion

IASC's Standard no 39 is oriented for the accounting and valuation of financial instruments. With IAS 39 a different dimension has been brought to derivative instruments which are acknowledged as balance sheet items and which are shown in memorandum accounts. This standard has emphasized that all financial assets liabilities including derivative instruments should be reflected in the balance sheet. The derivative instruments which were in memorandum accounts will take place in balance sheet with IAS 39. When we look the event in terms of income statement which is one of the basic financial statements; as the IAS 39 is revealed, the financial instruments will be associated with income statement through stated statement. As the result of transactions which are made for speculative oriented are associated to income statement directly, the contracts which are hedge oriented will be associated to income statement according to hedge accounting. At this point the most important detail which can be emphasized is that; the loss or profit which is resulted from protecting fair value is shown in income statement of the period; while the loss or profit which is resulted from protecting of cash flow will be shown in equity group until the transaction is occurred and these loss and profit will be deferred until this transaction.

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Chapter 8
The Evaluation of Financial Risk and Portfolio Selection

Ümit Hacioglu, Hasan Dincer and Ismail Erkan Çelik

Abstract A portfolio is simply a basket of revenue generating assets. Besides money and capital market instruments, these revenue generating assets can also include derivative market instruments. The principle of risk diversification allows variety in portfolio investments. Changing investment instruments of portfolios might affect yields. A portfolio investment is mostly private equity securities and bonds, and debt securities exported by the state. The measurability of portfolio risk and variability of investment instruments might affect also the maturity of portfolio investment. Therefore, portfolio investments might fail in satisfying short term expectations and lead to capital outflow. In this context, the study examines the theoretical framework related to the risks and investments in portfolio management.

Keywords Portfolio · Risk · Finance · Investment

8.1 Introduction

Rationally, an investor tries to maximize the revenue based on the risk taken. Therefore, he/she focuses on accessing all information that might affect the prices of investment instruments on the market. Previous experiences of the investor speeds up this process. However, choosing an investment instrument without setting up expectations with regard to future prices of equity shares is not viable. These two factors, in short, are the key to a rational decision making: experience and expectation. Considering the risks involved, and the positive and negative correlations between investment instruments, one needs adopt diversification

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Ü. Hacioglu and H. Dincer (ed.), *Managerial Issues in Finance and Banking*,

DOI: 10.1007/978-3-319-01387-9_8, © Springer International Publishing Switzerland 2014

against the risk to lose. What is the ideal level of diversification? Which conditions require which investment instruments? Rational decision making is only possible when scientific and analytical answers are found (Bartholomew and Whalen 1995). Therefore, portfolio management requires a theoretical approach while choosing the right securities. There are two main approaches to portfolio diversification: traditional and modern portfolio approach.

As an investment, one can create a portfolio composed of different securities and investment instruments in a capital market. Considering traditional securities such as equity securities and bonds, one might list three types of portfolios: (1) Portfolio of equity securities, (2) Portfolio of equity securities and debt securities, and (3) mixed portfolios including derivative market instruments (Ceylan and Korkmaz 1998).

Portfolio theory is simply the principle to diversify investment instruments so as to decrease risk effects. Portfolio theory was marked by traditional frameworks up until 1950s. Traditional approaches assert that a portfolio is less risky than a single instrument. According to this approach, yields of a portfolio are the sum of the profit shares of financial assets, coupon payments and periodical increase in the capital. Investor's expectation can foresee the yields that the portfolio will generate. According to the traditional portfolio theory, one needs to increase the number of securities to reduce risks. Once securities are incorporated into the portfolio, therefore, risks will be reduced. The fundamental reason of a portfolio is to spread the risk. As the securities in a portfolio do not bring the same yields, portfolio risk will be minor compared to a single security. Based on this basic principle, traditional portfolio theory rests upon increasing the number of securities (Basoglu et al. 2009).

Modern portfolio theory was introduced by Harry Markowitz in 1952. Markowitz's Modern Portfolio Theory was later developed by Merton Miller and William Sharpe. "*This theory was underlining the focus on investors' risk expectations and expected yields of each security of the portfolio*" (Markowitz 1952; Sharpe et al. 1985). In modern portfolio theory, Markowitz asserts that the risk and return ratio of a portfolio determines the investment performance, rather than the risk and yield ratio of a single financial instrument. This is why Markowitz's theory emphasizes that it is the portfolio, rather than the securities one needs to choose as an investment instrument.

Markowitz contributed to traditional portfolio theory in three fundamental ways (Karasin 1986; Terlemez 2008: 79; Markowitz 1959: 36–52). First of all, an investor makes a choice based on "Superiority Principle" and returns-risks level among portfolios. According to this principle, while investors choose portfolios with smaller risk among those with the same return level, they choose portfolios with higher expected return among those with the same risk level. Secondly, as diversification reduces portfolio risk compared to the risk of other assets, one can eliminate unsystematic risks. And lastly, the term efficient frontier was introduced. According to efficient frontier, a portfolio bringing maximum return at each risk level can ensure a composition.

According to Markowitz's approach, an investor investing in risky assets evaluates expected return and standard deviation criteria while creating a portfolio. "*Although the concept of risk had been used until Markowitz, there had been no specific instrument to measure it*" (Aksoy 2007: 3). To analyze portfolio performance, one should be able to measure the expected return and risks of a portfolio. For this analysis, one needs to find the expected numbers, standard deviations, and correlations of a portfolio composed of randomly selected financial instruments in a random period of time. The framework of the study is consecutively conducted with risk types and the key concepts related to the measuring risk, VaR method.

8.2 Measuring Portfolio Risk

Financial markets, institutions, intermediaries, and investors should adapt themselves to changes of the market conditions. Therefore, portfolio investments should be diversified; following a market audit, instruments that might increase portfolio risk should be closely examined and withdrawn when necessary (Bodie et al. 2002: 154–178; Kaufman and Scott 2003; Konuralp 2005: 211–245; Basoglu et al. 2009: 211–245). In terms of financial investments, one cannot know the future. Uncertainties in the market lead to different expectations. According to Bolgün and Akçay, "*Risk, in a sense, helps measuring uncertainty. Considering the relation between uncertainty and risk, one can turn risk-related threats into opportunity only with a well-established risk management*" (Bolgun and Akcay 2005: 37–43).

To measure risk, one first needs to define and categorize it

8.2.1 *The Concept of Risk and Risk Types*

In financial terms, risk is the loss resulting from the discrepancy between the expected price and the realized price of a security. That all investments are financially risky does not mean all investments are destined to fail. If risk means the deviation of realized price from the expected price, this deviation might be both positive and negative (Bollerslev and Zhang 2003).

Financial Risks are divided into three categories. Systematic Risks, Unsystematic Risks, Systemic Risks

8.2.2 *Systematic Risk*

According to Daves, Ehrhardt and Kunkel, *"factors that might affect deviation but cannot be directly managed by investors, companies or other actors are called Systematic Risk Factors"* (Daves et al. 2000; Levy and Zhenya 2007: 5–8).

The impact systematic risk has on investment instruments might be the same or quite different based on their types and the correlation among them (Aktan et al. 2009). For example, while conflict has negative impact on capital investments and equity securities, the parallel inflation and defence expenditures result in debt; and this debt leads to an increase in interest rates (Orhan and Erdogan 2008: 239). Market and banking risks are included in this type.

8.2.3 Unsystematic Risk

Unsystematic risk stems from the changes or developments in the operational, financial, environmental, technological etc. factors of an enterprise; and it affects the operational capacity and the exported financial instruments of that enterprise. While systematic risk affects all market actors, unsystematic risk only affect the enterprise and a specific sector. From a financial point of view, "*in a portfolio, a financial instrument belonging to a single sector might be susceptible to unsystematic risk of that sector. Unsystematic factors are independent of the factors affecting other industries and securities market in general*" (Basaglu et al. 2009: 208).

Financial structure risk, industrial risk, and management risk are parts of this risk group.

8.2.4 Systemic Risk

In Kaufman's words, *"Systemic risk is the probability that cumulative losses will accrue from an event that sets in motion a series of successive losses along a chain of institutions or markets comprising a system*" (Kaufman 1995). According to Kaufman, *"systemic is the risk of a chain reaction of falling interconnected dominos*" (Kaufman 1994). Kaufman asserts that in a setting of systemic risk, actors under risk rapidly communicate and affect each other.

The probability of instability in a system is called systemic risk. In an instable setting, market actors' decisions are less efficient; in a chaotic setting of instability brings irrational behavior.

According to Kaufman and Scot, "*this is why systemic risk can cause simultaneous bank failures in a single or various countries. Roots of systemic risk can be both in domestic markets and outside of national borders as in the case of global financial crisis*" (Kaufman and Scott 2003: 371–391).

Affecting financial markets at the beginning, mortgage crisis in USA housing market later hit real sector and created a domino effect in the whole world.

According to Frederik Mishkin, *"the likelihood of a sudden, usually unexpected, event that disrupts information in financial markets making them unable to effectively channel funds to those parties with the most productive investment*

opportunities" (Mishkin 1995). While Kaufman and Scott highlight that deposit outflow can affect capital adequacy under systemic risk, they also assert that banks will have to take necessary precautions against systemic risks in markets where effective actors do not exist.

> Under systemic risk market conditions where efficient guarantors do not exist, market actors will feel the need to take precautions against more risks. For banks, this precaution will be requesting higher interest rates on risky investments. They will need to ensure capital adequacy against any possible deposit outflow. This is a concurrent phenomenon among banks. And it underlines the triggering effect of systemic risk over financial markets (Kaufman and Scott 2003: 371–391).

In the issue of taking precautions against systemic risk, Kaufman says that *"private-market incentives can and do play a major role in limiting systemic risk and that the market will once again reach equilibrium"* (Kaufman 1996; Cresson 2009; Leaven and Valencia 2008; Hartman and Vries 2005).

8.3 The Relationship between Risk and Return, Uncertainty, and Volatility

One needs information and quantitative methods to manage and analyze risks. Setting up a risk limit and return expectation is not viable in settings of uncertainty. Therefore, one needs to define uncertainty, risk and return well. When risk is involved, one tries to realize probabilities even if all information is secured. Previous experiences and quantitative analyses enable interpreting available information, measuring, analysing and scaling the risk. The relation between uncertainty and risk is studied by Bolgün and Akçay as follows (Bolgun and Akcay 2003: 325):

> Risk analysis will limit existing uncertainty. As risk analysis adopts certain quantitative and qualitative techniques, one first needs to measure variability (volatility) before analysing uncertainty. Uncertainty, on the other hand, is measured by the volatilities of the variables involved. Volatility of variables such as interest rates, exchange rates, rate of inflation, stock exchange index, transaction volume, transaction costs, and production costs actually shows the rate of deviation of relevant parameters from expected values.

Risk and return are the key factors determining investment decisions and portfolios. Portfolio management underlines the relation between risk and expectation. This theoretical approach asserts a linear relation between risk and expectation. In financial terms, risk is the deviation (variation) of realized return of a certain investment instrument from its expected return (Bolgun and Akcay 2003: 325). Rapid developments in an economy increase especially the volatility. "*Accurate estimations of volatility help the defense against future surprises. That volatility has negative impacts on financial demands of individual and institutional investors avoiding risk is a known fact*" (Bolgun and Akcay 2003: 325).

8.4 Measuring Risk: Standard Deviation and Variation

Variation and standard deviation are fundamental criteria of the management of investment securities. Standard deviation and variation shows the extent probable returns deviate from expected returns. Statistical prevalence of price changes is measured by *variation*. *Standard deviation*, square root of variation, is used as the basic risk criteria.

$$\sigma^2 = \sum_{i=1}^{n} \frac{(y_1 - \bar{y})^2}{n}$$

Volatility of the price changes in financial instruments must be measured. According to Bolgün and Akçay, "*Risk is measured uncertainty. Without uncertainty, there is no risk. Future is uncertain. Risk is the measure of probable breakdown prevalence*" (Bolgun and Akcay 2003: 185).

8.4.1 VaR Approach in Measuring Risk

VaR is a commonly used statistical technique in risk management measuring the risk to lose in a portfolio composed of financial instruments (Jorion 2006). The rate of risk indicates the maximum damage in a certain period of time and confidence interval.

Bolgün and Akçay say that *"Value at Risk (VaR) is a commonly used and statistically supported method measuring market risks"* (Bolgun and Akcay 2003: 283).

According to Dowd, *"VaR is the maximum expected loss in a certain period of time and confidence interval"* (Dowd 1997: 39). Jorion *indicates that "Value at Risk (VaR) is the maximum expected loss in a specific time period and confidence interval under normal market conditions"* (Jorion 2001: 21).

Survival of Turkish banking system after recent global financial crisis thanks to capital adequacy shows that Turkey has taken lessons from November, 2000 Crisis and Turkish Banking Crisis of 2001. Innovations in institutional governance, as well as the efficient use of internal auditing and risk management systems helped Turkey to survive global financial crisis. In the crises of 2000 and 2001, the need for risk management techniques became evident as real sectors, as well as banks, were directly affected.

According to Bolgün and Çokaklı, models of VaR assume important roles in risk management and they are *"important units of measurement to understand the levels of risk undertaken by all institutions and persons operating in financial markets and measure financial risks and uncertainties"* (Bolgun and Cokakli 2007). As VaR models, Parametric Method, Historical Simulation, and Monte Carlo Simulation are recognized by audit monitoring authorities and commonly used market risk measurement models.

As Bolgun and Çokaklı put it, Bank for International Settlement uses internal VaR models in measuring the extent of real market risks as an efficient method (Bolgun and Cokakli 2007). According to Kayahan and Topal, this method can *"show financial risks in a certain period of time and confidence interval as a total sum. Still, VaR method cannot measure political risk, liquidity risk, staff risk, regulation risk or operational risk. It can only quantitatively show financial position risk in a certain framework of probabilities*" (Kayahan and Topal 2009). As Kayahan and Topal put it (Kayahan and Topal 2009):

> *If the level of confidence regarding the distribution of profit and loss in a certain period of time in VAR is chosen as α, VAR equals to 1 − α. Tail of the distribution curve 1 − α, represents incidents which are hardly possible (1 % or 5 % chance) but can have great impact on companies. If those incidents really take place, the loss will be great and company can go bankrupt. VAR calculations, therefore, mean that; when the possibility that a company daily reaches 30 million $ is 95 %, the other day by 5 % chance, that company might lose more than 30 million $.*

8.4.2 Parameters Used in VaR Calculations

Duration of holding period, confidence interval, and sampling period are among commonly used parameters in VaR calculations.

According to Bolgün and Akçay, *"VaR is based on calculations with regard to price changes of a portfolio or asset in a given period of time. There is a direct proportion between the duration of holding period and market risk. The longer the holding period, the higher the expected price change will be"* (Bolgun and Akcay 2003: 392). Duration of holding period is dependent on the liquidity of financial assets. As Kayahan and Topal underlines, while BIS suggest a ten-day holding period, BRSA (Banking Regulation and Supervision Agency) envisages a holding period of at least ten work days between a 99 % bank confidence interval, as published in the official gazette with the issue number 26335 in November 2006 (Kayahan and Topal 2009).

According to Bolgün and Akçay, confidence interval is one of the most important parameters used in VaR calculations. Basel Committee requires a unilateral confidence interval with the level 99 %. The higher the confidence interval, the higher the numbers in VaR calculations will be. In Risk-Metrics calculations, JP Morgan adopts a 95 % confidence interval level (Bolgun and Akcay 2003: 393).

Sampling period used in VAR calculations is a survey period observing price changes in a certain period of time and thus, calculating volatility and correlations. *"Basel Committee suggests adoption of a one-year survey period. The shorter the survey period, the more vulnerable the results of risk calculations as opposed to price changes"* (Bolgun and Akcay 2003: 393; Kayahan and Topal 2009).

8.4.3 Methods of VAR Calculations

According to Kayahan and Topal, *"There are basically two types of VAR calculation methods. The first one is also called parametric methods; calculations based on certain probable parameters. And the second one is called simulation methods. Simulation methods are divided into two as Historical Simulation and Monte Carlo Simulation methods* (Kayahan and Topal 2009).

According to Bozkuş, while parametric method is based on a certain distribution assumption, financial institutions generally adopt *Variation-Covariation* method and assume a normal breakdown of returns (Bozkus 2005). *"This method measures the behaviour of future risk factors based on past volatility and correlations of prices and ratios. This estimated volatility and correlations are used to measure the expected changes* of a position's values" (Bolgun and Akcay 2003: 396). Calculation of VAR model based on Variation-Covariation is as follows (Bolgun & Cokakli, 2007):

$$\sigma_p^2 = \vec{W} x \vec{V} x \vec{W}^t$$

$$VAR_p = MTMxZ_{CL}x\sigma_p x\sqrt{HP}$$

MTM: Position's mark to market

W: Weighted Matrix of Portfolio

V: Covariation Matrix of Portfolio

$W^{T:}$ Transposition of a Portfolio's Weighted Matrix

Z_{CL} Discrepancy between confidence interval and standard deviation based on standard normal distribution

HP: Duration of Holding Period

Method of historical simulation applies past 252 days and asset returns to existing portfolio weights. Accordingly (Bolgun and Akcay 2003: 406);

$$R_{p,k} = \sum_{i=1}^{N} W_{i,t} R_{i,t}$$

$$k \in (1, 2, \ldots..t)$$

W; current weight of risks involved in a portfolio

R; changes in returns

> *"Method of Historical Simulation is a simplified form of Monte Carlo Simulation method and basically shows the distribution of profit and loss based on historical data applied to existing portfolio value*" (Kayahan and Topal 2009).

There are similarities between Monte Carlo Simulation and historical simulation. The fundamental difference between them is the way they build their scenarios.

"While Monte Carlo Simulation is based on probable scenarios, historical simulations use previous scenarios regarding market movements. In MCS method, a statistical distribution representing the possible changes in portfolio assets is adopted and random numbers are created" (Ozden 2007: 283).

8.5 Conclusion

Risk diversification basically means diversification of financial instruments in portfolios. One should create a portfolio combining high-risk and risk-free investment instruments, and thus balance optimal revenue level and reasonable risk level. The most common financial instruments in portfolio investments are equity securities and bonds. While a portfolio is created, investment instruments should be diversified based on risk and expected revenues.

Value of equity securities and bonds are based on market conditions. A company's profitability and market conditions play key roles in setting the value of equity securities in capital markets. When all information regarding market expectations is bought, an investor aiming for high revenues and low risk is expected to switch from bonds and promissory notes to shares.

Modern portfolio theory stresses the correlation between securities. "*In this approach, portfolio diversification cannot eliminate risks as securities (or groups of securities) move under the same market trends*". According to modern portfolio theory, market is efficient. All available information on the market affects the prices, investors can access to all information. Nevertheless, financial risks may remain steady or be changeable according to the economic conditions or portfolio diversification. As a result, the risks and returns on investment should consider together and quantitative methods should apply for making investment decision.

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Chapter 9
The Control Mechanisms and Problems in Management Processes of Global Operations

Kerem Toker and Ali Gorener

Abstract With the process of globalization being experienced nowadays the operations of business have spread to all regions of the world. Both geographical distances and different cultural, legal and political structures in different countries of activity make it difficult for enterprises to control their activities in these regions. The control system established by enterprises becomes important due to the unpredictability of the future, especially for global enterprises active in dynamic international environments. In this study, it is aimed to draw the attention of enterprises active at a global scale to this important subject by emphasizing factors which must be taken into consideration in order establish an effective control mechanism, elements rendering operational control difficult and the important of operational control in the international management process.

Keywords Global operations · International companies · Operational control · Control mechanisms

9.1 Introduction

Operational control is a process to guarantee that whether operations are pursued in conformity with the parent company plans and employees act by these plans. Especially in dynamic environments, inner and external peripheral analysis and estimations made in a certain period for enterprises can lose their validity in a short

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Ü. Hacioglu and H. Dincer (ed.), *Managerial Issues in Finance and Banking*,
DOI: 10.1007/978-3-319-01387-9_9, © Springer International Publishing Switzerland 2014

period of time. Furthermore, in such a case the applicability of strategies are eliminated and operating budgets and programs are effective in the long term.

Operational control includes the processes of performance measurement and undertaking corrective action in case of a meaningful differentiation in the performance from business plans. With operational control, estimation deviations, deviations from purposes and plans are pre-determined and rectified with minimum effort. Operational control requires certain management skills such as planning, coordination, communication, information processing—assessment. Operational control process is comprised by the phases of establishing standards, developments of methods to observe individual and organizational performance, the comparisons of the realized performance and the planned performance and the use of means to rectify the deviations in performance (Çalışkan 2011). The control system has a significant impact in a company's performance. Control, in its simplest sense is the process of keeping a variant within certain limits. Control must be used with caution in multinational enterprises, because if not used appropriately they can impact employees' behaviour negatively. Therefore top management must know well the advantages and disadvantages of different control mechanisms.

Multinational enterprises use different mechanisms in the control of subsidiary institutes. Different control mechanisms of the parent company may be mentioned according to the subsidiary entity's impact on planning activities and ways of implementing control.

According to Persson (2006) local enterprises today strive to obtain more resources compared to the central enterprise. The purpose of control is to specify and rectify any situation different from what was planned. Since control plays an integrating role within the enterprise, the control and coordination of a multinational company's interdependent departments specialized in different areas. Control aims at decreasing unpredictability, increase predictability, harmony between the activities of the organization's different departments and setting common organizational purposes despite physical and cultural distance (Çalışkan 2011).

9.2 Control in International Operations

Academic studies in the ongoing notion of globalization, organization and control of enterprises active abroad have had extensive coverage since the last 30 years. Control practices of international enterprises are the preliminary element determining their success or failure. Therefore, we encounter the question of how activities across the world will be controlled as an important matter.

Control can be defined as the "process by which an existence changes and affects the behaviour of another existence at different degrees by using power, authority, bureaucracy, culture and informal mechanisms". Academic studies

conducted emphasize that the reasonable combination of several mechanisms will assume a key role in the successful control of local enterprises. However, it is possible to say that the control process in international enterprises is still a complex and multi-dimensional notion (Jacques and Schaaper 2006).

Studies to be conducted on control in international management necessitate internal questions to be asked in international context and data on various control mechanisms. Due to these difficulties, a small part of the studies conducted on international control could combine effectively the different means of control.

All successful enterprises use control systems to measure the effectiveness of their plans, assess their performances, make the required corrections and reward management performance. In international management (IM) control problems are more complex than single country structures. Its incorporation of different languages, cultures, behaviours of international managements; different tax and accounting practices, different currencies, labour costs, market sizes, political differences, personal and capital safety and the like render control mechanisms complex.

9.2.1 Factors Rendering Control in International Operations Difficult

According to Daniels and Radebough (1998), the reasons for differentiation of control in international management compared to local management are as follows:

9.2.1.1 Distance

Despite the increase in e-mail and facsimile communication; verbal or voice contact is in the best communication way for most meetings. Geographical distance (especially if operations are between several timeframes) and cultural differences in countries increase time, expenditures and communication between cultures. Inquiries and information retrieval between the main enterprise and local enterprise managers may not entirely be present. The time spent for verifications may impede the functionality of the control systems.

9.2.1.2 Differentiation

The more market size, competition type, nature of the product, labour costs, monetary adjustments differ, the more performance assessment, setting correct standards or developing enterprise functions become complex.

9.2.1.3 Uncontrollable Situation

Performance assessment must be used rarely unless it helps with the determination of correct behavioural patterns. Efficient correct behavioural patterns may be meagre because most foreign operations have to compete with the dictates of external shareholders. In as much as the main enterprise and targets may differ, local regulations are influential on the enterprises' short-term purposes.

9.2.1.4 Degree of Certainty

Control affects goal setting and planning by these goals. However, in some countries it is difficult to find exact and incisive economic and industrial information. Moreover, in some locations economic and political conditions change very rapidly. Such circumstances render in particular long term planning difficult and diminish definiteness in the consequences of plans.

9.2.2 The Dimensions of Control in International Operations

According to Steven et al. (2009) previous studies in control have explicitly emphasized the multi-dimensional nature of control. Control can be defined as three dimensional; these are (1) the scope of control, (2) control mechanisms and (3) the focus of control.

The scope of control is the implementations of main enterprise's decisions on local enterprise upon their centralization.

Control mechanisms are control means utilized at the implementation stage.

The focus of control however is about the performance of control practices on a local enterprise with long or short intervals.

9.3 Decision Mechanisms and Control

According to Mall and McCulloch (1999), there are three possibilities on decision mechanisms in international managements. Decisions concerning the management can be taken by the management board, local enterprise or by the joint participation of both. There are many elements determining in which region or by whom decisions will be taken. Some important variant are as follows: (1) products and tools, (2) skills of local enterprise management and the trust felt by central management for local management, (3) size and age of the international enterprise, (4) losses incurred by the local enterprise (5) disappointments experienced by the local enterprise.

9.3.1 Products and Tools

The first question to be asked in the inclusion of local enterprises in decision processes is whether product and means are standard or not. In enterprises providing standard products globally or at least regionally, local enterprises have to follow up on common company policies. Products are initially offered to the market of the host country and after production gains certain stability, production and marketing is performed in secondary markets. However, when deemed necessary local managers adapt products for local markets.

Even in cases where enterprises can explicitly specify and define their global policies, managers of main enterprises prefer standardization in product and production processes. However if local managers can prove that special product and production processes are more profitable for local markets they may also proceed on their own. However in cases where the veto power of enterprise management is high, decisions may also be taken jointly.

9.3.2 Skills of Local Enterprise Management and Trust Felt by Central Management

Determining the trust in the local enterprise is whether managers are known adequately, enterprise policies are adequately well understood, whether top management know the host country's conditions well, the distance between the main enterprise and local enterprise, the age and size of the local enterprise are among the important factors.

9.3.3 Size and Age of the International Enterprises

As a rule, grand scale enterprises can work with more experts and experienced managers. This experience and expertise force brings trust with them.

Several international enterprises bring the most talented and stable managers to top management in course of time. Therefore, the combination of host managers and central managers are comprised in time by managers who rely on their business knowledge.

Large scale and older enterprises take their decisions rather centrally. Smaller scale enterprises however work with managers with less international experience for short term businesses. Small scale and new enterprises have no other chance but to transfer decision making process to local enterprises.

9.3.4 Damages Incurred by Local Enterprises

International enterprises access local markets in order to reach local raw material sources and components in a suitable way, utilize local opportunities and transfer pricing. While such activities protect main enterprise's interests, they may harm local enterprises.

9.3.5 Disappointments Experienced by Local Enterprises

One of the most important matters the main enterprise minds is the motivation of the local enterprise and its attachment to the main enterprise. Adjudication of all decisions by the main enterprise may cause the local enterprise to lose its prestige in the eyes of employers and society. This may increase the local enterprise's enmity and disloyalty to the main enterprise.

9.4 Control Types

In international management, control mechanisms are the means of the central enterprise for establishing whether different local enterprises act according to the planned targets (Björkmen and Piekkari 2009). Control types in international management are divided into four by Legwie (2002), those being (1) centralized personal control, (2) bureaucratic official control, (3) output control and (4) socialization and network control.

9.4.1 Centralized Personal Control

It implies the notion of hierarchy. It is decision taking by central management or top management. Staffs are directly under the supervision of managers.

9.4.2 Bureaucratic Official Control

Another behaviour control mechanism is bureaucracy. Its significant difference however is it's being non-personal. Employee behaviour is guided by written orders and word of command. Knowledge based formal procedures, protocols and routines are a mandatory mechanism for large scale multi-national enterprises to guide their employees in line with the strategic targets of the organization (O'Connor et al. 2011).

Table 9.1 Classification of control mechanisms

	Personal/cultural	Non-personal/bureaucratic/technocratic
Direct/open	Centralized personal control	Bureaucratic official control
Indirect/closed	Control by socialization and network	Output control

Source Legewie (2002)

9.4.3 Output Control

It focuses on outputs rather than behaviours. Company outputs are production, sales or financial data. Outputs are compared to previously specified purposes. The assessment and control of final outputs are more important than the control of inputs and behaviour. According to Langfield and Smith (2003), output control is designed to measure and observe the results of behaviour and operations and they use techniques similar to performance control systems.

9.4.4 Control by Socialization and Network

According to Berry et al. (2009), even if control process has been considered to be a rational process of choice for many years, it is the product of the exchange between people and organizations. Therefore, socialization defines all other control methods. In other words, such control mechanism is not hierarchical, bureaucratic and formal or output focused. It has three sub categories: (a) socialization by shared organization values and targets, (b) horizontal and informal flow of information and the unimpeded flow of non-hierarchical information at all management levels (c) temporary formal relations in cross functional sets (Table 9.1).

9.5 Strategic and Operational Control Systems

In a general sense in literature, control systems are categorized as operational control systems and strategic control systems. Operational control, also known as budget control or feedback control is the verification of procedures and special tasks by pre-determined rules. While operational control is about short-term financial targets; strategic control, also known as management control or feed forward control, focuses on the realization of long term competitive and social targets. In general strategic control is proactive and integral to the nature of strategic management for the definition of complexity and ambiguity.

Successful competition by global industries generally requires a global strategy. In order to apply global strategies, central management has to interfere with local

strategies. In some cases local enterprises are dependent on central enterprises in terms of key personnel, technological, financial and managerial sources. These sources owned by the central enterprise are important tools in influencing the strategies of the local enterprise. However, in general, the self-efficacy and autonomy of the local enterprise limits the influence of its central enterprise significantly. In cases where the international enterprise has many local enterprises, it is very difficult to rebuild the impact of the central enterprise. In cases however where material dependency is high, the central enterprise will have a strong influence on the local enterprise.

9.6 Control Mechanisms for Central Enterprises

For the effectiveness of a successful central enterprise in the shaping of a global competitive strategy strategic and situational orientation is not sufficient. On the other hand, resource allocation to be made in local enterprises is an important subject. This in turn causes power changes within the organization. The effective application of resource allocation programs requires the change in the management control mechanisms. In other words, if the central enterprise wishes to apply an effective control programme, situational, strategic, power-wise and managerial orientations must change.

Managerial mechanisms affect all of these four orientation types. For instance, these mechanisms in time cause local enterprises to take integrated global strategies instead of national priorities in their decision processes. Although the ways these mechanisms are used vary by enterprise, again the typical mechanisms are as follows.

9.6.1 Three Types of Mechanisms

For success, these three mechanisms in the control processes of the central enterprise must work effectively.

Data Management Mechanisms reveals the structure of the enterprise's global performance.

Administrator Management Mechanisms is to change the expectations of local administrators and to shift their individual perceptions from local autonomy to international business performance.

Conflict Solution Mechanisms however are for realizing the need for change causing conflict between local enterprises, reveal that needs what more than others to perform a global strategies and the resolution thereof (Table 9.2).

Table 9.2 Prahalad and Doz control mechanisms

Data management mechanisms	Administrator management mechanisms	Conflict solution mechanisms
Information systems	Selection of key administrators	Decision responsibility allocation
Measurement systems	Career path	Integrators
Resource allocation procedures	Reward and sanction systems	Work teams
Strategic planning	Management development	Coordination committee
Budgeting processes	Socialization models	Task units, solution points

Source Prahalad and Doz (1981)

9.6.2 Control Mechanisms' General Characteristics

Prahalad and Doz (1981) have stated that in the determination of control mechanisms' combination to be used in international management, top managements must take the characteristics of these mechanisms into consideration. They have however listed the characteristics of control characteristics as *the need for the continued support of top management, mechanisms' confidential and symbolic values, selectivity, continuity, affected organizational tendencies*:

9.6.2.1 Affected Organizational Tendencies

All mechanisms do not influence the four organizational (situational, strategic, power-wise and managerial) tendencies at an equal extent. The assignment of key managers affects power tendency directly. Therefore, the assignment of people who are more undertaking, strong willed or with high personal attachment to local enterprises increases the effectiveness of the central enterprise on local strategies. Furthermore, those displaying high managerial properties as local managers must be distinguished from those displaying low entrepreneurial properties. While asymmetries in the personality structures of managers also create asymmetries in power relations, power struggles to be produced by similar personality structures will ensure a resource allocation consistent with common and company strategies and the explicit completion of managerial processes.

Other mechanisms may affect several tendencies directly. The procurement of various information, its dispersion and effective information systems can affect situational tendencies. At the same time, information systems affect strategic tendencies, information flow, while accessibility affects power relations within the organization.

9.6.2.2 Mechanisms' Confidential and Symbolic Values

Mechanisms give several signals about the confidential and symbolic values of the organization to medium level managers. Central management wish to keep control

in their hands by making various administrative and managerial changes within the organization. This situation however causes mid-level managers to read the clues about the symbolic values and power within each new mechanism.

For example, the decision to establish a coordination committee between branches is a relatively weak mechanism by itself. What matters here is how the committee is used here. A talented top management may use such mechanism for different purposes with each meeting. Such a committee can solve problems with great difficulties.

Nevertheless, the assignment of a respectable high level management for product line coordination across the world is a stronger and respectable behaviour. This is because the symbolic value of such behaviour is great and such a duty cannot be declined without the degradation of the top management. If another mechanism is more important, the cost of errors made in such a situation may be very high; the waste of managerial skills, power struggles, reassignments and costs such as the highly emotional and personal disappointments felt by managers. Top manager assignments and changes especially expected in the career path affect perceived power relations directly and such influence give strong signals for the future. Apart from the appointment of a committee it is the expression of an explicit change. This is because the direction of change is as critical as its content.

Mechanisms such as strategic planning procedures may not have the same power as other described mechanisms. However, the use of stronger mechanisms may legitimize these mechanisms by changing cognitive orientations and developing selected strategic opportunities or difficulties.

9.6.2.3 Selectiveness

Some mechanisms have the capacity to selectively determine decision issues such as the balance between branch autonomy and central control. This is an important issue because the tension between economic and political orders emphasized that in general there is no single solution and this tension must be managed continuously. Some decisions can be better if left to the discretion of branches. The effective representation of national perspectives must be continued if central control is established. The impact of central enterprises must not result in the assignment of complete power to worldwide managers in a way as to exclude branch directors and regional managers.

9.6.2.4 Continuity

Some mechanisms are costless and can be given up without notice easily. Leaving others however means high personnel costs—for the said directors. The time horizons of explicitly variant mechanisms change considerably. Task sets can be seen as short term interim mechanisms leading to fast results. Reaping the benefits of strategic planning procedures and seeing the results of career changes however may take a long time.

9.6.2.5 The Need of Top Management's Continuous Support

Mechanisms are not an alternative structure for top management's direct participation and personal leadership. They vary by the level at which they need top management support. Initially the direction of mechanisms is in general dependent on the support of top management. The presence of a mechanism rarely generates an action channel for the central enterprise. However, it does not directly expose the sense of direction.

Most mechanisms must be established and monitored by top management. Monitoring top management encompasses apparently important but critical tasks such as not excluding certain members when determining committee meeting dates or determining whether directors have really received the information specialized by information systems. Some mechanisms might necessitate the inclusion of top management even in daily operations. In addition thereto, the support of top management in the use and design of these mechanisms is utmost important.

9.7 Conclusion

Operational control; is the entirety of measuring organizational success level by pre-set standards, plans and targets, taking required corrective measures if there is any deviation between planned success level and measured success level, systematic efforts spent by managers for ensuring the most effective and efficient use of organizational sources.

Nowadays, in order to overcome the operational control problem, which is one of the most important problems global scale enterprises face, they must effectively analyse the periphery they're in. Each branch enterprise must assess the data yielded from internal and external periphery analyses within its own context and its relation with the central enterprise must be shaped by taking this context into consideration.

Pursuant to making the peripheral definitions both for central enterprises and branch enterprises and defining relationship patterns, the most effective control system must be determined and applied. However, the point which must be paid attention to here is that the mechanisms of the control system to be applied have the quality to meet the needs of the enterprise at the global scale.

Another point to be stressed in operational control processes is the comparison of the benefit to be yielded by the end of the control process and the cost of the control process. If the total benefit the system yield by the end of the control process is less than the costs incurred, control means and methods must be reviewed. As a result of this revision either the least costly control mechanism must be selected or the increase of the total benefit to be yielded by the control process must be resorted.

Therefore, central enterprise managers must know the properties of control mechanisms quite well and must be endowed to use more than one control

mechanism at the same time in the same or different enterprises. Otherwise, enterprises will deviate from their specified strategic plans in the process of realizing their targets and face serious degrees of resource waste and failure.

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Chapter 10
Proactive Approach to Organizational Crisis in Banking

Ümit Hacioglu, Hasan Dincer and Gul Nihan Guven Yeşildag

Abstract The latest studies on the impacts of the crisis on business sustainability and performance have illustrated that there are major factors inside business architect, considered as key solutions for strategies out of global recession. In this context, proactive organizational culture also provides top managers with opportunities to implement strategies out of a global recession while adopting competencies for forecasting and evaluating economic risk within an interdisciplinary approach. Businesses (trying) to locate strategies out of global recession firstly should evaluate internal resources such as skilled workers and managers. In this study, it is aimed to demonstrate the importance of proactive organizational culture in the banking sector as a strategic kit for developing effective ways out of global recession.

Keywords Crisis · Finance · Banking · Management · Behaviour

10.1 Introduction

The Global Economic Recession and European Debt Crisis had negative impacts on global economic activity having significant impacts on business profitability and sustainability (Conyon et al. 2011; OECD 2010; Naes et al. 2011, 139–142; Rjoub 2011, 83–95). In the era of financial crises, volatile conditions addressed the importance of proactive organizational culture for international business operations (Gupta 2010; Natale and Sebastian 2010, 309–315; Vaiman et al. 2011, 259–279). Communication skills, emotional quality and the consciousness of continuous learning have a significant role in maintaining proactive organizational

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Ü. Hacioglu and H. Dincer (ed.), *Managerial Issues in Finance and Banking*,
DOI: 10.1007/978-3-319-01387-9_10, © Springer International Publishing Switzerland 2014

culture inside business as a competitive advantage which can boost organizational success and sustainability (Cherniss and Goleman 2003; Goleman 1995; Holtbrugge and Mohr 2010, 622–637). Investing in human skills can provide the required core competencies to develop strategies and proactive thinking and manoeuvring capacity of the firms (Ashforth and Humphrey 1995; Girotra and Netessine 2011, 100–105; Kallenberg 2007, 1007–1025; Kimbrough and Companation 2009, 18–26; Nico et al. 2011, 127–132; Rodriquez et al. 2011, 427–442).

Organizations with proactive corporate culture are defined as intelligent organizations with high levels of emotional quality. These organizations are able to alert, direct, manage and lead emotions of individuals and groups within an organization. Moreover, they are capable of transmitting emotional skills of individuals into institutional quality. They also intensively focus on strategies with contribution and commitment of high skilled individuals with a high level of emotional intelligence. The success of the transmission process of emotional quality into organizational level depends on communication and learning skills of individuals. Within this context, emotional intelligence of individuals within proactive corporate culture affects communications. On the other hand, organizational communication mediates the relationship between motivation and commitment levels of individuals (Boyatzis et al. 2000; Goleman 2001; Matheson and Matheson 1998; Moller 2000). Within the framework of proactive corporate culture, our study focuses on transmission process of emotional intelligence into corporate intelligence based on communication and learning skills that mediate the relationship between motivation and commitment levels of individuals. The study has two main sections. It initially covers an effective literature review of corporate culture, communication, emotional intelligence and its dimensions.

10.2 Organizational Crisis and Formation Process

The word "crisis" means a difficult situation to pull off a complex phase in which a work or occurrence goes through, suddenly occurring developments in a negative direction and a dangerous moment (Can 2002, p. 72). By this definition, a crisis is defined as a suddenly occurring chaotic situation. Organizational Crisis is a situation which suddenly and unexpectedly evolves (Tağraf and Arslan 2003, 150). Organizational crisis is the state of tension which is hard to predict and threatens the organization's targets and values in case necessary precautions are not taken rapidly by the organisation when such tension is materialized. In other words, an organizational crisis environment faced without making any preparation may cause a decline for organisations. It is taken up as the greatest problem organisations face. Together with a crisis, the organization endures problems in reaching the targets and serious problems are faced in the communication network between employees and employers. Even if the organizational crisis is perceived

negatively, it may bear opportunities for some organisations. The most important component in the generation of opportunities is attitudes. Behaviour of managers becomes clear in the crisis environment. Managers who cannot transform crises into opportunities affect the organisation's success negatively. The organizational crisis formation process occurs in five phases. These phases are explained below (Narbay 2006, 14–19).

10.2.1 Blindness Phase

This first stage starts with the enterprise and it means being unaware of the changes and developments in the external environment. In this phase, it is difficult to forecast occurrences in advance. There are yet no solid indications of the organization's unawareness in change and developments. For this reason the management cannot perceive the newly forming organizational crisis. However, there are symptoms indicating a crisis. (Akıncı 2010, 143).

10.2.2 Inertia Phase

In this phase the organisation cannot see the impacts of the organizational crisis clearly and cannot well assess the negative consequences it will cause. The prevalent idea in the organisation's managerial ranks is that the present state is temporary and that it will improve in time with standard measures. Organizational management does not feel the need to tend towards new activities.

10.2.3 Incorrect Decision and Activities Phase

Organisations which cannot overcome the blindness and inertia phase as required start initiating wrong decisions and actions. In this phase, changes in the external area and ambiguities in the assessment of internal problems affect the thoughts and behaviours of organisational management. The organisation managers' personal intuitions and comments come to the foreground and it becomes difficult to reach an understanding between managers. Therefore, this situation obstructs the development of a strategy to eliminate the ambiguity within the organisation. As a result of this situation, decisions become even more centralized and tension within the organisation arises. This situation is both the reason and consequence of the organizational crisis occurrence.

10.2.4 The Crisis Phase

If the signals of the approaching crisis are not taken, evaluated and responded correctly until this phase, it will be inevitable for the organization to experience a crisis. The organisational climate becomes distorted and conflicts between the employees start (Demirtaş 2000, 365). In this phase, organisation managers must be strategic and give importance to the activities which may save the organisation from this situation.

10.2.5 Solution or Decline

This phase is the last chance for the organisation to elude the organizational crisis in the lightest possible way. If organisation managers can tip the scales of this phase in their own favour the crisis may be solved. Therefore, organisation managers must select the appropriate strategies and start change. In case organisation managers remain inactive against this situation as in other phases, the solutions of the crisis becomes even more difficult and in case of appropriate responses to the organizational crisis are not given, no problem solution probability will be left for the organisation and decay becomes inevitable in course of time. Organizational Crisis has many negative consequences for organizations. It is possible to list these consequences as follows (i) being compelled to make unplanned changes, (ii) centralisation of the authority, (iii) employee stress and fears, (iv) damage in operational processes and decision ability, (v) insufficiency in standard organisational structure. Organizational Crisis is not a situation in which organisations would wish to suffer. Organisations suffering from crises must assess crisis consequences and take immediate actions. A new organisation structure must be formed and the targets and values must be changed if necessary.

10.3 Proactive Solutions to Organizational Crisis

Crisis management is the process of a manager trying to meet his targets with an acceptable quality in possible states of danger (Sezgin 2003, 114). As may be understood by the definition organizational crisis management includes the use of organisation managers' own experience and skills in an organizational crisis environment at the highest level. Within the crisis management process the attitudes and behaviour displayed by organisational managers determine the organisation's future. Therefore organisation managers must show the most appropriate managerial approach against the crisis. Three significant approaches are mentioned for organisation managers to manage crisis effectively. These approaches are crisis elusion, crisis solution and the proactive approach.

10.3.1 Elusion Approach

In this approach, the organisation manager must initially determine the needs of the organisation and determine the situation the organisation is in and define the problems. The organisation manager must establish and preserve the structure to facilitate effective and efficient solutions at times of crisis before it emerges (Koçel 1998, 186). Moreover, in order to evade organizational crisis he must continuously examine the external environment and develop techniques for forecasting of the future. Especially he must follow up the technology closely. The most important aspect of an organisation is the work it wishes to succeed and the technology it uses to accomplish this work. Technology will affect everything in the environment. In general technology will affect people, groups, organisational relations and managerial techniques in an organisation. Additionally, the analysis of political, legal and economic environment factors must also be made. By-laws passed by governments, protective measures or the abrogation thereof, the discovery of organisations as micro units of new raw material energy sources and managerial, technical and physical work force affects significantly their attainment of new marketing opportunities. The timely follow up on these developments and correct analysis thereof by enterprises in terms of planning will provide them new opportunities with respect to decreasing production costs and increasing their sales volumes (Eren 2002, 111).

10.3.2 Solution Approach

Solution approach is an approach based on taking necessary precautions before the formation of the crisis and taking action at the most appropriate moment after the formation of the crisis (Barnes and Oloruntoba 2005, 535). For this reason the organisation's manager must foremost develop signals to receive crisis signals and form early warning systems. At the organizational crisis instant however, the crisis type must be determined and actions must be taken at the appropriate moment for solving the crisis. Moreover, the organisation manager must, in order to take effective decisions, form a hierarchical structure and take the opinion of all employees.

10.3.3 Proactive Approach

The proactive approach is a protective approach which foresees the crisis and preparation for the crisis by taking measures to adapt to the changes in the environment. (Özden 2009, 55). Before the organizational crisis emerges, certain symptoms appear. For example, fall in sales, shortcomings in distribution

channels, problems endured in raw material procurement can be counted among these symptoms. In order to be ready for an organizational crisis the enterprise must continuously and carefully follow up its inner factors and external environment and carefully analyse the signals received. Thereby, the enterprise must continuously prepare against uncertainties.

10.3.4 Emotional Approach

In literature, the latest studies on emotional quality have been located out important factors influencing the way of effective communication, supportive corporate culture and long term business success. In this context, studies focus on the relationship between individuals' emotional quality level and communication skills affecting the success of businesses especially in service industries (Boyatzis et al. 2000; Cherniss and Goleman 2003; Goleman 1995, 1999, 2001; Matheson and Matheson 1998). Moreover, these studies underline the fact that individuals' intelligence and communication skills have similar boundaries and there is high level of interdependency between effectiveness of organizational communication and Emotional Quality (Cooper and Sawaf 1997; Smith and Lazarus 1993; Fredrickson 1998; Gardner 1993a, b; Mayer and Salovey 1995; ve Salovey 1997; Mayer et al. 2000; Yeşilyaprak 2002).

10.3.5 Cultural Approach

Corporate culture as a source of competitive advantage has a significant role in future organizational success. The major fundamentals of a supportive organizational culture are communications, learning and leadership. The studies address the major problem on evaluating the role of organizational culture significantly depending on its nature as intangible issue. Two diverse effects are attached to organizational culture at business success. The first effect of organizational culture is devastative while managers do not pay significant attention to firm's future strategic planning process and are insistent on traditional approach to management and work place requirement in globally changing market conditions. One the other hand, second effect can be supportive while visionary managers and leaders are delegating authority and paying more attention to firm's future planning encouraging individuals to commit planning process. Developing learning skills, sharing information, effective communication among individuals and managing emotional quality skills of individuals help managers and leaders to build a supportive organizational culture. With the effects of emotional intelligence on building corporate intelligence, supportive organizational culture then convert into a proactive organizational culture which can provide opportunities for managers to improve proactive strategies before unpredictable conditions such as financial

turmoil (Ashforth and Humphrey1995; Boyatzis et al. 2000; Goleman 2011; Gupta 2010, 19–32; Kallenberg, 2007, 1000–1025; Matheson and Matheson 1998; Nico et al. 2011, 127–132).

10.4 Conclusion

The latest studies on the impacts of the crisis on business sustainability and performance have illustrated that there are major factors inside business architect, considered as key solutions for strategies out of global recession. In this context, proactive organizational culture also provides top managers with opportunities to implement strategies out of global recession while adopting competencies of forecasting and evaluating economic risk within an interdisciplinary approach. Businesses to locate strategies out of global recession firstly should evaluate inside resources such as skilled workers and managers. In this study, it is aimed to demonstrate the importance of proactive organizational culture in banking sector as a strategic kit for developing effective ways out of global recession. Organizational crisis is an undesirable situation for all organisations. Each organisation wishes to come out of the organizational crisis with the least material and moral damages. The fact is that even if the occurrence of some crises still cannot be determined, albeit these are quite few, most of them can be forecasted in advance. At this point what really matters is the attitude and behaviour to be displayed in a crisis environment. With a good crisis management process the manager would apply, the organisation may tip the scales of this unfavourable process in its own favour. Otherwise however, an incomplete and incorrect crisis management process the manager will implement can even lead the organisation to its demise.

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Part III
Competitiveness and Management in Financial Institutions

Chapter 11
The Game Theory and Reflections on Competitive Strategies in the Banking Sector

Hasan Dincer, Ümit Hacioglu and Ismail Erkan Celik

Abstract The Game theory pays attention to the behaviour of people who put their money into banks that offer the highest interest rates expecting a high income, or the ones who expect a crisis try to draw their money before due date. It is possible for a bank to go bankrupt in the financial system if it offers the highest interest rates compared with its rivals and has relatively high fund resource cost. Similarly, if the customers run on the bank expecting a financial crisis despite being individually a very secure transaction for the customers this creates a liquidity crunch and makes it difficult for the banks to respond to the demands. This study aims to find out the interaction between customer and competitors in the banking sector within the scope of game theory.

Keywords Game theory · Banking · Finance · Competitiveness

11.1 Introduction

Companies have the right to change their own prices and this largely prevents the price changes that happen concurrently. Each company must act in accordance with their interests and determine the price changes considering their own expectations. If the prices determined for the goods and services in an oligopoly market are in parallel to each other, this may express an agreement between the players in the sector.

Lack of information between the good and service providers in the market increases the bargaining power of the consumers. Hence, it is possible to offer

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Ü. Hacioglu and H. Dincer (ed.), *Managerial Issues in Finance and Banking*,
DOI: 10.1007/978-3-319-01387-9_11, © Springer International Publishing Switzerland 2014

Table 11.1 Strategies based on trust between the customers and suppliers

		Customers	
		Lower Trustworthiness	Higher Trustworthiness
Suppliers	Lower Trustworthiness	Prices in the Original Level; Purchases in the Original Level	Increasing Prices; Increasing Purchases
	Higher Trustworthiness	Decreasing Prices; Purchases in the Original Level	Decreasing Prices; Increasing Purchases

Source Laaksonen et al. (2009)

Table 11.2 Banks' Choices of Interest Rate (Million TL)

		Bank Z (Interest rate)	
		%10	%20
Bank Y (Interest rate)	%10	0 TL; 0 TL	40 TL; −10 TL
	%20	−10 TL; 40 TL	10 TL; 10 TL

Source Şıklar (2004)

Table 11.3 Game Matrix between Bank and Third Party Payment

		Third party payment	
		Non payment	Payment
Bank	Non-co-operator	10; 0	8; 2
	Co-operator	12; −2	100; 30

Resource Yin and Wu (2009)

lower costs for the goods and services to the consumers. If the customers simultaneously act in this way, it will decrease the average prices Tables 11.1,11.2,11.3. In oligopoly markets, when the transparency of the market is being discussed, information sharing between the competitors will help maximize the profits. On the other hand, multilateral information transfer about the future prices is regarded as a precise sign of cooperation and agreement in the market (Akkaya 2003: 11−12).

Another situation to be considered in terms of oligopoly markets is that the companies operating in the market tend to have a mutual and oligopolistic dependency. This is why the profit of each company is shaped not only according to the factors such as capacity, price, quantity, product, advertisement and innovation which all based on their own strategies, but also strategies of other companies. Oligopolistic dependency proves both the strategic thinking in game theory and the importance of the effects on the company and its competitor.

The game theory which is an interactive decision theory can determine the cooperative and non-cooperative behaviours of the agents in order to achieve the target which basically has a multi-agent game structure. This is why in case of a mutual transaction formation of strategic decisions becomes possible in game theory (Çoban 2003: 47).

In various studies, since the aforementioned competition presents a more monogamist structure, it is stated that competition and game rules can't be

predetermined, but they appear during the game. Hence, as a result of these kinds of strategic interactions game theory is among the methods to be used in order to predict the result (Kirazcı, 2008).

The study has undermined the competitive strategies in the banking sector. That's why the study initially tries to explain the basic concepts of competitiveness and the game theory and continues with the determining reactions between customers and competitors in banking sector.

11.2 Concepts of Competition and the Game Theory

There are several factors which normal competitive conditions should possess according to the authorities. Normal competition primarily enables every firm to freely determine the price for their own products and services. Everything that affects the actors taking liberties in a pricing mechanism means that the competition is limited by illegal procedures.

On the other hand, price competition may basically occur between the oligopolists by hidden price decreases. At this point, the hidden price decreases are the actions intended to prevent the competitors from responding instantly to the price shifts in an oligopolistic market.

Trust is another phenomenon that gains importance in markets based on competition. The phenomenon of trust contains various concepts such as loyalty and expectations (Edkins & Smyth 2006). Relationships based on trust, between the customers and goods and service providers that are two different important factors in a competitive strategy, can be expressed in that way within the context of game theory Table 11.1:

Within the framework of the game theory, trust perception levels between the customers and good and service supplying enterprises may be the basis in determining the strategy of the parties. Lower trustworthiness of the suppliers ensures the supply of the goods and services by means of original price level. Lower trustworthiness of the customers similarly keeps the purchase tendencies in the original level.

However, despite the lower trustworthiness of the suppliers, customers have trust. This situation causes an increase in the purchases of customers, when the suppliers increase the prices. If there are customers who have low level of trust in the presence of the suppliers who have high level of trust, purchases will continue in the original level if the prices decrease.

Presence of customers who have equally high level of trust in the presence of suppliers who have high level of trust indicates that there will be increases in customer purchases while the prices are decreasing. When considered from this point of view, the trust relationship between the customers and enterprises that supply goods and services may affect the efficiency and decisiveness of the parties to a great extent. Thus, games based on trust have a recurrent feature. The negative strategy results acquired in the first game because of the low trust level of the both

parties indicates that it can be formed successfully in the future games if the both parties have high level of trust. What is most important here is permanently controlling low prices and increasing purchases with a high level of trust achieved by the both parties and the need for analysis of the trust and efficiency level (Laaksonen et al. 2009).

Another fact to be considered in a cooperative game theory is Shapley Value. This study defined the formation of a solution and a group of axiom related to each cooperative game by Lloyd Shapley in his article called “A Value for n-person Games”, published in 1953. This is how Shapley Value was developed (Çelik 2005). Due to Shapley Value, defining the most important factors has been achieved successfully within the framework of the customer satisfaction problems (Conklin, 2004).

In free market conditions, many rival firms can operate in the market. There might be several differences in the financial and administrative structures of these companies. It is necessary to determine the pricing that will be applied while presenting the goods produced and services to the customers considering their ability to pay and expectations. Strategies should also be determined in this way. Companies sometimes want to take part in the competitive environment by diversifying their products and services, or by creating impacts that will decrease the costs and low price policies within the strategic extent. This is why, no matter how much they ensure the activity within the company, analysing the competitors in the market and revising the strategic decisions seems to be a more rational way. This circumstance makes the companies a part of the game within the competitive framework.

In 1940 s, when Von Neumann came up with the basics of the game theory, it was a priority to discuss a zero-sum model considering the profit of a player means the loss of the other player. In 1950, with his PhD thesis about game theory, John Nash stated that in real life games may not be limited to two players and each player may try to choose the best position for himself by adjusting his moves in accordance with the moves of the others. There will be a balance, if each one of the actors in the game takes the best position for itself (Fudenberg & Tirole, 1991: 11). John Nash won the Nobel Prize in Economics in 1994 with this study (Ertek 2009: 346).

Another striking case concerning the game theory is “Prisoner’s Dilemma”. What is important here is predicting that both parties will reach the most profitable solution while every player has a mutual trust (Weibull 1997: 2). If the players do not trust each other, choosing the best option for their own interests may cause them to encounter the worst results. Consequently, choosing the best strategy pursuant to the strategy a company practices is discussed in sectors where Nash Equilibrium is applied. In other sectors where Nash Equilibrium does not exist, it is possible to encounter some firms that went bankrupt due to the deficit caused by the intense competition. Hence, Nash Equilibrium should be applied sensitively so that the market can be a competitive one and this competition should not be in a destructive level (Dayoğlu 2006).

That’s why the first decision of the first player affects the second player’s decision. The second decision of the first player is also formed according to second

player's decision. It seems reasonable that in a competitive environment the parties will agree on a strategy that is beneficial for both parties within the framework of the game theory. Within Nash Equilibrium, low price strategy of two companies will mean choosing a "no-win situation" for both parties. On the other hand, determining a higher price strategy together will help them meet in a "win–win situation" (Cansen 2010). Moreover, Cournot Theory is a theory that helps put forth strategic decisions in the fastest and strongest way at that point. Because of this fact, this theory is regarded as one of the pioneers of the game theory (Yıldırım & Özer 2006: 146).

11.3 Game Theory and Its Effects on Competition Strategies in Banking Sector

As a result, the game theory states that observing the general interest to protect the individual benefits also puts at risk the individual risks. It is necessary to study closely here the dynamics of the game theory to provide individual and general interest (Özen 2004).

In the financial sector, one of the structures that are changed by the game theory is also the financial intermediation system. Banks and other financial intermediaries have institutionally functions to decrease the transaction costs. Modelling a bank that guarantees against liquidity shocks to the depositors is also included in the game theory (Chatterjee & Samuelson 2001: 31).

Considering the financial sector volume and asset size of banking system in the developed countries, it is possible to say that Turkish banking sector has an oligopolistic structure (Bankacılık Sektörü 2010). Considering the European Union member countries, banking sector concentration ratio in some regions seems to be high. Besides, it is stated that according to the recent studies, banking sector in EU countries has started monopolization (Erdönmez 2005).

By nature, banking sector is a parameter dependent. Leave aside macroeconomic indicators, any changes that companies within the financial sector experience might dramatically affect banks. As for the loan requirements of customers within competition strategies, the decision is made following an analysis of banks' loan requests and the amount of optimum loans. The most distinctive feature of oligopolistic banks is the interdependent decision making mechanism among competitor companies. One of the best methods of measuring the rate of interdependency is determining the concentration ratio. Concentration ratio is measured by the total revenues of the top five or ten enterprises of the sector.

An example might clarify the point about dependency in banking sector. When a measure is taken by a bank in a certain city, the profit of another bank operating in its vicinity might be affected. In this vein, when a bank decreases its interest rates, it will result in a decrease in another bank's profits as customers will be attracted by the former. This very result underlines the interdependency of banks.

These oligopolistic banks are so much interdependent shows that decisions or options adopted by banks carry strategic importance. Therefore, strategic decisions of banks are evaluated in terms of the game theory. An example might clarify the point about strategic decisions based on interdependency. Interest rates of bank Y and bank Z are 10 % and 20 %, respectively.

Upon examining the table above, one can see that both banks make 0 % profit despite low interest rate in loan allocation. When the interest rate of bank Y is 10 % and that of bank Z is 20 %, bank Y makes a profit of 40 million while bank Z lose 10 million TL. In other words, bank Y can attract the other bank's customers by applying lower interest rates; bank Z loses money when it applies higher interest rates. Conversely, if bank Y applies higher (20 %) interest rates and bank Z applies lower (10 %) interest rates, bank Y will lose 10 billion whereas bank Z makes a profit of 40 billion. Still, if both banks apply an interest rate of 20 %, they both make a profit of 10 billion Table 11.2.

Upon a scrutinizing the table, one will realize that this applies to other banks, as well. No matter which strategy bank Z adopts, the best thing for bank Y is to adopt lower interest rate. In this case, while high interest rates cause loss for bank Z, both banks will make a profit of 0 % with low interest rates. At this point, the optimum solution for banks is to act in cooperation and reach to a joint resolution (Şıklar 2004: 208−2010).

Just like interest rates banks offer to their customers according to their competitors, alternative delivery channels used by customers are of great importance. Whether the ATM network of a bank is available only for its customers or open to all is another option in terms of game theory (Economides 2000: 1).

Another instance of cooperation among banks in the game theory is third party payments. The cooperative solution for each game is to consider the maximum bilateral acquisitions instead of unilateral and independent acquisitions (Atiyaş & Gürkaynak, 2005). As internet has become widespread, the development of third part payments has been brought to agenda. At this point, third party payments seem like a potential competitor as opposed to electronic payments. The relationship between the bank and third party payments is critical for the development of such payments in the future. For this reason, banks need to cooperate. The most fundamental reason for this cooperation is the failure in third party payments without the bank's permission, as well as the necessity for technical service.

In such games, there are two options for the parties. The bank might have cooperative and uncooperative options. The third party might choose to pay or not to pay. Therefore, there are four possible conclusions between two parties. Above is a payment matrix, as explained earlier Table 11.3.

If a third party refuse paying because of bank's uncooperative options, a bank might offer electronic payment. In this case, transaction costs will be higher. Therefore, the bank will acquire a certain volume of electronic transaction. In this strategy, the bank has ten units of conclusion, whereas third party payment has none. The reason is that third party payment has no transaction. Similarly, if a bank sustains its uncooperative behaviour and the third party decides to reactivate payments, that third party might start cooperation with another bank. As a result of

competition in payment systems, a bank might experience a certain loss in electronic payments. As seen in the matrix, while the bank's acquisition is eight units, that of the third party systems has risen to two units.

If a bank is cooperative but the third party is unwilling to pay, then the bank might look for cooperation with another third party payment. While the bank acquires 12 units, third party payments start losing. Cooperation of the bank and the third party payments will improve the market for electronic payment. And this might make electronic payment and online commerce more attractive. In this case, while the bank's acquisition is 100 units, that of third party payments is 30 units. As a result, both parties benefit from cooperative behaviour in payment systems, as in the case of interest rates (Yin & Wu 2009).

Based on the cases related to game theory and competition in banking sector, one can reach to some conclusions. Game theory assumes at least two actors. In the framework of banking sector, banks are the actors; aggressive or cooperative behaviours seem to be the most important elements of competition strategies. Policies based on aggressive competition are based short term revenue growth at the expense of long term value loss; companies usually experience adverse effects. Policies based on cooperation -the second alternative- establishes market equilibrium in banking, prioritizes customer requests, aims for long term revenue growth instead of short term aggressive behaviour, and therefore reactivates joint decision making mechanism in baking sector.

Although banks act in oligopolistic manners, they start making decisions under perfect competition and in a process marked by innovation. With this behaviour, customers acquire new and cheaper products and services in accordance with their expectations and needs; as for banks, attractive profit margins temporarily decrease. The best measure for a banking sector determined by low profit margins and organized for the benefit of customers in perfect competition is to lower product development costs and avoid policies of fierce competition when providing service -thanks to cooperation.

11.4 Conclusion

Customers are among key variables in competition strategies. While customers aim for new and cheaper products and services in accordance with their expectations and needs, priorities of banks is to attract existing and potential customers, grow their market share, achieve revenue growth, and increase their market value.

In the triangle of Customer-Competitors-Product and Service, the only way to ensure competitive advantage is the adoption of Game Theory in banking sectors as a compulsory element. According to the assumptions of the Game Theory, if a zero-sum game is adopted, one party's profit will result in the other's loss; and therefore, even if they have an oligopolistic structure, banks will be in trouble because of fierce and perfect competition.

Short term customer retention and market domination might have adverse effects on long term profitability. These are aggressive, short term reforms, and have nothing to do with cooperation. The strategic thinking in game theory, on the other hand, aims to create a long term customer portfolio and maximize market value; while this approach ensures a wholesale profitability of the market, "moderate reform and cooperation" assumes a key role in this endeavour.

To prove the claims of the Game Theory, "customer and competitors" -fundamental components of competitive strategies- need to get directly involved in the processes; reforms and improvements of the products and services should gain a momentum; payments and sales through different channels and operations under competitive circumstances should be tracked for process reforms and improvements.

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Chapter 12
The Implementation of Competitive Corporate Governance in the South East Asia Banking Industry

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Abstract The awareness of the implementation of good corporate governance varies throughout the world. As for Asia, especially South East Asia, the trigger was the 1997 economic crisis. The crisis showed the importance of good corporate governance implementation. It is understandable that every country has different policies and regulations; therefore, will lead to different implementation of good corporate governance. In this chapter, we will focus on the implementation of good corporate governance in selected South-East Asia banking industry (Indonesia, Malaysia and Singapore selected listed-banking firms). We will analyse the implementation in three countries based on corporate governance rules and practices, enforcement, political and regulatory environment, IGAAP (accounting and auditing) and corporate governance culture. From five factors, we found that Singapore is the best country in the implementation of good corporate governance in its banking industry followed by Malaysia and Indonesia.

Keywords: Governance · Banking · Auditing · Crisis

12.1 Introduction

The failure of governance is one of the key triggers in major crises and scandals. We can see that after a major accounting scandal (i.e. Enron and WorldCom), there were calls for major reforms in corporate governance. The Transatlantic credit crises in 2007–2008 were initially argued to be attributed to failure of governance

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Ü. Hacioglu and H. Dincer (ed.), *Managerial Issues in Finance and Banking*,
DOI: 10.1007/978-3-319-01387-9_12, © Springer International Publishing Switzerland 2014

Table 12.1 Comparison of corporate governance principles in Indonesia, Malaysia and Singapore

Aspects	Indonesia	Malaysia	Singapore
Method	In case CG principles have not applied, it must be disclosed in annual report	A compulsory disclosure about the principles and practices of good corporate governance	A compulsory disclosure about corporate governance practices with its references
Independent board	1, or at least 30 %	1/3	1/3
Sanctions	No sanctions	Sanctions given if there is no GCG disclosure in annual report	Detailed explanation needed if CG principles have not applied
Remuneration	Disclosure of remuneration procedures and amount of the remuneration	Related to individual performance and experience and responsibility	A structured remuneration, according to organization and individual performance

in the financial sector (Van Essen et al. 2012). Also, this failure could be relevant to 1997 Asian financial crisis as well; thus, it was due to failure of authority. For this reason, corporate governance is essential to avoid crisis and scandals.

The banking industry was the most impacted industry during the 1997 Asian financial crisis, and the South East Asian region was most affected by the crisis. It is understandable that this crisis led to a reform of governance and the implementation of good corporate governance in South East Asia. This chapter will specifically discuss the good implementation of corporate governance in the selected South East Asia banking industry (Indonesia, Malaysia and Singapore).

12.2 Corporate Governance

According to the OECD, corporate governance is defined as the procedures and processes according to which an organization is directed and controlled. Corporate governance also works as a checks and balance system to ensure the existence of organization and a responsibility to stakeholders (Cadbury 1992; Solomon 2007).

There are six OECD principles of corporate governance (OECD 2004): ensuring the basis for an effective corporate governance framework, the rights of shareholders and key ownership functions, the equitable treatment of shareholders, the role of stakeholders in corporate governance, disclosure and transparency, and the responsibilities of the board. Comparison of corporate governance principles in these countries could be found in Table 12.1.

In Indonesia, according to statement of SOE Secretary, there are five basic principles: transparency, accountability, responsibility, independency and fairness.

Principles, best practices in corporate governance and exhortations to other participants are regulated in The Malaysian Code of Corporate Governance. While in Singapore, there are 5 points included in the Singapore Code of Corporate Governance: board matters, remuneration matters, accountability and audit, communication with shareholders and disclosure of corporate governance arrangements.

The implementation of corporate governance (good corporate governance) differs around the world. For example, the USA uses an Anglo-American model. Most Asian countries use a standard established by the OECD. The USA started to implement corporate governance since the issuance of Cadbury Report in 1992, and developed its standard and ethics after Enron and the WorldCom saga. In Asia, it was 1997 when Asian financial crisis trigerred the need of good corporate governance.

12.3 Good Corporate Governance Implementation in South East Asia Banking Industry

We will discuss GCG implementation in Indonesia (ID), Malaysia (MY) and Singapore (SG) based on five following sections.

12.3.1 Enforcement

There are five points analysed to determine GCG implementation in three countries as summarized in Table 12.2.

From Table 12.2 we can see the comparison of GCG implementation in enforcement based on selected points adopted from Corporate Governance Survey of ACGA. Malaysia and Singapore show a regulator's consistency in enforcing their own CG rules and regulations, securities commission has an effective powers of investigation and sanctions, have had a successful track record prosecuting cases of insider trading and market manipulation in recent years; regulators disclose detailed and credible data on their enforcement track records and there is an independent commission against corruption that is seen to be effective in tackling public and private sector corruption.

While in Indonesia, regulators show an inconsistency in enforcing their own CG rules and regulations as it is only voluntary so we found only some organizations apply the CG principles, rules and regulations. There are no sanctions against organization that do not apply the CG principles, rules and regulations. In Malaysia and Singapore, regulators always revise the CG regulations to ensure organizations apply the CG. Although it is only voluntary, an explanation is needed if organizations do not apply corporate governance.

Table 12.2 GCG implementation–Enforcement

	ID	MY	SG
Regulator's consistency enforcing CG rules	N	Y	Y
Main statutory regulator's effective powers of investigation and sanctions	Y	Y	Y
Successful track record prosecuting insider trading and market manipulation in recent years	N	Y	Y
Disclosure of detailed and credible data on enforcement track record	N	Y	Y
Independent commission against corruption	Y	Y	Y

Table 12.3 GCG implementation–Political and regulatory environment

	ID	MY	SG
Government's clear, consistent and credible policy in support of corporate governance reform	Y	Y	Y
Signing of IOSCO multilateral MOU by securities commission	N	Y	Y
Regulators' informative websites	Y	Y	Y
Independence and cleanliness of judiciary	N	N	Y
Media's freedom to report on corporate governance abuses among listed companies	Y	Y	Y

Insider trading and market manipulation is regulated in the Capital Market Act, but there is no data on this successful record prosecuting these cases although sometimes there is a trading suspension on a 'suspicious' stock transaction. Meanwhile, we found that the Securities Commission of Malaysia and the Monetary Authority of Singapore are prosecuting insider trading and market manipulation cases successfully, and it is also supported with the disclosure of detailed and credible data.

Based on these five points of enforcement, GCG implementation in Malaysia and Singapore is better than Indonesia.

12.3.2 Political and Regulatory Environment

Table 12.3 shows our analysis in the political and regulatory environment.

From five points in political and regulatory environment analyzed in three countries as summarized in Table 12.3, it is clearly seen that Singapore has the best implementation of GCG in political and regulatory environment followed by Malaysia and Indonesia.

Governments of Indonesia, Malaysia and Singapore have a clear, consistent and credible policy supporting CG reform. In Indonesia, government and regulators create a new regulation (for example: corporate governance code) to support CG implementation. Malaysia also has The Malaysian Code of Good Corporate

Table 12.4 GCG implementation–Corporate governance rules and practices

	ID	MY	SG
Reporting of audited annual results in 60 days	Y	N	Y
Disclosure of ownership stakes of 5 % and above	Y	Y	Y
Disclosure of share transactions by directors and controlling shareholders in 3 working days	Y	N	Y
Adequate disclosure of material transactions	Y	Y	Y
Clear and robust definition of independent auditor	Y	Y	Y
Disclosure of exact remuneration of individual directors and senior executives by name	Y	Y	Y
A mandatory audit committees	Y	Y	Y
Audit committees chaired by independent director and given sufficient powers in practice	Y	Y	Y
Regulatory requirement that directors convicted of fraud or other serious corporate crimes must resign	N	Y	Y
AGM notices 28 days before date of meeting	Y	Y	Y

Governance. The Singaporean government supports corporate governance reform; therefore, all organizations are required to report their corporate governance in an annual report.

IOSCO (International Organization of Securities Commissions) issued IOSCO multilateral MOU, which means to support development of member's securities market and sharing information between members. Malaysia and Singapore are the members of IOSCO and signed the MOU. Indonesia is not a member of the IOSCO.

All three countries regulators have informative websites, providing English translations of all key laws, rules and regulations and these are easily accessible. In the judiciary system, Indonesia and Malaysia seem somewhat not too independent, clean and excel in handling company and securities cases which is opposite of Singapore.

In relations to media freedom, the report on corporate governance abuses among listed companies, and media in three countries have freedom to report a corporate governance abuses among listed companies (if any).

12.3.3 Corporate Governance Rules and Practices

We analyse good corporate governance implementation in rules and practices based on 10 points as summarized in Table 12.4.

From 10 points discussed in Table 12.4, 7 points is fully implemented in three countries. All securities laws require disclosure of ownership stakes of 5 % and above (i.e. when an investor becomes a substantial shareholder) and adequate disclosure of material transactions. Code of listing rules provides a clear and robust definition of independent auditor in Indonesia, Malaysia and Singapore.

Table 12.5 GCG implementation–IGAAP (accounting and auditing)

	ID	MY	SG
Policy of following IFRS accounting standards	Y	Y	Y
Local accounting rules largely in line with international standards	Y	Y	Y
Disclosure of consolidated accounts	Y	Y	Y
CEO, CFO or directors sign and certify company's annual accounts	Y	Y	Y
Strengthening the regulation of accounting profession by government	Y	Y	Y

Companies in three countries must disclose the exact remuneration of individual directors and senior executives (top five) by name. Audit committees are mandatory in three countries and chaired by genuinely independent director and given sufficient powers in practice to examine financial reports and announcements, internal control and the independence of external auditors and also operate independently. The last point implemented in three countries is companies release AGM notices (with detailed agenda and explanatory circulars) at least 28 days before the date of meeting.

There is no regulation in Malaysia stating that companies need to report their audited annual results within 60 days. Malaysia securities laws require disclosure of share transactions by directors and controlling shareholders, but not within 3 working days. While directors convicted of fraud or other serious corporate crimes, there is no regulation regulated that they have to resign from their positions on the board and in management. The regulation only regulate that the directors will be sanctioned according to laws/regulations violated.

12.3.4 IGAAP (accounting and auditing)

In analyzing IGAAP (accounting and auditing), there are five points we analyzed. And all three countries implement these five points, as could be viewed in Table 12.5.

Based on our analysis we found that accounting regulator in all countries have a policy following IFRS accounting standards. Local accounting rules in Indonesia, Malaysia and Singapore are also largely in line with international standards and there is a requirement to disclose consolidated accounts. CEO, CFO or directors in three countries must sign and certify a company's annual account. And lastly, there is effort by the government to strengthen the regulation of accounting profession in Indonesia, Malaysia and Singapore.

Table 12.6 GCG implementation–Corporate governance culture

	ID	MY	SG
Listed company believes corporate governance will provide tangible benefits	Y	Y	Y
Listed company actively seeking to improve communication with shareholders	Y	Y	Y
Company boards generally have separate chairmen and CEOs, chairman being independent of the CEO	N	N	Y
Listed company provide adequate disclosure of their internal control and risk management functions in annual report	Y	Y	Y
Other professional associations promoting corporate governance training and awareness raising	Y	Y	Y

12.3.5 Corporate governance culture

Five questions need to be answered and analysed in relation to implementation of good corporate governance implementation in Indonesia, Singapore and Malaysia. Summary of our analysis could be found in Table 12.6.

Indonesia, Malaysia and Singapore comply with 4 of 5 questions listed in Table 12.6. In three countries, listed companies believe that corporate governance will provide tangible benefits (investor's trust, improve performance, increase of total assets, lower cost of capital, better risk management). Listed companies are actively seeking to improve their communications with shareholders through detailed online disclosure, better reports and webcasts. Information technology really helps listed companies on improving their communication with shareholders.

In their annual report, listed companies in all three countries provide an adequate disclosure of internal control and risk management functions. Other professional associations also promote corporate governance training and awareness. There is an Annual Report Award in Indonesia, which the scoring component is corporate governance-related. Regulator, Indonesian Accountant Association, Indonesian Institute of Certified Public Accountants, Securities Commission of Malaysia, Malaysian Institute of Accountants, Monetary Authority of Singapore and Institute Certified Public Accountants of Singapore are actively engaging in these activities.

While there is a separation function between the chairman and CEO in Singapore, in Indonesia and Malaysia usually there is only one person acting as a chairman and CEO.

12.4 Conclusion

Singapore shows the best implementation of good corporate governance in its banking industry compared to Indonesia and Malaysia. Based on five points discussed and analysed (enforcement, political and regulatory environment, corporate governance rules and practices, IGAAP and corporate governance culture) we found out that Singapore complies with all selected questions in each sections.

Indonesia and Malaysia have also shown a good implementation of good corporate governance, but there are some areas that need improvements (for example: Indonesia's enforcement and Malaysia's corporate governance rules and practices). This analysis provides a guideline for both countries to see which area still need improvement to fully implement good corporate governance.

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Chapter 13
Priced-Based Goods and Services in the Banking Sector

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Abstract To create awareness in a highly competitive environment, actors in banking sector need to create diversity in the products and services they present to customers and thus provide a price advantage. Introducing various pricing techniques and analyses for the provided products and services is now a necessity. In this study, price analysis-based product and services of banking sector have been clarified in competitive environment and the product and services which affect the sales and customer behaviours have been also determined in detail.

Keywords Competitiveness · Services · Banking · Pricing

13.1 Introduction

Pricing-based approach is one of the profitable applications on indirect income in which banks might consider their pricing policies. Most of the daily banking transactions are offered to customers free of charge. Other product types such as credits and savings generate revenue. Besides commissions charged to extend loans, interest spreads (margins) also bring income to banks. Moreover, management fees received for savings bring income, as well as interest margins in savings (Capgemini 2007, p. 17).

Fees that banks charge for their products and services only form a small part of the total fees paid by customers. For example, fees in Italian banking system are 30 % more expensive than those in Australian banks. Compared to other countries, fees charged for products and services have considerably increased in China and Eastern Europe. Commissions and fees charged in the banking system are high.

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Ü. Hacioglu and H. Dincer (ed.), *Managerial Issues in Finance and Banking*,
DOI: 10.1007/978-3-319-01387-9_13, © Springer International Publishing Switzerland 2014

However, some products and services are offered free of charge to attract customers in developed countries such as USA and European countries like England. One can also see that a similar strategy is used in some economies with growth potential (Capgemini 2005, p. 10).

Service channels in banking started to change considerably since the beginning of 2000s when the internet became widespread. A study shows that the rate of branch banking in total channels reached 70 % in 2000s, while it decreases to 30 % in 2010s. ATM utilization has also increased from roughly 20–30 %. In 2000s, online banking utilization was around 4 %, but this rate compared to all other channels has increased roughly to 28 % in 2010s. Mobile banking utilization has increased roughly from 5 to 12 % (Capgemini 2006, p. 18).

As a recent research shows, main trends in branch system are as follows (listed in terms of importance): developing proactive behaviour of customer advisors, operation automation, increasing the number of branches, market specialization, enlarging the size of branches (Capgemini 2006, p. 19).

In the study, the prominent approaches affecting the pricing analysis on banking products and services are declared in Sect. 13.1. However, the product and services affecting sales and customer behaviours as well as invisible services in banking sector are uncovered in the following sections.

13.2 Products and Services in Pricing Analysis

There are several approaches to pricing in banking. Charging fee on customer accounts is one of the most frequently used pricing techniques. These kinds of fees can generally be taken through a demand deposit that does not yield any interest. All products and services operate correlatively with a current account. This is why it is necessary to open an account before performing a financial product and banking transactions. This obligation enables banks to charge certain fees while opening such accounts in transactions. New entrant banks may sometimes prefer to get into the market by presenting current accounts at a low cost. In general, these kinds of banks attract customers by underlining their distinction in terms of better service and higher interest rates for deposit accounts (Capgemini 2004, p. 5).

Another pricing approach is based on charging for banking products and services in transactions. A certain amount of money can be charged for products and services such as check, money transfer, ATM and credit card. While fees per transaction are fixed, it is also possible to set up different fees for each customer and within certain transaction limits.

Similar to fees per account, yearly fees can also be charged on current accounts for the services provided. Based on their capacity to increase cross selling ratio, these kinds of fees may usually ensure growth (Table 13.1).

As seen in the table above, products and services listed in global and local pricing index serve four basic necessities: account management, payments, cash

Table 13.1 Products and services in global and local pricing index

General banking requirements	Products and services
Account management	Current account
	Online banking
	Call center
Payments	Cheque
	Debit card
	Credit card
	Branch internal wire transfer (Remittance)
	Branch external wire transfer (EFT)
	Branch standing order
	Direct debit
Cash utilization	Cash deposit at desk
	Cash deposit at ATM
	Withdrawal at desk
	Withdrawal at bank's ATM
	Withdrawal at other bank's ATM
Exceptional handling	Debit card stop payment
	Cheque stop payment
	Document search
	Banker's draft

Source Capgemini, EFMA and ING, World Retail Banking Report, Capgemini 2009, p. 7

usage and exceptional cases. These products that meet basic daily needs of the banks are divided into subgroups (Capgemini 2009, p. 7).

Besides abovementioned distinctions, banks categorize banking products and services based on their influence on customers to account for changing prices of available products and services.

13.3 Products and Services Affecting Sales

Pricing approaches related to banking products and services generally focus on items affecting sales. In banking sector, current account, debit card and credit cards can be regarded as the products and services that affect sales according to customer behaviours.

Current Accounts. Banking sector serves as an intermediary between parties that demand and supply funds in financial sector. Banks serving as an intermediary in the amount, due and risk between entrepreneurs and account owners can be of service as a financial intermediary at that point.

The accounts (demand deposit) from which depositors can freely withdraw money any time they want are current accounts. Such accounts are used in business; and since they do not have any restraints in terms of time, they do not interest

yield. Small transaction fees might be demanded depending on the number of transactions in these accounts (NIOS 2010, p. 26). Current accounts are given different names in different countries. They are called check accounts in USA and Canada, while they are called current accounts in England (Wikipedia 2010).

Debit Card. Using Debit Card payments has become increasingly widespread. In many cases, it has become one of the common payment methods. Shops accepting cheque and credit card can also accept debit cards. It is possible to make debit card payments online (with PIN) or offline (with signature).

Using debit cards is useful in many ways. Sellers do not request identification or personal information, and it is possible to verify the sale within a few seconds. Besides, using debit card has a considerable effect on avoiding frauds and thefts. When cash exchange is not involved during a sale, operational burden of selling and paying disappears. For vendors, investment is minimal in terms of the equipment used in debit card payments. Customers are presented with the options of signature and PIN. The procedures at this point are carried out according to certain security steps so as to prevent any third parties abuse during the process (USDC 2010, p. 1).

Besides above-mentioned advantages, certain security problems are reported in various card payment systems such as debit card. Once a card and the relevant information are acquired, abusers can use them to buy products or to withdraw money without the permission of the customer. At this stage, precautions such as Personal Identification Number (PIN) application (Valentine 2006) and smart card technologies offer security and turn debit cards into a trustworthy payment system like any others (Jones 2005).

Credit Card. One of the signs that show credit card portfolio performance is account balance of the customers. Account summaries and balance are expected to increase steadily in a well administered credit card portfolio. Decreases in active accounts are regarded as an important sign. At this point, one needs to investigate the reasons of the changes depending on the behaviours of the card holders.

Changes in the periods and the range of products and services purchased with credit cards, as well as risks related to loans and marketing need to be closely tracked. The average account balance per each credit card can shed light into the ways in which customers use their credit card. Having a low account balance might mean that there are non-competitive interest rates and low credit limits. If the account balances are low, taking the necessary measures to make the customers spend money is important. Credit limits are also regarded as a significant indicator related to this case. Using low credit limit might mean that customers compensate their needs with alternative card types or other instruments. It may also mean that using high credit limits relatively increases the risks.

The number of credit card users is also one of the basic tools, and it helps determine demands of customers for the service offered. If the number of credit card holders is low, it is an indicator of non-competitive products and weak marketing strategies. There are also problems in clearing credit card debts and

customers may misuse these kinds of instruments. These are important points while evaluating how successful the banks are in reaching the activities in credit cards (Barth 2004).

13.4 Behaviour Oriented Products and Services

In banking sector, there are a number of products and services affecting customer behaviours and sales. It is possible to analyse products and services affecting behaviours in terms of their costs in two groups.

(i) *Low-Cost Products and Services.* Call centre services, online banking, cash in ATM, cash withdrawal from ATM, direct transfer system, electronic fund transfer (EFT) and remittance.

Call Centre Services. The number of call centres has dramatically increased in various sectors. In terms of management, it minimizes interaction cost and increases the efficiency of the activity between customers and services. Call centre services is an umbrella term embodying telemarketing, account management, customer services (Rose 2002). Among non-physical services banks offer, call centre service is one of the biggest burdens. Bank staffs try to solve any kind of trouble related to above-mentioned activities and banking activities of customers through a phone call. At this point, determining customer satisfaction and the quality of the services offered has utmost importance. Thus, customer feedbacks are critical to correct any kind of mistakes in the call centre system and to constantly improve the services offered.

There are several studies in the literature to measure the relationship between call centre services and customer satisfaction. The common feature of these studies is to measure the effectiveness of the services customers receive during their call, and how this exchange affects their decision-making processes and behaviours. These studies finally discuss about the improvements to ensure customer satisfaction. Critical operational variables in customer satisfaction within financial services and banking call centres are as follows: level of service, average response speed, duration of call, length of hold time, total number of calls, calls that solve problems at once, and blocked calls (Freinberg et al. 2002).

On the phone, customers generally make inquiries or carry out transaction regarding account balance, credit cards, fund transfers, stop payments, updating personal information, opening deposit accounts, investment operations etc. (Lunt 1996). Recently, transactions carried out on the phone have changed and varied. The necessity to run online banking and call centre services together is another development that has recently been taken into consideration. Customers might prefer to use self-service and staff channel services together in terms of non-physical channel utilization. In this respect, banks should carefully analyse various customer reactions so that they can improve the structure of call centres. It can especially be very boring for the customers to be transferred from one officer to another in each inquiry. The fact that the relevant staffs for the banking

transactions do not answer the phone when called out of working hours is another situation that troubles the customers (Floyd 2002).

Online banking. Internet-based technologies have a significant place in the new world of financial services. When it comes to banking sector that has an important share especially in financial sector, the effects are similar. Internet-based services enable full accessibility for customers, once the relevant infrastructure is established. Online banking services, therefore, has become an ever more attractive service (Claessens et al. 2002).

Improvements in the internet-based technologies help internet banking (also known as online banking) to develop. As part of individual banking transactions, customers can carry out various banking transactions such as account balances, bill payments, credit cards (Actuate Corporation 2007), direct transfers and payments orders, remittance, EFT by using online banking channel.

Developments in self-service based channels depend on micro and macro trends in retail banking. Economic integration between countries, improvements in information technologies, legal reforms such as liberalization represent developments in macro level. On the other hand, increasing competition and new service and product improvement that play a key role during the growth of financial sector are effective in micro level (Oliver et al. 2009, pp. 196–197).

There are several positive and negative technology-based matters in the development of online banking. Easily managed software, direct communication between customers and bank, concurrent access of all customers to bank are among positive developments. On the other hand, some customers might have trust issues although security systems have been radically improved. Besides, there might be a problem related to internet band-width and connection (Oliver et al. 2009, p. 198).

Automatic Teller Machines (*ATM*). Financial institutions can offer services to customers through cheque and payment order. Most of these transactions have national characteristic. The recent developments in the banking sector and the increasing customer interactions forced banks to use various technology-based instruments. ATMs are one of the most important technology-based banking instruments that offer most of the banking services outside working hours and enable the interaction with customers (Khawaja and Manarvi 2009, p. 1440). First ATM transactions were carried out in 1969 in USA. This steady growth continued from 1970s to late 1980s (McAndrews 1991).

While choosing financial institutions, customers consider several factors such as interest rates, ATM accessibility, online services and sufficiency level. Customers pay attention to ATM accessibility and online services offered by the bank during their decision making processes (Haytko and Simmers 2009).

Security of an ATM has been ensured by legal regulations in the international arena. There are certain precautions such as regular camera surveillance around an ATM, adequate lighting in ATM terminals and setting up card system at the entrance (Myers 2003).

The infrastructure of ATMs is based on fiber optic foundations. This is why, it is discussed that intervention and compensations might be more difficult than

satellite technologies to correct any serious trouble that might happen in banking transactions carried out using ATMs in the future (Saunders 1992).

Direct Debit (*Automatic Payment System*). Direct Debit system is an important instrument ensuring accurate and efficient payments. It is possible to make regular payments such as insurance, telephone, gas and electricity through this system (Australian Securities and Investments Commission 2010).

There are some advantages of Direct Debit system. First of all, automatic payment system has positive impacts on controlling cash flow. It also allows more comprehensive controls in terms of the timing of funds in accounts. Payments are made automatically with Direct Debit; and thus, obligations are fulfilled before their deadline. In the remaining period, one can decrease costs and yield interest income. Besides, one can achieve flexibility and accuracy thanks to efficient account management, control, and security (The Royal Bank of Scotland 2010, p. 2).

Electronic Fund Transfer (*EFT*) *and Remittance*. EFTs, also known as External transfers, are essential fund transfer instruments related to the retail and wholesale activities of the banks. Banks started to enable electronic applications in fund transfer by improving their know-how in technology and system management.

The efficiency of EFT in banking appears at this point (Ernst 1975). Towards the end of 1970s, the increase in utilization of EFT shows that application area expanded not only in retail but also in enterprise banking (Hall 1978).

Remittances which represent internal bank transfers indicate transactions between different accounts of a bank. As in EFT, remittance transactions are commonly used in both retail and wholesale banking activities.

Central banks usually manage the EFT system. EFT centre enables some activities of the participant banks such as completing fund transfers and reconciliation, managing accounts and various reporting. When a message is received in EFT accounts, reconciliations are completed. At the end of the workday, abstracts of accounts are reported to the participant and Central Bank (Korkmaz and Govdeli 2010).

Payment Orders. These are the orders given regularly by the account holder to transfer a certain amount from one account to another. Payment orders are structurally similar to automatic payment orders, but they have a significant difference. They are used for more regular payments like rents rather than unsteady expenses such as electricity, credit card and water bills.

(II) *Higher Cost Products and Services*. There are certain banking activities that have relatively higher costs than the other banking transactions. If one places or withdraws deposit in cash, costs are higher. Hence, this system, also known as branch banking, shows that physical transactions mean higher costs in products and services.

Modern day banking services are mostly offered via electronic instruments and distant banking. Distribution of IT based banking service is cost efficient. A study by Booz, Allen and Hamilton companies proves that costs per service are as follows: 1.07 $ in branch banking, 54 Cent in mobile banking, 27 Cent in ATM

and 1.5 Cent in on-line banking. In terms of cost and efficiency, electronic banking products and services are more advantageous for both the bank and customers (Heffernan 2005, p. 92).

The cost of any cash withdrawals from the ATMs of other banks is another case to be discussed considering low-cost products and services. Small scale banks can provide services to their customers through membership within local ATM networks. This is how small scale banks will increase customer satisfaction and their share in the market as a result of the acceptability they offer. If major banks demand extra fees for the customers of small banks when they use their ATMs, these customers suffer from additional fees and the portfolio of small banks decreases as a result. The decrease in the competition causes the market dominance of the major banks (Prager 2001).

These costs vary depending on how these transactions are completed. When it is not easy for the customers to use ATM networks, they may prefer alternative ways to withdraw money. In this case, the costs will increase, if the network of the bank is not adequate (Bjorndal et al. 2004). A certain fee is charged from customers, when they use other banks' ATMs for banking services (Siskos 2002). Increasing transaction costs force customers to use alternative ways. Cost efficient online transactions are encouraged instead of ATMs.

13.5 Invisible Services in Banking Sector

Some of the services provided by the banks include exceptional activities, also known as invisible services. Banks do not consider these kinds of activities as their major activities. Banker's drafts are the first transactions that come into mind at this point. It is possible to use banker's drafts in large-scale transactions such as foreign trade, buying cars etc. (Kaya 2008, p. 92). This is how money transfer from one account to another is enabled through banks. This also guarantees payments for sellers. A certain commission is usually required for the drafts arranged by the banks themselves (BBA 2010).

Invisible services offered by the banks are for blocking transactions such as cheque, debit cards etc. Recently, customers have experienced many fraud and misuse problems. Credit cards have been highly protected against theft and fraud. Depending on the company policies and situation, debit cards are not protected as much. This is why banks can block these services in case of a misuse and fraud upon the order of customers (Lazarony 2007).

Banks also deal with additional operations such as document investigation as a part of invisible services. In loan applications and cases where investigation is required, following activities are of utmost importance: acquiring information about relevant person and enterprises, managing the archives, a comprehensive financial analysis and verification by intelligence department etc. While evaluating loan applications, one needs to consider these merits; confidentiality, accuracy,

neutrality and stability (Yilmaz 2010). It is important to ensure that document investigation procedures are performed under the control of a competent staff, on time and by using adequate data sources.

13.6 Conclusion

As an instrument of competition, major banks open branches in strategic locations. It is necessary to pay attention to physical channels that are slightly costly. With this regard, the efficiency in positioning a branch to prevent dominance of rival banks and staff recruitment for the branch are very essential.

Distribution channels offered as alternatives for branch banking have relatively low costs. However, some customers still prefer to complete critical operations like investment and retirement by face-to-face meeting because of customer tendencies. This shows that branch banking is still an important service, although its cost disadvantage.

However, banks have been forced to apply the pricing analysis-based competitive strategies for reducing transaction costs and efficiency in banking sector. Nevertheless, the positive effects of the strategies on behaviour and sales reflect on the pricing policies of banking product and services. As a result, innovative pricing policies in banking sector besides conventional policies should be accurately determined in order to be one step ahead in the competitive environment.

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Chapter 14
Reputation Management in Global Financial Institutions

Mehmet Emin Okur and Mehmet Lutfi Arslan

Abstract The economic crisis which began in the USA at the end of 2008 has first and foremost affected global financial institutions. The most destructive effect of the crisis on global financial institutions has been loss of reputation. It is obvious that "large scale" factors such as disruptions in current financial structures, the fragile structure of global financial architecture, assessments of risk system, and requirements for new regulations have impact on reputation and its management. However, from the managerial disciplinal point of view, reputation management is a comprehensive approach which involves the anticipation of all variables available, and where different stakeholders and circumstances are taken into consideration. The reputation of global financial institutions depends, in the final analysis, on the administrative processes of these institutions; in other words whether or not they are managed well. A good management requires foreseeing crises, and considering the opportunities and threats together with their strengths and weaknesses, and putting into practice an action plan towards that end together with the active participation of all their stakeholders.

Keywords: Reputation · Reputation management · Reputation management and Financial institutions

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Ü. Hacioglu and H. Dincer (ed.), *Managerial Issues in Finance and Banking*,
DOI: 10.1007/978-3-319-01387-9_14, © Springer International Publishing Switzerland 2014

14.1 Introduction

The economic crisis which began in the USA at the end of 2008 has gained a global dimension that affected the whole world in a short time. The global financial institutions were one of the most affected institutions by this crisis, which has an informative aspect in terms of understanding the phenomenon named globalism. The consecutive news of bankruptcy of famous banks and financial institutions which had global reputation, image and brand recognition created a discussion platform where both the management processes of these institutions and even the legitimacy of the whole banking industry were questioned.

It can be argued that the most destructive effect of the crisis on the global financial institutions which still continue has been loss of reputation. Much as reputation is a concept which requires contribution of different disciplines, and has a large content, it is basically a perception intended for a business and this perception depends primarily on the efficiency of managerial processes and of managers who manage these processes. It is obvious that "large scale" factors such as disruptions in current financial structures, the fragile structure of global financial architecture, assessments of risk system, and requirements for new regulations have an effect on reputation and its management. However, from the managerial discipline point of view, reputation management is a comprehensive approach which involves the anticipation of all variables available, and where different stakeholders and circumstances are taken into consideration. The reputation of global financial institutions depends, in the final analysis, on the administrative processes of these institutions, in other words whether or not they are managed well. A good management requires foreseeing crises, and considering the opportunities and threats together with their strengths and weaknesses, and putting into practice an action plan towards that end together with the active participation of all their stakeholders.

The concept of risk management, which can be labelled as the total of the measures financial institutions take in the face of a crisis, has begun to be considered within the scope of corporate governance in recent years. This concept, which is normally expected to have the integrated approach in management processes, is within the narrow context of the risk concept in the way of types of precautionary measures against potential bad scenarios. However, the reputation management approach is a long-term road map aimed at enhancing the whole part of management processes, and it is an integrative approach which pays regard to all partners of a business, that takes account of a business and its operations with both its internal and external environment. Furthermore, it is not a reactive, but a proactive approach. From this standpoint, it can be argued that the reputation management approach which takes into account the constituents such as senior management, employees, activities, products, and social responsibility has a healthier approach to the loss of reputation in the global financial institution's face.

The ambiguity, fragility and variability that the final crisis brought out in the financial architecture has a complexion of a solution with the help of a human-

centred management process approach, not only with the skill of complex financial techniques and algorithms. Management is a human activity which is based on foreseeing perceptions and ambiguities, and it offers a simple, plain and a clear road map for each single process. No matter how complex financial markets, and how unforeseeable the actors in this setting are, each process where a person is in the limelight has a chance to plan, to direct and to be audited.

14.2 Reputation and the Basel Criteria

The obligation to handle the reputation of management in global financial institutions, within the framework of process management approach, with its internal and external environment is not only a management approach, but is rather a requirement suggested by The Bank for International Settlements. This issue, which was also on the agenda of the Basel Committee, which brought in some new requirements to global financial institutions, has become even more transparent when the term reputation risk was introduced in 2009. Reputation risk is defined as a concept which depends not only on internal factors but also external factors of a bank, and that reflects the perceptions of the stake holders in the market, and is multi-dimensional. The criteria oriented approach towards the banking sector which incorporate the regulations introduced regarding risk management, financial regulations and auditing, and which are evaluated under three different categories introduced in different time fundamentally aims to form a structure resistant to financial crises to develop risk management and audit, and to increase the capability for sharing the transparency of a financial institution and sharing information with the public. In this context, it is claimed that the criteria which anticipates the duty of managing and implementing the bank does not receive the attention it reserves, though it in fact involves internal auditing and control of the institution. The essence of the report, prepared by Lord Adair Turner in the UK after the economic crisis, and which summarizes the outcomes of the crisis under seven items also suggests that the matter arises from corporate governance.[1]

Research about the 2008–2009 economic crises has shown that performance comes with good governance. According to Drobetz, good corporate management is closely linked to a higher market value and more feedback. The study Erkens, Hung and Matos carried out in 2009 has shown that institutions with sound corporate structures are able to overcome crisis atmosphere more easily.

[1] In his 2009 report on the causes of the crisis, Lord Adair Turner, chair of the UK's Financial Services Authority (FSA), cited seven proximate causes: (1) large, global macroeconomic imbalances; (2) an increase in commercial banks' involvement in risky trading activities; (3) growth in securitized credit; (4) increased leverage; (5) failure of banks to manage ffnancial risks; (6) inadequate capital buffers; and (7) a misplaced reliance on complex math and credit ratings in assessing risk. For more information see: Adair Turner, The Turner Review: Regulatory Response to the Global Banking Crisis (London: Financial Services Authority, 2009).

In conclusion, in a period when crises deeply affect the banking sector, an approach to reputation needs to have an integrative approach that includes all management processes, and which encompasses risk or perception management, as well as the global mission, vision and strategic goals of a business.

14.3 What is Reputation?

Reputation, from the standpoint of management science, is an indicator of how a business is perceived by its internal and external environment. Reputation which is defined as how internal and external clients perceive the company and with which expressions they define it. Also, the process with regard to establishing a corporate image, its protection, and maintenance can be described as reputation management. Actually, reputation, which can be defined as the common perception level of different stakeholders and the entire environment connected to a business, means, sometimes in an exaggerated way, the reproduction of activities of a business and the outcomes of these activities by different groups.

According to Fombrun, who has conducted significant studies regarding the subject, reputation is a perceptual representation of a company's past actions and future prospects that describes the firm's overall appeal to all of its key constituents when compared with other leading rivals. The definition provided by Bennett and Kottasz offers a wider framework. According to them, reputation is a product of expectations, perceptions and ideas established as a result of comments, observations, and experience regarding the qualifications, attributes and attitudes of clients, employees, suppliers, investors and the whole public. The definition suggested by Anca possesses a frame of similar reference: corporate reputation is, on the whole, a long-term compound of assessments of stakeholders regarding what an institution is, how an institution fulfils its responsibilities, how it meets the expectations of stakeholders, and performance of an institution in keep pace with the environment. It can be understood from these definitions that reputation is a perception about the results of business activities which encompasses all the stakeholders connected to a business, and is built in the long-run. This concept, which is about how a business is perceived by its internal and external environment, has intensively become a subject of academic studies recently. Furthermore, it draws attention, so much so that, it is dealt with within the framework of professional consultancy by businesses.

One of the most important points that should be conveyed about the term reputation is that it is the total of perspectives to a company of not only clients, but also of other groups associated with a business, shareholders and partners, investors, customers and suppliers. Also, another point is the reality that it is hard to gain and maintain reputation, but it is an asset which is easy to lose. The emergence of reputation as a competitive advantage takes place in the long-run; however, the effects of a loss of reputation usually happen in the mid and short term.

How important reputation and trust for global financial institutions is one of the most important lessons that the latest global crisis taught. Moreover, the vast majority of services that a banking sector provides are services based on intangible assets. The most important relationship between a bank and a client is a relationship based on trust. Banking cannot be carried out without trust. For banks reputation, in this sense, is a concept which should be managed as a term that should be established, protected and maintained.

Furthermore, the fragile structure of global markets and growing inconsistency between financial markets and real counterparts has increased the need for holistic reputation management. In this regard, reputation management of financial institutions should be examined in terms of their strategies that cover relations of their internal and external environments along with the management of their intangible and tangible assets.

14.4 Reputation Management

According to Sanchez and Heene, the management process of an organization is putting into practice the formation and coordination of an organization's strategic logic, tangible and intangible assets. In addition, this means first gathering some information about the capabilities, activities, goods, resources, sectors, in brief, all its internal and external environment of an organization; then, interpreting this data, and finally forming decision processes particularly resource allocation according to the results obtained. Reputation management, therefore, should be considered as a process that includes first identifying reputation resources, then carrying out an action plan towards these resources. Action plan consists of a series of actions that will reshape the capabilities, attributes, goods and services of a business that establishes its identity.

It is obvious that reputation forms as a result of activities and a communication policy of a business, and this expresses the management of a complicated process of the strategy, business processes, culture, employees, managers, value provided to the customers, and management style of a business. Thus, reputation management is actually management of factors that can be labelled as a source of reputation because reputation is, to a large extent, a perception which forms outside of the company. In this respect, reputation management is the management of factors that can be described as a source of reputation. Therefore, the first step in reputation management is to identify what reputation resources are. The next step is identifying what business activities these correspond to, in other words, what the functions and parties that concern a business are should be presented.

What are the sources of reputation in global financial institutions? The factors that generate reputation or that can be described as source of reputation has been a subject of a number of studies. The research, often called reputation measurement, usually consist of company rankings. As a matter of fact, the ranking that has been carried out by Fortune magazine since 1984 in which the most reputable

companies are presented among 1,000 American companies is of this type. The criteria used are as follows: The quality of company management, the quality of goods and services, long-term investment value, innovation, financial reputation, the ability to attract and develop skilled and successful human resource, perception of environmental and social responsibility, and being able to use corporate assents efficiently.

Another method used in reputation measurement apart from company rankings is a reputation quotient. In this method, developed in 1999 by Charles Fombrun, Executive Director of Reputation Institute and Professor Emeritus of NYU's Stern School of Business and Harris Interactive, reputation quotients are examined with twenty variables listed under six categories. These six variables are: emotional appeal, products and services, vision and leadership, workplace environment, financial performance, and social responsibility.

According to another study conducted by Arlo Brady in which constituents of reputation management are put forward the reputation quotients are listed as follows: knowledge and skills of employees, emotional connections, leadership, quality, financial credibility, social credibility, and environmental credibility.

As can be seen, there may be different statements about the reputation quotients. The differences may arise from the industries and business branches in which businesses operate, as well as from reasons such as activities and orientation of a business. In this study where we deal with the constituents that need to be considered in the reputation management of global financial institutions within the scope of management approach, we will examine reputation quotients in five categories. These categories are: Top management, employees, products and services, social responsibility, and efficiency and performance.

14.4.1 Top Management

The top brass of global financial institutions can be considered, in a way, a showcase of reputation of a business. The parties outside a business, for whom it is not easy to access information about the internal environment of a business, shape their perceptions of that business by looking at managerial staff and their activities. Research studies of subjects such as the structure of the board, applications/implementations of the board, organizational structure, and the contribution of management priorities to a business shows that there is a direct relation between leadership and reputation.

Top management can be studied under two categories: the board and senior managers. The board is the most important organ that draws up the strategy of a financial institution and decision mechanism. It is not possible to say that the decisions taken by the boards had no share in the scenario appeared in the 2008–2009 financial crises. Taking healthy decisions for employees, shareholders, clients and the whole economy entails understanding the functions of the board within the framework of reputation management. The boards of global financial

institutions basically have three functions, which are setting out strategies, risk management and manager selection. The final crisis has shown it is essential that each function should be reconsidered by evaluating it with a long-term perspective from the viewpoint of reputation management.

Senior management, on the other hand, forms the most important connection point between the board and other stakeholders. According to the studies carried out, it has been realized that there is a very close relation between the individual reputation of company leaders and corporate reputation. Therefore, the leaders with a clear and sensible vision who notice the opportunities in the market and can direct the business towards them accordingly make a positive contribution to corporate reputation by establishing their own reputation. It can be easier for them to manage their personal reputation than corporate reputation in terms of flexibility and orientation to change. However, in order for this advantage to be used positively, it is essential that they have speed and flexibility.

The effects of leaders on reputation management can be studied under three main categories, which are: their power to choose the people they will work with, setting out the incentive systems for these people and influencing the way it does business with organization culture.

Powerful leaders tend to work with people who can adapt to their own performances and working styles. As a result of reflection of positive attributes of a leader, employees get similar qualities and performances. However, negative attributes of the leader may also be seen in employees as a different reflection. Ultimately, leaders are in a position to directly affect the organizational culture and this is reflected on the employees. According to Blass and Ferris, the main factors that form leader reputation are: the positive impression a leader makes on people he or she interacts with and strong adaptability.

One of the areas where the impacts of powerful leaders on reputation management are widely observed is in incentives and reward systems. The authority of leaders to receive high bonuses and shares both for themselves as well as for their employees was seen as a function that affected the reputation of financial institutions negatively in the final economic crisis. High bonuses and incentives that were paid to employees were the Achilles heel for the banking sector which had huge trouble in that period. The argument about Royal Bank of Scotland (RBS) CEO, Stephen Hester is an example of this. He was awarded a bonus of £963,000 for 2011. This was controversial because the public bailed out the bank in 2008 and is 83 % taxpayer owned. There were also accusations of the banking industry precipitating in a global financial crisis and mistreating customers in the PPI scandal.

14.4.2 Employees

Qualified work force is among the most important factors in managing reputation. Institutions like banks, where reputation and trust are essential, put forward these

intangible assets of theirs through their employees. This approach, which also explains the term “employee brand”, has moved the employees to the position of envoys for financial institutions. Institutions which have managed to convey their vision, culture and values to all people in the company, from employees at the bottom level to high-level executives, increase their reputation and what is more, they succeed in turning their reputation into a competitive advantage.

It is clear that businesses with a good corporate reputation can attract qualified human resource in the market. According to research studies conducted among university graduates, graduates tend to prefer firms with a high corporate reputation. On the other hand, reputation leads to invisible added value for a business in terms of motivation of current employees. It is a time-consuming task to find at the right time the right people who have the right characters and can adapt to the organizational culture. Research studies show that the external reputation of a service business is greatly affected by the ideas of their employees about the employer. Employees develop their ideas with the help of the work experience which is also affected by the organizational culture which the institution leader established with his style.

Businesses that cannot define the corporate culture, which is an important source of corporate reputation, have trouble directing the human resource for their own goals. Therefore, ensuring corporate culture adopted by the employees should be a primary objective. If the corporate culture and business setup have been established too strictly in a way that the employees cannot utilize their capabilities and skills, neither human resources efficiency nor operational efficiency can be achieved.

Increasing the trust placed in the abilities within an institute is a factor that more positively affects the financial efficiency, employee motivation, and more importantly human capital compared to other incentive systems. In order for this to happen, qualifications and abilities should be clearly recognized, the business should make sure that employees contribute to corporate decisions, there should be work with teams that consist of people with different capabilities, and educational and experiential programs that will develop skills.

Establishing an atmosphere of trust is significantly important for individual performance as well as for corporate performance. Confidence is affected by the employees being clear and transparent in information sharing and solving problems, and again by the employees abiding by the written and verbal agreements they have with the institution, and consistency of the parties. Behaviour and belief of employees in achieving the targets with the abilities and work methods of each other is also effective in the establishment of an atmosphere of confidence.

14.4.3 Products and Services

The perceptions of businesses in society usually appear and are shaped mainly through their products and services. The businesses that provide products and

services at a high quality and value gain a reputation in time. This reputation is either protected or eroded according to the development level of products and services offered according to the customer needs. The management of products and services as a source of reputation needs multi-layered efforts such as brand, quality control processes, advertising and promotion.

It is obvious that a company with high corporate reputation is more reliable also for investors and that this will make a positive contribution to the market value of the business. Reputation plays a key role, also for the competitors in the market, in ensuring standardization in relations, fulfilling contracts and assurance, and settling disagreements. In this regard, reputation has an important effect on global financial institutions. Reputation carries meaning of letter of warranty in the eye of other clients and competitors.

The most important component that establishes reputation of an institution is high customer satisfaction. Therefore, it is essential that institutions continuously develop the quality of their products and services in order to gain reputation. However, in the development of improvements in products and services, the properties of the industry as well as the analyses about traditional product curve should not be ignored. The financial tools sector which welcomes innovation and change warmly at first hand, but prioritizes the search for efficiency in the mid and long term has a highly sensitive structure in terms of its reputation in products and services of financial institutions. And in the 2008–2009 crises, the bankruptcy of Lehman Brothers led to a shock in the market of asset-backed commercial paper, and the loss of reputation of this financial tool caused a number of developments which directly damaged the reputation of institutions.

14.4.4 Efficiency and Performance

Another factor that increases reputation or ensures its continuity is efficiency and performance. By this, level of efficiency in all business operations including financial performance is meant. Efficiency and performance as a factor which determines an internal or external perception that a business is well run, also includes the factors such as profitability history, low risk investment opportunities, market value of a business and credit standing, which can be measured. Another sub-category that can be studied under this heading is about the degree to which the competitive properties that a business has against the competitors can be developed. The effects of all these factors on reputation come as a difference between the value of assets of a business and the real value in the market, which is defined by Fombrun as reputational capital.

Global financial institutions are corporations that are expected to show efficiency and performance mainly in two levels:

1. The quality of the products and services that will meet customers' expectations,
2. Success at financial intermediation and managing risk

In these two fields, however, the first selection of the right strategy, then implementation of the strategy, and taking account of environmental conditions, is needed.

14.4.5 Social Responsibility

Global financial institutions operate within a social environment. The fact that a business is sensitive to the social environment it lives in leads to increase in reputation, and sensitivity to the social environment takes place in the form of supporting activities that benefit the public and being sensitive to the physical environment. Reputation that has emerged in this way contributes greatly to the intangible assets of the business.

Corporate social responsibility can be defined as treating all the stakeholders in the internal and external environment "ethically" and "responsibly" shaping the decisions the business took in this way, and ensuring the implementations again in this direction. According to Mohr, Webb and Harris, corporate social responsibility is the promise of reducing every harmful effect to a minimum or eliminating it completely and of increasing the long-term benefits to a maximum. There have also been some who define this activity as a part of society in which businesses live. Within the framework of this definition, Carroll suggests that corporate social responsibility has four components: economic, legal, ethical and philanthropic. According to this, a business should grow in terms of economy and make profits, play legally by the rules of the game, show respect for others' rights in the ethical sense and fulfil its responsibilities, and finally provide society with some philanthropic services.

The increase in investments in social and corporate responsibility produces a remarkable effect in the market. Studies in these two areas gain some different insight together with market value, social values, personal interests and social interest. The studies in social responsibility and corporate social responsibility help to form new markets.

14.5 Conclusion

Effective governance is the main source of reputation. Reputation which is fundamentally a perception that belongs to the environment outside the business possesses a dynamic content shaped by factors such as the vision, performance, policies, leadership of the business. Hence, the term reputation needs to be dealt with within process approach and be placed on a management model. This approach, which can be defined as reputation management, and is fed from five sources, which are, top management, employees, products and services, efficiency and performance and finally social responsibility is a dynamic and holistic

approach connected with internal and external environment of the company. In the crisis periods when the destructive effects of globalization is felt more, and when global financial institutions suffer loss of reputation and trust, the role of reputation management as an approach that takes account of all management processes would be more pertinent in the establishment of more prosperous, more harmonious and more peaceful social structure.

Institutions that succeed at reputation management actually deliver successful governance and performance with all their levels. Top management serves as a good bridge between the board of directors and the employees and integrates their personal reputation with corporate reputation. Employees are able to take their skills and capabilities to the utmost point with corporate culture and become envoy volunteers for their institutions. The quality of products and services is continuously improved and contribution is made to the increase in the level of efficiency and performance. And implementations of corporate social responsibility provides an added value on the issue of increasing the wealth of society

Reputation management, which is a term beyond risk management or corporate governance, can attain success only through a planned, disciplined and integrated approach. This task is such an important duty that it cannot be assigned to a department within an institution or to an individual stakeholder. Reputation management, in this respect, should be personally adopted by senior management, should become a part of corporate culture, and ought to be adopted by all stakeholders in both the internal and external environment of the institution.

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Chapter 15
The Impact of Advertising on Financial Performance in the Era of Global Economic Crisis

Emine Banu Yegin

Abstract The aim of this study is to examine advertising and financial fields working for the same purpose but seeming differently. In this regards, it has been examined theoretically the support of advertising which has been seen as an abstract investment for the same purpose-the profitability of the business to the strengthening of a company's financial performance can be seen clearly by becoming concrete with the help of some data and analysis. Initially, advertising was seen necessary for only product or service sales according to the businesses, but today it has become a necessity to be able to adapt to increasing international competitive conditions and to achieve the objectives by developing investor relations and attracting more domestic and foreign investors. It is crucial for businesses to read the tables well. With his study, it is intended to encourage managers read the tables well with ease especially during a crisis.

Keywords Globalization · Financial performance · Financial concepts · Advertising · Advertisement concepts

15.1 Introduction

The competitive market in this globalizing world has been strengthening together with the development of technology. Businesses form various sales marketing strategies in order not to fall behind their competitors by increasing their market share. This study consists of three sections with the aim of supporting managers that are work result-oriented. In the first section, the focus will be on the study and how it is completed. In the second section, the focus will shift to evaluating

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Ü. Hacioglu and H. Dincer (ed.), *Managerial Issues in Finance and Banking*,
DOI: 10.1007/978-3-319-01387-9_15, © Springer International Publishing Switzerland 2014

globalization, the effects of globalization, formation of economic crisis, how the crisis should be managed, what is financial performance, and some information about which concepts are considered is given as well. In the third section after explaining the importance of marketing studies for the businesses, promotional concepts, and the importance of advertising in promotional decisions; the aim of advertising and its proceeds are explained and lastly the data and analysis that should be carefully checked during and after advertising are explained in detail. In the conclusion, the necessity of advertising for strengthening a company's financial performance and the positive effects of studies' results completed by regarding the advertising analysis on performance are described.

15.2 The Globalization Process and its Reflections on the Crisis and Financial System

The world has become a little village. With globalization; products, services, international capital flows and technologic developments between countries have increased and liberalized (Kara 2009: 67). Because of this reason, the size of the competition has grown; efforts for the product and service delivery for the consumers spread over a wide area have increased (Yurdakul 2003: 206).

In today's world, in which financial markets are becoming integrated, instability in any country's financial market can cause successive instabilities and even an economic crisis in international financial markets. Whatever their reasons, the results of the crises are the same. As the national income decreases the public gets poor; with the result of increasing fluctuations in finance, the market investors lose money (Apak and Aytaç 2009: 71).

Economic crises are the conditions that create an atmosphere of uncertainty by causing imbalances in business activities, and threaten the existence of the business and restrict the decision-making process of the business managers. When the literature is examined, the crises are generally gathered in two groups. The first of these is a financial crisis and the other is an economic crisis. Financial crises are considered as serious economic problems experienced with the results of severe price fluctuations in financial markets like foreign exchange and stock markets or with the intensive increase of "dead" (non-performing) loans that are not returned to the bank in the banking system (Büyüksalvarcı 2011: 226). Economic crises emerge as the serious shrinking in the amount of product-service and labour force markets-in the product and/or employment (inactivity and/or unemployment crises) (Elmas and Yıldırım 2009: 161–170).

During a financial crisis, the decrease in the sales volume and shrinking in the production are seen. When it concurrently happens with decrease in the sales, accounts receivables turnover and stock turnover, it causes a decrease in working capital and liquidity; thus, non-payment of debts on time and bankruptcy or financial problems occurs. In order to overcome the crisis the businesses try to

decrease the destructive effect on them by taking some measures to increase the demand (Arıçay 2010: 175). In an economic crisis, companies whose sales incomes decrease lay off increase. Thus, the vicious cycle transforming into crisis starts (Ertuna 2009: 8).

The most important problems of global economic crises for the businesses are the increase in the production and fixed costs per unit coupled with the production decrease emerging parallel with demand decrease, labour force problems due to the layoffs and increases in financial costs due to reduced resources. The solutions to these problems, a business firstly should make their production and marketing systems more flexible in case of rapid decrease in the demand; unnecessary activity and non-operating expenses should be determined and tried to be decreased by internal efficiency analyses. Especially during a crisis when liquidity problems are more common, some precautions about increasing the net working capital share in the total investments (Ariçay 2010: 190).

15.3 Impacts of a Global Recession on Financial Performance and Product Life Cycle

The inactivity in product and service sales is the most important factor of crisis dynamics. Usable semi-finished or finished substance produced by a specific material or giving a human service is called product in the economy. On the other hand, service is generally defined as actions, processes and performances. Some marketing authorities define service as; "all the activities produced in the world without having a physical product and its structure" (Cutler and Schimmel 1998: 143).

Businesses experience the sales and debt collection problems mostly during a crisis; they need to take some precautions by developing some strategies in order to overcome these financial problems. Especially they need to advertise by strengthening their promotion studies in order to find new customers and open up new markets, so that businesses would strengthen financially.

Performance measurement is an approach to determine the business' performance level; to measure what level the principles like economy, effectiveness, efficiency, etc. are achieved in the activities of the corporation and resource using; to determine the problems and that forms a basis for the necessary precautions for the reformation (Elitas and Agca 2006: 344–365). While evaluating performance businesses, look for an answer to these questions: Where are we now? How better we could be? Where should we be? Performance measurements should tell how an activity meets the needs of domestic and foreign customers, besides each team or operation should reflect their contributions to each other in order to achieve the organization objectives. Basing upon this explanation, performance measurement is necessary in terms of the points specified below (Atkinson vd. 1997: 86). (a) A value's being not managed without measuring it, (b) Determination of what would be developed, how showing attention, (c) Preparing an observation chart so that

employees can follow their own performance level, (d) Determining the existing inefficiencies' costs, (e) Creating the standards fort the comparison, (f) Determining the efforts proper for the business objectives.

Businesses should take their financial performance under their control by evaluating the macroeconomic indicators in order to continue their existence in the competitive market and if available to maintain a competitive advantage. What is financial performance? In other words, what is the ultimate purpose of the business? The most common answer for this question is "maximizing profits" (Ertuğrul 2009: 19–46). The aim of the financial performance measurement is providing information to the decision-makers about the financial condition of the business. Financial analysis not only to help the business managers to make decisions about the future, but also it provides information about the business and help credit agencies make their own decisions about the business (Yükçü and Atağan 2009: 28–35). Financial performance criterions unveil that a strategy of a business and the execution and practices of this strategy whether contribute to the business or not. Measurable profitability like operating decision, profitability ratio of investment and capital, economic added value, etc. are commonly used financial measures (Gencer 2006: 34). Performance measures used for the purpose of revealing the financial performance of the business are examined in four main topics: [(1) Income-based measures, (2) Cash-based, measures, (3) Proceed-based measures, (4) Value-based measures (Ertuğrul 2009: 22).

Financial performance enables the managers both to evaluate the long-termed success of the company on what measure and determine the most important factors in order to achieve the long-termed objectives. The factors in the financial performance are special to the sector, environment and strategy of the company. This approach presents a template that will help them determine financial objectives for some subjects like income plus, production plus and decrease the costs, providing effective benefit and risk management (Kaplan and Norton 1996: 78).

Financial performance evaluations are divided into two parts: traditional and non-traditional. Classical performance measures generally focus on profit and efficiency measurements. This method remains incapable at some point as it takes traditional management accounting as a basis (Brinberg 2000: 10).

15.3.1 The Determinants of Financial Performance

There are many values used in measuring the financial performance of businesses. The use of these values becomes very helpful for the decision of managers. Some of them are:

Liquidity ratios: show the business financial status, helps to identify the opportunities for payment of overdue debts. In other words, liquidity ratios measure the company's ability to pay short-term debts (Altas and Giray 2005: 20).

Profitability ratios: They are used in the measurement of the degree of efficiency of equity and foreign sources that issued for business. It is determined with these ratios whether the business works profitable or not.

Leverage ratio: It is the ratio of debt to equity or total capital. It provides to be able to see how much ratio and which sources of business entity are met. With these ratios, it gets information about the status of the financial structure like the long-term debt payment ability of the business.

Activity ratios: It is the ratio measuring whether entities in business activities are used effectively or not.

Return on assets (*ROA*): This ratio is calculated by dividing the net profit to total assets (Yildiz Dogan 2012: 353–366). This ratio that shows how much profit has been obtained with 1 TL entity, used in evaluation of assets that used or not used effectively by the company.

Return on equity-(*ROE*): Earning power of equity is calculated by dividing net profit by the amount of equity capital. When showing the investment done by shareholders to the company is being used effectively or not, it reflects the effect on company profitability of financial leverage. With using financial leverage effectively, the profitability of the company's equity is expected to increase (Çakir and Küçükkaplan 2012: 74–75).

Return on sales (*ROS*): This ratio shows net income that obtained through sale of an each currency of business (Zell 2008: 148).

Earnings per share (*EPS*): Profit per share. It is obtained by dividing the year-end profit and losses of the companies to number of shares in the same period. EPS determines the market value of the firm.

Price-earnings ratio (*F/K*): is the ratio of the share price of the earnings figure per share. It is used in the measure of the return that expected from the stock on which the owners of capital invested their capitals.

Net present value (NBT): It is obtained by subtracting them of discounted values of a certain discount rate of net cash flows expected from investment from the sum of present values of investment costs. According to this method, if the net present value is positive, the investment can be done but if it is negative, it cannot be done. Net present value method is expressed as follows (Aydın 2001: 179):

Internal rate of return control (*IRR*): It is the discounted cash flow method. It describes cash inflows from a project that will be gotten to cash inflows ratio that the project required. For the acceptance condition of an investment, aforementioned investments' internal rate of return (Internal Rate of return-IRR), must be equal to at least the cost of the resources used for this investment, in other words weighted average cost of capital (Ercan and Öztürk 2006:14).

Market value of firms (*PD/DD*): It is found out by dividing the companies' stock shares' market value to the equity amount per share. With another saying this rate expresses the value and equity of the company in the market (stock market). When this ratio increases, it means that stock gains value. If PD/DD < 1 it means that the company does not produce value for its shareholders, it is desired to be bigger than 1. When evaluating this ratio the sector averages should be taken as basis (Çakır and Küçükkaplan 2012: 74–75).

Economic value added (*EVA*): It is the comparison between the obtained profit and costs of the resources used to obtain this profit (Yükçü 2007: 626).

Discounted cash flow (*DCF*): The net cash flow should be increases in order to increase the company value.

Weighted average cost of capital (*WACC*): These rates differentiate according to the change of the capital costs in the market. It provides positive or negative effect on the company value.

Return on invested capital (*ROIC*): It is a concept developed to increase the efficiency of the business managers; they are the evaluation of the activity profit of the company or any department of the company with the invested capital. The companies create the ROIC value by increasing their profit mark-up or increasing their sales income in a way with their wealth turnovers (Öztürk 2011: 357).

15.4 Effects of Advertisement Works on Financial Performance

15.4.1 The Interaction Between Competitive Marketing Strategies and Financial Performance

Businesses should develop various marketing strategies by using the analysis that is listed above. In marketing other operations should be done besides selling the products for the needs of the consumer groups in appropriate places with proper prices. The demand stimulating function of marketing is done through the transmission of the messages in terms of promoting the goods and consumption with proper channels to the target the consumer. The marketing function that enables it is promotion. Promotion is the process consisting of many elements that convey the information about a business, a corporation, a person himself or the products they produce to the businesses, masses, target groups or individuals in the desired way (İslamoğlu 2011: 447).

The most effective factor in the promotion mix is arguably the financial possibilities and resources of the business. It is natural that financially powerful businesses operate in more efficient in promotion activities than the others. While the small or financially weak businesses make promotions in a restricted area and with a restricted budget, the financially powerful and large businesses can use various promotion methods during the same period efficiently and intensively (Öztürk 2011: 137). One of the most important tools of promotion is advertisement.

Advertising is a set of messages that reflect the mutual interaction between a consumer culture and popular culture; remove the "Communication gap" rising especially between production companies and consumers as a result of development of the Market economy (Yılmaz 2004: 1).

The advertising term is derived from the Latin-originated word "clamere" meaning "calling" (Babacan 2008: 21). An advertisement is a product or service, a corporation, a person or idea's promotion and adapting to the public by a defined person via communication tools paying a price that is determined previously (Oluç 1990: 3).

According the definition of The Institute of Practitioners in Advertising (IPA), advertising is the occupation that expresses giving the most persuasive message in the proper promotion of a good or service with the lowest possible price (Mucuk 1982: 160). In 1964, AMA (American Marketing Association) defined advertising as "the promotion of a product, service or idea by paying its price in non-individual ways by the advertiser" (Gürüz 1996: 14).

But in today's world, it is getting more difficult to budget high marketing activities without knowing that to what extent marketing activities will contribute to the company objectives and performance. Expectations of senior managers about the financial returns of marketing activities are increasing day by day (Haigh 2000: 9–19).

Especially during a crisis, the possibility of falling behind in market share of the company decreases when the competitors continue their advertising. The managers of the advertising agencies choose the way of presenting case studies that prove the performance of the companies who continue their advertising at the crisis times to these kinds of companies. In such conditions the companies who continue advertising and increase their sales and Market share explain everything more easily and they even transforms crisis into opportunity.

While the main objective of the advertising is increasing the profitability for businesses, it has some special objectives for marketing as well. The chance of being successful of in an advertising campaign is weak without regarding the special objectives. Supporting an individual sales program, reaching to the persons, to whom the salespersons do not reach, presenting a new product/service, developing the sales of industry branch, standing up against prejudices, providing the respect for the business (Cemalcılar 1988: 344).

In order to direct the media strategy basic questions are asked: to whom will the ad be directed towards? Determination of the target market, where and which geographic region the ad will be done? How long the ad campaign will be for? Finding the best campaign periods, what will be the best media environment for the message of the advertiser?

15.4.2 The Determinants of Advertisement

Media planners should have a lot of information that would help them a lot in planning. Some of them are demographic profiles, psychographics, life styles and product using segment.

Brand development index (*BDI*): BDI shows the geographic and demographic regions where the brand is more or less powerful than his competitors. It is an

index that shows in which markets the analysed product is powerful (Başal 1998: 29).

Category development index (*CDI*): CDI tells us whether the analysed product or service in the market is over the national sales or not (Başal 1998: 29).

TV Viewing Rates (*Rating %*): Rating is the rate of people watching a program or advertisement to the accepted universe (Özkunduracı 2009: 108).

Total TV viewing rate (*TVR*): It indicates how many people of each 100 persons in the universe is watching TV in a specific time or within a demographic group (Başal 1998: 62).

Views share (*Share %*): Share of a channel or program from the total viewing (Özkunduracı 2009: 109).

Reach %: Different people who watch a channel in a specific time interval for at least one minute or the rate of these people to the universe. It shows how much of the universe is attracted by the channel for at least one minute (Demir 2008: 46).

Gross rating points (*GRPs*): GRPs expresses the gross viewing, listening or reading rate of an advertisement message in television, radio, printed media, billboards for a specific time period (Başal 1998: 65).

Average Time Spent (*ATS*): ATS is the average time spent by the people who have watched the cannel timeframe or program for at least one minute (Özkunduracı 2009: 103).

Gross Impressions: With this term the GPRs rate is transformed into the number of persons in terms of percentage (Başal 1998:66).

Coverage—Reach: It expresses how many different people watch, listen, read or hear the message in the television, radio, printed media, billboards, etc. for at least once in a specific time period (Başal 1998: 67).

Markup: Bottom-up profit mark-up. The gross profit that we reach the sales price by adding to the cost of a good (Özkunduracı 2009: 107).

Opportunity to see (*O.T.S.*): It expresses that how many times an advertisement is watched averagely by the same person during the advertisement campaign (Demir 2008: 46).

Rate Card: A communication tool's advertising rates, gross list price (Özkunduracı 2009: 109).

Adhesion: (*Audience profile*) It expresses the rate of a program's viewers in terms of target audience to the entire audience. We can find out how much share does have target audience in the whole audience with this concept (Başal 1998: 29).

Affinity Index: In terms of formula, the rate of a target audience's viewer intensity to its existence in all persons (Başal 1998: 72).

Return on investment (*ROI*): The measure of financial success of a campaign. The rate of campaign's income to its costs (Özkunduracı 2009: 109).

Cost per thousand (*CPT*): Advertising space way of purchase varies according to different media tools. For example the costs of 30-second advertising spot on radio or TV, 60-second commercial film for a week in the cinema, coloured full-page advertisement space in a magazine, renting 20 billboards per line weekly are different. The need of evaluating the efficiency of advertisements in all of these

tools causes the necessity to make a comparison in terms of cost. CPT expresses the reach cost of each 1,000 persons in a demographic group that is the objective of an advertising campaign of a media tool in a specific period of time (Başal 1998: 78).

Cost per rating point (*CPP*): It is the cost per each rating of the target audience in an advertising campaign. CPP expresses the cost to be paid to get a rating in the media planning before the campaign (Demir 2008: 47).

Cost per second per GRPs (*CPS/GRPs*): It is concept used in cost-effectiveness evaluation. Shortly 1 s cost of buying 1 GRPs is calculated by CPS/GRPs.

Share of market (*SOM*): Market share of brand %. It can be expressed as unit or turnover share (Özkunduracı 2009: 111).

Share of spending (*SOS*): It expresses the share of an advertising investment for a product from the total advertising investment in its product category (Başal 1998: 83).

(*Share of Voice* (*SOV*): It expresses the share of a product of a GRP purchased in the sector from the total GRP in that product or GRP category (Demir 2008: 47).

Single source panel: It is the name of a panel installed for the measurement of the effects of television advertisements. In this research the viewing data taken from the people-meter is combined with the purchasing data of the same persons in the measured panel. As a result of this a really valuable data that is necessary for the advertisement efficiency measurements like whether the product having an advertisement on television is bought or not, how often it is bought is gained (Başal 1998: 28).

Data fusion panel: It is another method used in the measurement of television advertising efficiency. The only difference of this method from "single source" is using two separate panels. It doesn't lay a labour burden to the same people, on the contrary it forms two separate panels with the same features and the data of whether the product having an advertisement on television is bought or not, how often it is bought is gained (Başal 1998: 28).

15.5 Conclusion

It may be too late waiting for the first six months without doing anything in order to understand whether inactivity is a crisis or not. While the tendency to spend is decreasing as the Gross National Product makes no progress or decreases, the unemployment rate increases, the reliance on the consumer decreases and thus strengthens the crisis dynamics.

During a crisis, it becomes a period of opportunity mostly for the financially powerful companies. Advertising during this time when the economy tends to decline provides opportunities such as brand identity and strengthen the customer base by gaining new customers. The only way to overcome the crisis is managing the crisis and not waiting. The first reactions of many corporations would be derogation, shrinking, reducing, cutting, minimization, and removal. However, the

companies that sees the crisis as an opportunity to make an impression for the consumers show growth by taking advantage of the decreasing advertising prices during a crisis. In order to create difference the businesses should make their product or services. As the active corporations overcome the crisis by increasing their market share, this increase turns into a growth in the sales volume later.

As a result of this study it is seen that financers and advertisers do not leave it up to chance when it comes to business profitability. They benefit from the past, present, make strategies for the future and take the possibility of the negative results when they support these with concrete data to the lowest level as possible. In this study it is seen that some concepts and analyses like Liquidity Rates, Profitability Rates, Leverage Rate, Activity Rates, ROA, ROE, ROS, EPS, F/K, NBT, IRR, PD/DD, EVA, DCF, WACC, ROIC help and direct the company managers for seeing the financial performance. In addition to all of these; concrete data and analyses of advertising and media planning would contribute a lot to the business managers in terms of advertising investments and these data and analyses create the chance of starting their advertising works with more confidence and evaluating the results with the data of demographic profiles, psychographics, life styles and product using segment, BDI, CDI, RATİNG, TVR, SHARE, REACH, GRPs, GROSS IMPRESSIONS, COVERAGE—REACH, MARKUP, O.T.S., RATE CARD, ADHESION, AFFINITY INDEX, ROI, CPT, CPP, CPS/GRPs, SOM, SOS, SOV, Single Source Panel, Data Fusion Panel.

Even this study is made theoretically, it is seen that businesses of the managers that use the financial analyses and media planning, advertising analyses carefully and read the formed table well can transform the crisis times into an opportunity and strengthen their financial performance.

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Chapter 16
The Financial Implications of Corporate Social Responsibility in the Banking Sector

Hasan Dincer, Ismail Erkan Celik, Recep Yilmaz and Ümit Hacioglu

Abstract Corporate Social Responsibility (CSR) is a recent and popular term used to establish an understanding between corporations and social environment. Fundamentally based on the framework of *Two Way Symmetrical Model*, these activities conducted to raise corporate reputation and thus, ensure credibility have gained importance in public relations. This research aims to analyse corporate social responsibility activities of deposit banks operate in Istanbul Stock Exchange based on various financial indicators. The main objective, however, is to identify the importance banks place on institutionalization in their promotions and its consequences. This research observes that banks that do not place importance on promotional activities have lower profit margins, whereas those that only make effort for advertising and public relations hardly compensate their expenses; the highest profit margin is achieved by banks that co-ordinately use both promotional methods.

Keywords Public relations · Banking · Finance · Corporate social responsibility

16.1 Introduction

This research deals with the financial outcomes of corporate promotional activities. Analysing the corporate social responsibility activities of the deposit banks listed in Istanbul Stock Exchange, this research aims to deal with advertising investments, total assets, consumer loans, commercial loans, savings deposits, commercial deposits, and periodical net profits; as well as the importance placed on institutionalization and its outcomes. In this vein, the first part conceptually and

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Ü. Hacioglu and H. Dincer (ed.), *Managerial Issues in Finance and Banking*,
DOI: 10.1007/978-3-319-01387-9_16, © Springer International Publishing Switzerland 2014

categorically deals with the term corporate social responsibility and clarify the financial outcomes of CSR. The second part will deal with the principles of corporate management and the way it changes banking sector. These two parts aim to establish a framework allowing comparative reading on both public relations and finance. Part three aims to clarify the problems of this research based on available data. The data covers a 3-year time span beginning with the crisis of 2008, and is based on the deposit banks listed in the Banks Association of Turkey. The last part presents certain de facto conclusions based on the theoretical framework and findings.

16.2 Concept of Corporate Social Responsibility and Financial Outcomes

Corporate social responsibility (CSR) is an old, but (academically speaking) recently used concept. Introduced by Howard R. Bowen through his book titled *Social Responsibilities of the Businessman* (1953), CSR has recently gained prominence after certain developments. Scandals in the business world (Enron, WorldCom, Parmalat, Qwest, ImClone etc.) resulted in consumers' loss of confidence towards corporations, leaders, and economy; and consequently, it aroused interest among academicians towards "business ethics" and "corporate governance" in terms of causality. The term "corporate social responsibility" gained prominence following the same developments. On the other hand, international organizations have developed protectionist approaches to human rights, environment, and labour force; the standards they developed also enhanced the above-mentioned circumstances (Bali and Cinel 2011; Aktan and Börü 2007). But what is corporate social responsibility? Does it have different levels? What are the current conditions in terms of corporations? What purposes does it serve, how is it made use of? How does one ensure financial outcomes? Answers to these questions will solidify our understanding of the subject.

To put it simply, CSR means the responsibilities of a business towards its *stakeholders*. One should keep it in mind that today's businesses do not solely exist with their technical and economic aspects. Businesses also have social aspects (Sabuncuoğlu 1998, 13). The relation between businesses and outside world is known to many businesspersons. Even the most ordinary investor knows how important trust establishment is. Great businessman such as *Oliver Sheldon*, *John D. Rockefeller Jr*. and *Henry Ford* helped establishing the understanding of social responsibility. These three figures were fully aware of the power of public opinion and they led the way towards a holistic perspective in which profitability of governance philosophy met the society (Peltekoğlu 2001, 170–171).

Still, *social responsibility* and *corporate social responsibility* are totally different terms. While the definition of social responsibility is the sum of rules required for the sustainability of a business' characteristic value, the concept of

corporate social responsibility points to social projects that a business voluntarily undertakes (Orçan, 2007; Balı and Cinel, 2011). On the other hand, one should keep in mind that they are both pragmatic approaches: while the former works on its internal image, the latter focuses on the image formed following social interaction.

CSR is not a one-dimensional activity. An academically recognized model was developed by *Archie B. Carroll*. In his article titled *The Pyramid of Corporate Social Responsibility*, the author categorized institutional aspects of social responsibility from bottom to top as follows: economic, legal, ethical, and charitable.

According to this categorization, corporations' first-level responsibility is commercial. Businesses fundamentally exist for profit following production. Organizations called businesses are the most basic economic units, and they make profit by providing products and services to meet customer requirements. Businesses unable to take economic responsibility fail in other responsibilities, as well (Carroll 1991).

Obeying the law is the second-level responsibility of a business. Conducting their activities, businesses should obey regulations in force. Business managers should also keep moral dimension of their decisions in mind. And this situation brings ethical obligations. Morality, therefore, is an important responsibility in all activities. The third level of the pyramid is occupied by such responsibilities. Responsibilities related to charity are on the top of the pyramid. Such responsibilities require a business (as a good citizen) to conduct beneficial activities towards its country, society, and the world (Carroll 1991; Ilic 2010).

CSR activities are also categorized in terms of levels. *H. For this reason, H. Johnson* developed a five-level *Corporate Social Responsibility Scale*. In his article titled *Does it Pay to be Good? Social Responsibility and Financial Performance* (2003), Johnson lists categories such as (from bottom to top) *irresponsible*, *compliant*, *fragmented*, *strategic*, and *social advocacy* in CSR scale.

According to this scale, the first level is used to define companies with no responsibility. While the companies in the second level have minimal compliance with laws, those in third level have partly complied and conduct minimal number of social responsibility activities. As the author puts it, if companies conduct CSR activities for financial performance, they are *strategic*; if they discard profit and conduct such activities solely for the good (without any benefit), this is called *social advocacy* (Johnson 2003; Ilic 2010).

Considering the categorizations used in the scale above, one can say that companies today move between the first and the fourth levels. Depending on the level of institutionalization, the main objective of CSR activities is to establish an image. And this objective is in the domain of public relations. In the four Ps classification (price, product, promotion, and place), public relations is included in promotion along with advertising, sales promotion, and personal selling. While public relations activities establish an institution's image on the institutional and judgmental curve, they also manipulate the reception of the target audience through this image. Such activities provide companies with credibility. And while

this credibility helps companies survive chaos, it also makes it easier for a company to benefit from the elements of promotional mix (Yilmaz and Ertike 2011, 132–134).

Various public relations models, which were previously popular, can meet different requirements of companies. *Press agencies* with the motto of "any kind of promotion works", *public briefings* overcoming crises, *two way asymmetrical* models are used in this field. The last model is *two way symmetrical model*, which is based on mutual understanding and commonly used by many companies in public relations (Peltekoglu 2001, 66–97). CSR activities assume a key role in this model and contribute to companies in many respects.

The main institutional functions of CSR activities are as follows: Expectation of the society, long term profits, ethical obligations, positive image, better environment, reducing state intervention, responsibility and power balance, protection, ownership of resources, interests of stakeholders. As *Stephen P. Robbins* underlines in his book titled *Management* (1994) that society has had higher expectations since 1960s, social expectations as well as economic expectations have been brought to agenda, the fact that companies recognizing their social responsibilities are more profitable in the long run, the necessity of ethical consciousness for companies and managers, companies with positive public image are more active among the target audience, the fact that environmental contributions and support can solve more difficult social problems, that companies are aware of their social responsibilities and this actually reduces the necessity of state intervention in terms of legal arrangements, the power that companies have are balanced by responsibilities undertaken and thus reduce negative behaviours, these can lead to an increase in exchange market values, companies will have adequacy and can more easily solve social problems (Ilic 2010).

One can also talk about the financial outcomes of corporate social responsibility activities. As in advertising activities, CSR activities conducted under public relations bring certain financial outcomes with them. Nevertheless, as these activities are indirect, their outcomes remain implicit. The most conspicuous effect of CSR is the prominence that differentiation has recently gained. Companies adopt drastic changes in their marketing strategies to differentiate themselves from their competitors. "Value-based" marketing is now a central theme. And to establish such values, companies should now contribute to society not only economically, but also socially. With this in mind, companies now put more effort into social responsibility activities and can indirectly gain huge advantages in the long run (Bali and Cinel 2011).

Besides, once *Two Way Symmetrical Model* was centred in today's public relations, promotional activities have also adopted the idea of mutual understanding. The idea of corporate social responsibility, which is based on giving what you inherited from society back and pursuing the benefit of society, enables better marketing for the products and services a company produces, as well as brand image strengthening. Besides differentiation, CSR activities increase visibility, familiarize masses with a company and its brands, and help establishment. While corporate image increase a brand's preferability, this corporate image also

helps advertising, personal selling and sales promotion activities. When a new brand is released with a corporate image, this image is transferred from corporate to brand and thus, people adopt this product or service more easily (Yilmaz and Ertike 2011, 132–134).

Considering all these, one can say that corporate social responsibility activities are conducted between companies and the public, and they primarily focus on strengthening corporate image. These activities have economic, legal, ethical, and charitable aspects and today they are adopted by companies for implicit, pragmatic reasons. One can relate CSR activities to marketing communications and market conditions. Companies conduct these activities to differentiate themselves, strengthen corporate image, establish visibility and ensure familiarity with the target audience. These show us all that CSR activities contribute to other marketing communication elements, are conducted with implicitly commercial reasons, and have certain financial outcomes. The next part of the research deals with the principles of corporate governance and the way it has changed banking sector. The concept of CSR will be re-evaluated in terms of the principles of corporate governance.

16.3 Principles of Corporate Governance and Changing Banking Sector

Recent changes in corporate governance are rooted in the international corporate scandals and bankruptcies (Kirkpatrick 2009, 2–4). Following these negative developments, there have been numerous studies in corporate governance in the light of legal arrangements such as Sarbenas-Oxley (Green 2005). Based on systematization, corporate governance aims corporate efficiency and stakeholder satisfaction (European Commission 2010, 2–4; OECD 2004, 17).

Prior to 2001, corporate social responsibility and social responsibility investments meant relief activities conducted by action groups. But today, once can see that businesses make ethical investments. The fundamental reasons behind social responsibility activities are technology, transparency, sustainability, globalization, global governance approaches, stakeholder satisfaction, and mega-risks such as climate change, population etc. (Fahy, Roche and Weiner 2005, 225–227). Although measuring financial outcomes of social responsibility activities is difficult, one can easily see positive effects in the value of stocks, corporate growth, and employment (Fahy, Roche and Weiner 2005, 234–235; Clarke and Rama 2008, 31).

Managers feel the need to improve resources, processes and labour force to meet the requirements of stakeholders and provide quality. At this point, concept of quality assumes a key position both in production and service sector for financial success. Discussions on quality service in banking sector underline the importance of activities and expectations with regard to customer satisfaction and

properties meeting requirements. Although quality assurance standards are commonly used in production and partly used in service sector, banking sector rarely make use of them. Here one realizes that banks should also take non-financial outcomes into consideration to bring their financial product into prominence during design and promotion (Yeung 2011).

Principles of corporate governance minimize uncertainties during foundation and activities of companies, as well as reduce resources costs. Therefore, companies adopting corporate governance principles increase their outputs with lower capital costs. In this vein, such companies can better use their resources and attract foreign investment compared to other companies (Erdönmez 2003; Bjuggen and Mueller 2009, 139).

As banks power up economic growth in developing economies and assume central position in financial system (Levine 2004; Dinçer and Hacıoğlu 2009); manage institutions where savings are placed; as banking sector shows liberal tendencies in developing economies and bank managers are more free in their activities, corporate governance gain importance each and every day in banking sector (Das and Ghosh 2004). Especially in developing economies, market competition decreases for products, whereas asymmetry in knowledge triggers less competition (Caprio and Levine 2002, 21).

Competitive environment of globalization and increasing number of products and services require arrangements and attention with regard to security and risk transparency for customers in banking sector. Social responsibilities of banks are not restricted to establishing legal frameworks for operations, but they include close audition and efficient application of those operations to ensure customer trust (Yeung 2011; Stavrinakis et al. 2007).

As part of corporate governance principles, social responsibilities should be taken seriously by companies; in this framework, companies should conduct activities in accordance with ethical rules, elements with regard to customer and environment (Capital Markets Board of Turkey 2003, 40). Basic parameters to evaluate corporate social responsibility in banking sector are as follows: reception of complex financial services, risk assessment, strengthening business ethics, strategic application with regard to financial crises, defence of customer rights, providing customers with right channels to submit complaints (Yeung 2011).

Along with mounting systematic risks, operational activities should increase risk transparency of financial products (Macey and O'Hara 2003).

Besides, one should also evaluate product and service management ethics in the framework of corporate social responsibility. Firstly, one should define and judge ethical behaviours. Secondly, right channels must be found to adopt a certain marketing program, following ethical analysis of products and services. Results of marketing programs should be announced; with the participation of marketing staff, marketing organizations should possess ethical standards for the promotion and development of new products.

The Board of Directors should confirm corporate values and strategic objectives, and accord relevant activities to corporate social responsibilities (Bank for International Settlements 2006, 9). To survive in a competitive market, banks

should be able to evaluate economic conditions and focus on risk management and marketing strategies in a responsible manner (Yeung 2011).

Next part of the research deals with the factual analysis of the elements mentioned in the first two parts. Diagrams based on banks' annual reports and data tables, the research aims to come up with tangible findings. In the light of our conceptual framework, the research concludes with some de facto remarks based on interpretation of existing data.

16.4 CSR Activities of Banks in Turkey

The research deals with the deposit banks listed in Istanbul Stock Exchange and registered in the Banks Association of Turkey. In this respect, 12 deposit banks are analysed. To analyse the banking sector of post global crisis era, the data covers the period between 2009 and 2011.

Examining the data on assets in the balance sheet, one can realize that total assets of all banks are on the rise towards 2011. While the biggest assets belong to Isbank, the smallest share belongs to Tekstilbank.

Analysing corporate social responsibility activities, one will realize that CSR activities are heavily composed of charities. The year 2009 was marked by corporate social responsibilities of Isbank. The lowest rate of activities in the same year belonged to, respectively, Tekstilbank, ABank, Finansbank.

Among the banks operating in Istanbul Stock Exchange in 2010 and their CSR activities, Garanti hold the first rank, while Tekstilbank, ABank and Halkbank are the last.

In 2011, while Garanti was once again held the first place in terms of CSR activities, the last ones were Tekstilbank, ABank, and Finansbank.

In those years, one can see consistency in terms of CSR activities. While the first four ranks were occupied by Garanti, Yapi Kredi, Isbank, and Akbank, the last ones were Tekstilbank, ABank, Finansbank, and Halkbank. While the types of CSR activities varied over the years, the number of activities regularly increased in general.

Based on a 3-year period covering 12 banks in terms of CSR activity types, one will see that charities hold the first rank in the CSR pyramid. The analysed activities (259 activities) make up 80 % of the total. While economic activities occupy the second rank with 11 % (37 activities), legal activities are in the third rank with 7 % (21 activities) among all CSR activities. The last rank is occupied by ethical activities with %2 (6 activities).

Research on corporate social responsibility in Europe shows that activities are mostly related to climate change and gender equality (Rare 2006, 59). Compared to activities in Europe, CSR activities in Turkey mostly concerns charities. The reason behind this is the fact that public relations mostly use current market conditions and *two way symmetrical model*.

Based on this 3-year period, Garanti holds the first rank with 51 activities while Yapi Kredi (49 activities), Akbank and Isbank (each with 44 activities) closely follow Garanti. The number of activities conducted these four banks heavily outnumber those of others. The number of CSR activities conducted by Tekstilbank and ABank are quite few.

Based on the activities conducted and the scale of *Corporate Social Responsibility*, the first four banks work on *Strategic* level, Tekstilbank on *Irresponsible* level, whereas ABank is on *Compliant* level.

Based on the same 3-year period, one can see that advertisement and publication expenditures vary. Those constantly increasing their advertisement and publication expenditures are Isbank, Denizbank, Halkbank, and VakıfBank. While Isbank takes the lead as of 2011 in terms of above mentioned expenditures, it is followed by Garanti, Akbank, Yapi Kredi, and Denizbank. Apart from Tekstilbank 2010 witnessed a rise in expenditures in all banks. One can also realize that Tekstilbank and ABank hardly possess an expenditure for advertisement and publication.

Based on the commercials loans banks extended in the same 3-year period, almost all banks increased the number of extended loans, and the first five banks having the biggest share are as follows: Isbank, VakıfBank, Garanti, Yapi Kredi, and Akbank.

Just like commercial loans, consumer loans were on the rise in the period between 2009 and 2011. Bank having biggest share in consumer loans are Garanti, Isbank, Akbank, Yapi Kredi and VakıfBank.

In their CSR activities, banks mostly focused on individuals in this 3-year period, rather than businesses as their target group. In this respect, Yapi Kredi took the lead in the 3-year period; and whereas it was the leader by far in 2009, it was closely followed by Isbank in 2010; in 2011, Isbank and Garanti were closely following Yapi Kredi. And while Akbank was the second in 2009, it fell in the rankings to the fourth spot in the following 2 years. From an institutional point of view, TEB was the leader in the first 2 years; it lost the title to Garanti in 2011. And the reason was that while TEB terminated CSR activities intended for SMEs, Garanti made a move in this issue.

Based on the banks' net profit and loss during 2009–2011, one can see that net periodical profit decreased in all banks except for Halkbank, VakıfBank, and Denizbank in 2011. In terms of net periodical profits, the first five banks were Garanti, Isbank, Akbank, Halkbank, and Yapi Kredi. The last ranks were occupied by ABank and Tekstilbank.

Considering the relation between net periodical profit/loss and expenditures on advertisement and publication, one can see that while Isbank took the lead in advertisements and publication expenditures, it was the second in terms of profitability; vice versa, while Garanti held the first rank in terms of profitability, it ranked second in terms of expenditures on advertisements and publication. Therefore, one can say that coordination between CSR activities and advertising activities is crucial. Garanti focused on institutional advertisements and announcement of CSR activities as well as product/service centred commercials in

its promotion strategies was quite effective in obtaining these results. Akbank ranked third in terms of both parameters. That Akbank could preserve its position with lower advertisement and publication expenditures explains the power of similar policies. One can also realize a curious relationship in terms of profitability between Halkbank and Denizbank: while Halkbank ranks fourth with low expenditures on advertisement and publication, Denizbank ranks seventh with higher expenditure.

As for the relationship between net profit and CSR activities, although Yapi Kredi is by far the leader in terms of individual oriented CSR activities over years, the bank surprisingly ranks fifth in terms of net profitability. One can observe that Isbank and Halkbank recently focus on CSR activities, and in return they share the first two ranks in profitability. Another interesting point is that TEB does not generate much profit, although it is quite active in CSR activities. In terms of deposits and loan allocation, this fact is very much related to the number of individual customers; over 3 years, the bank started CSR activities intended for institutional target groups.

It is another interesting finding that while CSR activities mostly target individual customers, Turkish banking sector also target individual target groups in terms of deposits and loans. In this vein, one can say that ongoing CSR activities are in parallel with the policies of output-oriented profitability for banks as commercial institutions.

One should not underestimate the relationship between CSR and advertisement & publication costs as in the cases of ABank and Tekstilbank.

16.5 Conclusion

Along with globalization, increasing competition requires customer oriented approaches from banks. Following bankruptcies in real sectors and financial institutions, more transparent and predictable management is now on the agenda. In accordance with corporate governance principles, stakeholder satisfaction, transparency, and providing service to satisfy customer expectation are now basic requirements.

One should not underestimate the positive impact corporate social responsibility activities have on financial performance to be one step ahead in competition.

As a key element in current marketing conditions, CSR activities are crucial for companies to differentiate themselves and strengthen their image. Once they differentiate themselves and sustain a positive image, companies increase their profitability.

One can figure out from earlier chapters that expenditures on advertisement and publication influence profitability. As more companies invest in advertisements and publications, the more the profitability will be; and vice versa. Coordinating CSR activities and advertisement and publication expenditures, one can efficiently increase profitability.

Reading CSR activities and banks' financial data together, one can present an argument as follows:

- Companies that wish to increase their profitability should also increase their promotional activities.
- Those underestimating the importance of promotional activities cannot obtain enough profit margins.
- The highest profitability rate belongs to companies coordinating public relations and advertisement expenditures.

Following these developments, banks should promote not only products and services, but also their compatibility with customer expectations during their launching activities to have a share in a shrinking market.

Analysing the outcomes of various activities, one can see that deposit banks listed on the Istanbul Stock Exchange have higher volume of consumer loans and savings deposits as opposed to commercial deposits and credits. The reason behind banks' focus on CSR activities targeting individuals might be these conditions. Charity as an individual category and two way symmetrical model in public relations contribute to this situation. After all, when categories of CSR activities are analysed, one can see that charitable activities in banks assume a central position with 80 % prevalence, compared to all other activities with a 20 % rate.

To sum up, one can say that CSR activities are very crucial to the banking sector, as others. In current market conditions, in which integrity is a key word, public relations and advertisement activities are intertwined. *Principles of Corporate Governance* contributes to above-mentioned relations for sure. Banks that adapt themselves to relevant principles achieve success in terms of promotion and profitability; those that superficially adopt these principles fail in institutionalization, establishing a corporate image, and taking a market share.

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Part IV
Custom Finance in Theory and Practice

Chapter 17
The Banking Sector and Islamic Banking in the Middle Eastern and North African Countries

Arzu Varlı

Abstract The Financial sector has been a priority field for MENA. Financial deficiencies do have an impact both on the funding and materialization of projects and the inability to accumulate savings in countries. Colonial impacts dating back to the nineteenth century were decisive in the development of banking in the MENA. However, the circumstances changed in the twentieth century, when the region started to enrich its banking experiences through different and original practices in İslamic banks or other banks. Islamic Banking which has been rapidly emerging in the MENA extends over to Europe and Asia. Yet, the important thing at this point is to enhance the effectiveness of these banks in parallel to their development. The models of Islamic banking which emerged in the banking sector in a modern way did not remain limited to Muslim countries only, but have also grown internationally. Islamic banks mostly operated in the MENA region in the past, but proliferated in the Muslim parts of Asia after the 1980s. This proliferation of Islamic banking was particularly made possible by the fact that Islamic banks continued to operate successfully and holding a greater proportion of liquid assets than other banks made Islamic banks more resilient and successful during the crisis.

Keywords MENA · Banking · Crisis · Islamic banking

17.1 Introduction

The Financial sector has been a priority field for all underdeveloped countries. For such countries, the need for funding is a significant challenge as it is required for capital projects that would create economic value for every country. Financial

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Ü. Hacioglu and H. Dincer (ed.), *Managerial Issues in Finance and Banking*,
DOI: 10.1007/978-3-319-01387-9_17, © Springer International Publishing Switzerland 2014

deficiencies do have an impact both on the funding and materialization of projects and the inability to accumulate savings in countries. This is a much more obvious phenomenon in underdeveloped countries, where individuals often use their income to meet their daily needs and are unable to make any savings. This in turn leaves both individuals and societies insecure and vulnerable.

In comparison to other underdeveloped counterparts, the Middle Eastern and North African (MENA) countries enjoy a major advantage: Oil. Oil has been a quite influential factor in the making of the region's peculiar economic characteristics. Yet, albeit a substantial source of income, oil cannot account for the region's development and prosperity in its own right. Beside natural resources such as oil, capital market, commercial banking and other financial institutions should also be there so as to achieve development. As oil economies, Middle Eastern countries do experience sudden rises in income as a result of economic booms based on oil. For instance, Saudi Arabia had sudden rises in income in 1972, 1974 and 1978, which, however, were not accompanied by any increase in savings.

The presence of foreign capital in the MENA countries has been the primary cause of low level of savings in the region. If foreign investment is higher than the amount of savings, international borrowing constitutes the principal cause of reduced domestic savings. Financial institutions play a crucial role in the economic development of countries. In economic systems with strong banks and financial institutions, the amount of national savings will be greater, and other financial institutions will save national revenues in banks, which is a point often discussed in the literature (Fry 1979, pp. 464–475).

The Middle East presents certain paradoxes in itself. In the early decades after independence, there was a tendency to promote national banks instead of foreign ones, and public banks were established through nationalization movements. The region also has different tendencies towards liberalization. Some countries force the pace of liberalization, while liberalization efforts are in its infancy in others.

17.2 Status of the Banking Sector in the MENA Countries

Colonial impacts dating back to the nineteenth century were decisive in the development of banking in the Middle East. However, the circumstances changed in the twentieth century, when the region started to enrich its banking experiences through different and original practices of its own.

All the early banks in the MENA region were owned by Europeans. The Ottoman Bank, an Anglo-French enterprise, was the bank with the broadest range of operations in the region. Contrary to the common belief that the banks in Egypt and Iran were national enterprises, they were actually owned by the British as well. These banks carried out credit transactions and arranged letters of credit in their home countries on behalf of the European companies operating there (Jones 1986, 40–54). They concentrated their operations on areas that could yield greater returns for themselves, rather than on local merchants.

Close relations with European financial circles allowed the banks in the region to develop funds instead of the MENA governments themselves, and as a result, the most important activity of these banks was confined to issuing debt bonds.

Thanks to the broad scope of their operations and authority, these banks came to assume the role of a central bank, which they continued until the home country established an independent central bank of its own. Banking operations started in the MENA region (Wilson 1983, 28–49):

- in the 1920s in Iran and Egypt;
- in the late 1930s in Palestine and Saudi Arabia;
- and in the late 1960s in the Gulf countries.

Local banks appeared in the 1920s in the region. Local banking operations were launched in 1920s in Iran and Egypt; in the late 1930s in Palestine and Saudi Arabia; and in the late 1960s in the Gulf countries (Wilson 1986, pp. 28–49). In (Wilson, 1983, pp. 28-49) Iran the Melli Bank was established as the central bank in 1928, and started to compete with the British-owned Imperial Bank (Jones 1986, pp. 207–208).

In contrast to Iran, the first local banks in Egypt were established by the local Egyptian merchants. The aim in establishing these banks was to support local merchants (Arab and Muslim merchants). These banks established in Egypt had important contributions to the country's industrialization movement in the 1930s (Deeb 1976, pp. 69–86).

In 1930, a bank called the Arab Bank was founded in the British-ruled Palestine. The bank was also funded by Abdel Majid Shoman, a Palestinian businessman, and later moved its headquarters to Amman in 1948, becoming the greatest bank in Jordan. Banking operations initially faced opposition in Saudi Arabia. As they believed that they themselves carried out banking operations in the country, the wealthy circles in Saudi Arabia asked the King to deny foreign bank entry. The National Commercial Bank was established in 1938 and later became the greatest bank in the Middle East (Wilson 1982, pp. 278–300).

The presence of imperial powers and pressures in the MENA region affected all sectors in the region. The willingness to gain freedom and independence from imperial powers resulted in the nationalization movement in the banking sector. Nationalization efforts in industry and banking in Iran and Egypt were carried out to resist this existing power and to prevent further imperialist encroachment. Nationalization policies were effectively pursued in the 1950s and 1960s as a strategy in many countries of the region (Saidi 2006).

- In Syria, all foreign banks were merged under the Commercial Bank of Syria.
- Iraq incorporated all banking operations under Rafidain Bank in 1958.
- Algeria nationalized all banking operations in 1966.
- In Kuwait, the shares owned by foreigners in the National Bank of Kuwait were sold to national investors. The government of Kuwait also purchased British-owned shares in the British Bank of the Middle East operating in the Gulf region; thus, bringing the bank under the control of local forces.

Nationalization brought about an increase in the number of publicly-owned institutions; and enhanced government control in economic domain in general and in banking in particular created discontent among private entrepreneurs, leading to the flight of capital. Despite capital flight, transactions that were carried out illegally to a great extent significantly increased during the 1950s and 1960s in Egypt, Syria and Iraq.

Adopting the "laissez-faire" principle in the banking sector as different from other MENA countries, Lebanon took pioneering steps in the field. Following the example of Swiss laws in 1956, the country implemented the principle of account security and confidentiality, which was largely sought by the region's businessmen and rich classes. By the mid-1960s, Beirut now has a banking system providing the businessmen of the Middle East with a personalized banking service based upon the Swiss model. This experience turned Beirut into a significant financial centre for the Middle East.

As a result of the civil war that broke out in Lebanon in 1975, Beirut ceased to exist as a financial centre and Lebanon now turned into a risky country, thus has lost the international interest. Although it attempted to undertake certain arrangements in the banking sector in the early 1990s, Lebanon would never recover its role as the financial centre in the pre-war period.

During the ongoing civil war in Lebanon, the governments attempted to adopt several arrangements in order to prevent the flight of capital from the region. By enacting the Off-Shore Banking Law in 1970s, the Bahraini government took on the role of Lebanon; and more than a hundred offshore banking subsidiaries were established in the 1980s (Azzam 1984, pp. 23–25). These subsidiaries generally attempted to gain customers from Saudi Arabia. Off-shore banking operations also rejuvenated the service sectors in the country such as engineering, consulting, lodging, tourism, which in turn promoted local economic activities (Azzam 1984, pp. 23–25). Later on, Iran-Iraq War, Gulf War and chiefly the decline in the prices of oil led to great uncertainty in Bahrain.

United Arab Emirates (UAE) also founded the Dubai International Financial Centre (DIFC) by following the offshore banking model (Hashmi 2007, pp. 77–78). In fact, this system based on the example of offshore banking implied a decline in the strict and tight control in the entire region. This development turned the DIFC into a financial free zone and completed its liberalization attempts in the field of banking. Under such scheme, foreign banks, with the enterprises they own by 100 %, were now able to freely act without any restriction. This also reduced tax rates down to zero. As a matter of fact, the underlying reason for such liberalization was the desire to attract the $2 trillion Arab capital through offshore banking and the investment of foreign banks (Hashmi, 2007, pp. 77–78).

The development of modern communication and digital networks allowed bankers and investors to access remote financial centres and divert their investments in a non-agency environment. In fact, these developments most importantly resulted in an increasing need for corporate banking centres in the region. From a regional point of view, the development of the banking sector in the region involves considerable differences, as it was stated above. From a sectorial point of

view, on the other hand, the only common point among the region's banking systems is that they are not yet sufficiently developed. Except for the Gulf countries, the region's cash markets are still at their infancy. Particularly with reference to the political and economic changes in the Middle East in the post-Iraq War period, it would be meaningful to stress that the region had now greater interest in the banking and finance sectors.

The banks of today's Middle East have faced the pressure of increasing their profitability and the added value for their shareholders under the growing competitive environment and higher customer expectations. In this respect, while the banks of Saudi Arabia and Kuwait achieve remarkable success, the local banks in Bahrain and Lebanon display relatively weaker performance in general.

The banking and finance sectors underwent two distinct periods, i.e. the 1970s and 1980s, the first of which is particularly remarkable. During the period in question, banks were quite positively affected by the income derived from oil. The world economy suffered a crisis concomitant to the complications in the US economy following the increase in the price of oil by OPEC. The problem of insolvency as a result of the crisis drove the banks of the Middle East into a crisis; and the banks sought for relief with government intervention.

Government intervention in the banking sector still persists in some of the Middle Eastern countries after the crisis in question. United Arab Emirates, Syria and Qatar are notable examples of such countries. In contrast, countries such as Kuwait, Jordan and Saudi Arabia have made attempts to privatize the banking sector.

In the 1970s, the United States forced Saudi Arabia and Kuwait to restrict other foreign banks in the region. As a result of the operations by the Citibank, the Saudi American Bank of Saudi Arabia (SAMBA) was founded in 1979. The ownership of the bank was distributed among the Citibank and Saudi shareholders by 40 and 60 %, respectively. The motive behind the creation of this bank could be seen as the US aspiration to become the sole power in the region.

From the mid-1980s to the 1990s, liberalization attempts in the banking sector however did not prove to be fruitful. In many countries, the banking sector was either protected from competition or was highly segmented and subjected to regulations, thereby resulting in a failure to create a competitive environment. It was the state entrepreneurship to consolidate the banking sector, which in turn subordinated loan mechanisms and policies to the government itself.

Privatization and liberalization movements that prevailed during the 1980s and 1990s did not play a remarkable role in the making of the banking sector. Thus this field was neither popular enough for politicians, nor a sufficiently democratic structure was created for shareholding.

After the September 11 attacks, Arab investors were adversely affected by the nationalistic and Islamophobic policies of the United States, and chose to curtail their investments in the US. Initially perceived to be a crisis, this situation turned out to be an opportunity for the countries of the region: The investments did not flee the countries and a surplus fund emerged in the region, enhancing liquidity as a result.

With a view to have a stronger banking and finance sector against the crises, some of the Gulf countries came together to establish the Gulf Cooperation Council (GCC). Member countries of the council are Saudi Arabia, Bahrain, United Arab Emirates, Kuwait, Qatar and Oman. The council was intended to enforce collective action in the banking domain, and compared to other Arab countries, it succeeded in minimizing the impacts of the unfavourable attitudes of foreign investors upon its members. According to the Standard and Poor's, the six members of the council superseded the European banks following the debt crisis in the Euro Zone. Among the council's members, particularly Saudi Arabia is better off in terms of capital requirements and liquidity. Saudi banks are highly profitable and performing quite well.

Uncertainty in the region as well as the substantial ongoing government involvement in the economy constitutes some of the major obstacles to the development of the banking sector in the Gulf countries. Although oil still stands as a significant source of power, it can also serve as the main reason behind the region's political and economic instability and may affect the economy.

In fact, the underlying reason behind the lack of a well-developed banking sector in the MENA region is the confidence of these countries in nationalization policies rather than liberalization. A closer examination of the banking sector reveals that, compared to other countries, government ownership of banks is the highest in the region (Worldbank 2008, p. 1).

The journal 'The Banker', which is owned by the Financial Times Group, published a list on the first 1000 banks of the world in 2011. Through a comparative analysis with their global counterparts, the study delved into how regional banks manage to survive in the market. According to the study dated 2011, there are a total of 83 banks in the Middle East, a figure which had been 90 the previous year (Tables 17.1 and 17.2).

The following is some examples from, revealed by the journal's rating based on "Tier 1"[1] (Capital Stock Scale) (www.thebanker.com, 2011):

- National Commercial Bank of Saudi Arabia maintained its position as the region's strongest bank in terms of Tier 1 capital. According to the same journal, the bank ranked 121st on global scale.
- The NBD bank of the United Arab Emirates is the second strongest bank in the region.
- Speaking in overall terms, the accounts of regional banks fell from 3.58 to 3.32 % according to Tier 1 capital scale.
- With one bank, Iraq appeared for the first time in the list. Ranking 418th in the list, Iraqi Bank of Commerce gave an early indication that the country will gradually emerge as an actor in the international area.
- Egypt emerged as the fourth most profitable country for banks. As in the case of Egypt, Qatar also emerged as the fifteenth most profitable country.

[1] ****Tier 1* (*Capital Stock*)**: *It consists of paid-in capital, retained earnings and contingency reserves.*

Table 17.1 Number of MENA banks ranking among the first 1000 banks for the year 2011 according to *The Banker* Journal

Country	Number of banks
United Arab Emirates	15
Saudi Arabia	10
Iran	10
Kuwait	8
Bahrain	8
Qatar	7
Oman	6
Egypt	5
Morocco	3
Jordan	3
Libya	1
Iraq	1
Total	83

Source The Banker (2011), The 1000 Bank Rating, www.thebanker.com

Table 17.2 Leading banks of the Middle East in the year 2011

Regional ranking	World ranking	Bank	Country
1	127	National Commercial Bank	Saudi Arabia
2	128	Emirates NBD	UAE
3	136	Riyad Bank	Saudi Arabia
4	140	Samba Financial Group	Saudi Arabia
5	141	National Bank of Abu Dhabi	UAE
6	143	First Gulf Bank	UAE
7	148	Al Rajhi Bank	Saudi Arabia
8	169	National Bank of Kuwait	Kuwait
9	175	Kuwait Finance House	Kuwait
10	181	Arab Bank	Jordan
11	185	Qatar National Bank	Qatar
12	192	Abu Dhabi Commercial Bank	UAE
13	193	Banque Saudi Fransi	Saudi Arabia
14	206	Arab National Bank	Saudi Arabia
15	211	Arab Banking Corporation	Bahrain
16	224	Saudi British Bank	Saudi Arabia
17	233	Mashreqbank P.S.C	UAE
18	246	Union National Bank	UAE
19	259	Bank Saderat Iran	Iran
20	270	Dubai Islamic Bank	UAE
21	306	Commercial Bank of Qatar	Qatar
22	321	Export Dev. Bank of Iran	Iran

Source The Banker (2011), Top 1000 Bank Rating, www.thebanker.com

- A study on Europe belonging to the same year reveals a rather precarious situation for European economy. In contrast, growing by 40 % in the year 2010, China continues to expand its performance in global financial circles.

17.3 Islamic Banking

Sharia Law comprises of various practices and arrangements regarding commercial banking. In fact, Islamic practices concerning financial life can be found in very early periods. Dating back to the Hammurabi period, interest-free banking was revived in Islamic countries during the twentieth century as a solution to the problem of financing. Increasing oil prices in the 1970s particularly contributed to this development in banking. The Islamic Development Bank was established to meet the existing needs for financing in Muslim countries.

Islamic banks did not apply interest used in commercial banking. The year 1960 witnessed debates on how to develop a system of modern commercial banking by avoiding interest.

In Egypt, a model developed by Ahmad al-Naggar was implemented. The system regulates banking by organizing local investment banks and distributing savings to partners in need of funds; thus, eliminating the need of Muslim fund holders for interest.

Naggar materialized his idea by opening a small savings bank in the town of Mitr Ghams in the Nile delta. This venture was successful in attracting the deposits of small merchants and landowners who had their concerns about interest and sixty thousand Muslims opened accounts in 3 years (Mayer 1985, pp. 35–50).

During the Nasser period, Islamic banking institutions in Egypt became the subject of negative opinions. Despite the unfavourable attitudes, the Egyptian government did not close the banks but chose to take possession of them instead. For instance, Naggar's investment bank was sold to the government for 1.4 Egyptian Pounds in 1972.

Islamic Banking could only be introduced to the Gulf countries during the 1970s. In fact, merchants in the Gulf countries rejected using traditional commercial banking and used Islamic financing methods instead. Until 1970s, a period of rapid increases in oil prices, these merchants mobilize their resources to funding new banks. However, upon seeing new opportunities arising after the increases in oil prices in the 1970s, they pioneered in establishing new banks.

In this context, a group of merchants founded the Dubai Islamic Bank in 1975. This bank was followed by the establishment of Kuwait Finance House in 1977, Bahrain Islamic Bank in 1979, and Qatar Islamic Bank in 1982 (Wilson 1983, pp. 80–86). Thus, deposits from individuals who chose not to invest their savings in banks were attracted to Islamic banks to achieve their success.

During the period from the 1980s until the Gulf War, Kuwait Finance House managed to attract more than 20 % of all deposits in the country and made

business and commercial investments on behalf of its clients. Later, it concluded Islamic Leasing contracts with a majority of its clients and started providing services to its checking account clients.

Islamic banking experiences were highly effective in reinforcing the relations of Saudi Arabian businessmen with the rest of the Muslim world. Prince Mohammed bin Faisal founded Faisal Islamic Bank in Egypt and Sudan in 1977; and later established Dar al-Maal al-Islami to operate in Western markets through Islamic methods (El Ashker 1987, pp. 115–140).

Islamic banking developed in different ways in other countries. After the Islamic Revolution of 1979, a legal arrangement was made for all banks in Iran in accordance with the Sharia Law (Aryan, 1990, pp. 155–170).

In Iran, interest-free banking practices were put into effect in all retail banks, in which discounts in transactions were exploited by the national bank, while interest was permitted for foreign transactions with non-Muslim foreigners.

Abu Dhabi and Dubai Islamic banks operate along with all other banks. These are two most rapidly growing banks in the region with a rate of 77–83 % (UAE Central Bank 2005).

Islamic banking which has been rapidly emerging in the Middle East and North Africa extends over to Europe and Asia. Yet, the important thing at this point is to enhance the efficiency of these banks in line with their expansion and make certain arrangements so as to invest them with more inclusive roles. This requires the regulatory circles in the Middle East and North Africa to make arrangements covering Islamic Banking institutions. Thus, new principles need to be developed at national and international levels, which would make it possible to further the institutionalization of both Islamic and non-Islamic corporations.

Protecting investors has been the priority in the steps taken to this end in the region. Efforts are made toward developing Islamic finance methods and contracts in accordance with standards and extending their scope to include the existing financial products and contracts in financial markets.

In the Middle East, Islamic banking is practiced not only by regional banks, but also by other banks; chiefly including the Citi Group and HSBC Group. These two groups have invested in Islamic banking in the Gulf Region, as well as in Islamic financial products in Bahrain Islamic Stock Exchange and international stock markets. Table 17.3 shows some of the Islamic banks in the countries in the region (Ernst and Young 2011–2012):

There is a growing volume of studies on Islamic banks and other banks in the literature. The research on how two types of banks are affected by crises is particularly extensive. In 2012, nine countries and 30 banks in the Middle East and North Africa were examined to investigate the effect of the 2009 crisis on Islamic banks and other banks. The study yielded the following results (Ali 2012, pp. 1–45):

- Islamic banking grew and has been growing before, during, and after the crisis. The rate of deposit growth was faster than asset growth before the crisis, when compared to the post-crisis period. Yet, the asset growth in the post-crisis period

Table 17.3 Sample of islamic banks in the MENA region

Country	İslamic banks
Bahrain	Al Baraka Banking Group
	Ithmaar Bank
	Bahrain Islamic Bank
	Al Salam Bank
Saudi Arabia	Al Rajhi Bank
	Banl Al Jazira
	Alinma Bank
	Bank AlBilad
Kuwait	Kuwait Finance House
	Ahli United Bank
	Boubyan Bank
	Kuwait International Bank
Qatar	Qatar Islamic Bank
	Masraf Al Rayan
	Qatar International Islamic Bank
UAE	Dubai Islamic Bank
	Abu Dhabi Islamic Bank
	Emirates Islamic Bank
	Sharjah Islamic Bank
Egypt	Faisal İslamic Bank of Egypt

Source Ernst and Young (2011-2012), The World Islamic Banking Competitiveness Report.

was greater. The size of asset growth has varied among the countries. Although Bahrain is a well-known centre in the region for Islamic banking, Kuwait and Saudi Arabia are the leaders in terms of assets per bank. As for shareholders' equity, Saudi Arabia is followed by Kuwait, UAE, Qatar, Bahrain, and other countries, respectively.

- Different growth rates for Islamic banking are a result of various differences among the countries. The reasons behind such diverse growth rates include the general status of conventional banking sector in these countries, government regulations on and support for Islamic banking, and the demand for Islamic banking.
- As for the average performance of Islamic banks in terms of return on equity and return on assets, a converging trend of decline was seen in both return on equity and return on assets between 2006 and 2008. However, after the crisis, there has been a significant differentiation in both ratios among the countries. This could be attributed to the differences in Islamic banking practices among the countries in the region.

Holding a greater proportion of liquid assets than other banks made Islamic banks more resilient and successful during the crisis. The crisis affected these banks only later and indirectly, as a result of its impact upon the respective country's economy. Certain Islamic banks were affected by the crisis since they concentrated their assets in the real estate sector. Yet, there was not a single case of total failure among the Islamic banks in the region.

Table 17.4 The share of islamic banking in the banking sector in MENA countries

Countries	Share in Per cent (%)
Saudi Arabia	35
Yemen	30
Kuwait	31
Bahrain	27
Egypt	4
Tunisia	2
Algeria	1

Source Ernst and Young (2011-2012), The World Islamic Banking Competitiveness Report.

Another investigation report demonstrates that Islamic commercial banks differed greatly with respect to return on equity between 2006 and 2010, a period during which the Islamic banks in the MENA region achieved a 15 % ROE ratio on average (Ernst and Young 2011–2012). The models of Islamic banking which emerged in the banking sector in a modern way did not remain limited to Muslim countries only, but have also grown internationally. Islamic banks mostly operated in the MENA region in the past, but proliferated in the Muslim parts of Asia after the 1980s.

This proliferation of Islamic banking was particularly made possible by the fact that Islamic banks continued to operate successfully in periods of crises, as noted above. According to the results of the report, the asset size of the Islamic commercial banks in the MENA region rose to 416 billion dollars in 2010 and they attained a compound annual growth rate (CAGR) of 20 % in the five-year period until 2010, while their conventional counterparts had only a nine-per cent CAGR. The countries with the largest Islamic banking assets are Saudi Arabia, Yemen, Kuwait, and Bahrain. The Islamic banking institutions in the Middle East are more active and have greater shares in the sector when compared to their counterparts in North Africa (Table 17.4).

17.4 Conclusion

It poses certain challenges to harmonize the traditional banking operations of the MENA countries with the global banking system. As their primary goal, countries of the region should seek to develop a banking system compatible with its own regional resources and realities. This would in turn help the region attract the funds and resources in other parts of the world.

It has a vital importance for the region to avoid the flight of capital resources and accumulated funds as well as attract foreign funds and resources. The development of capital markets in the MENA countries largely rests upon financial instruments and stock market as well as the ability to attract foreign investors. This would be possible through reforms in the financial sector as well as well-functioning banking and finance sectors and markets.

Islamic Banking plays a great part in this respect. Its remarkable success in the face of the global economic crisis might reveal the need to transform the Islamic Banking system as the main element of banking sector in the region. The system is further favoured by the fact that Islamic banks abstain from risky transactions and are less affected by crisis.

Despite various nationalization efforts in the MENA region for the sake of liberation from imperialism, the banking sector has not undergone radical changes. In terms of its contribution to the process of the region's independence, nationalization movements have not been very successful in general.

Despite its failure on a regional scale, the region achieved considerable success in terms of corporate quality with its Islamic banking operations. This largely owes to the fact that the banks are governed by the Sharia law. This in turn played an important role in helping these banks being widely accepted by the local people with its products and services, compared to other banks operating in the region.

The degree of fragility in financial markets may result in crises, which in turn adversely affects the real economy of countries. The financial crisis of 2008 profoundly shook every economy on the globe, and clearly revealed the role of banking and finance sectors in the economy. The crisis was more destructive in countries where the banking sector engaged in more speculative activities rather than funding the non-financial sector. On the other hand, countries with stable banking systems were less affected by the crisis. In fact, the crisis demonstrated the necessity to have a stable banking system.

Compared to other parts of the world, the shattering effects of the 2008 financial crisis were felt relatively slight in the Middle East. This owes greatly to the notion of Islamic banking and banks, which succeeded in maintaining their growth during the crisis. With its upside trend during the crisis period, Islamic banking can not only contribute the growth of the non-financial sector in the region, but also alleviate the risk of vulnerability to potential crises. Thus, as they could assume substantial roles in financial stability and consequently economic growth of the region, actors should consider ways to improve the efficiency of Islamic banking institutions not only in the Middle East but also in Northern Africa. Further, enhancing the share of the banking sector should be among the first priorities of regulations in the banking industry. As a long-standing past experience, Islamic banking stands as an opportunity for the sector in the making of a new banking and finance sector.

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Chapter 18
The Development of the Islamic Financial System in Turkey Strategies Applications

Muaz Güngoren

Abstract Islamic banking and finance have contributed significantly to the development of financial sectors and deepening of financial services in several countries for the last three decades. The Islamic finance industry is in the midst of a phenomenal expansionary phase, exhibiting average annual growth rates of about 15 % in recent years. This rapid growth has been fuelled not only by surging demand for sharia-compliant products from financiers from the Middle East and other Muslim countries, but also by investors around the world, thus rendering the expansion of Islamic finance a global phenomenon (Hesse et al 2008). Islamic financial services expanded to include almost all the financial services that comply with Sharia laws as Investment Funds, Assets Management and Insurance companies (also known as Takaful) even Dow Jones and FTSE created their own indices for securities complied with Sharia's (Rashwan 2012). Today, as Islamic banking and finance are expanding rapidly worldwide, the systemic importance for the stability of national, regional and global financial system is also increasing rapidly. The present study aims to explicate the short story of the Islamic Financial System (IFS) within the traditional financial system of Turkey as well as to reveal the implementation of sukuk, which is recognized as one of the most important instruments of IFS, and a model proposing for Turkey.

Keywords Financial industry · Islamic financial services industry · Islamic financial instruments

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Ü. Hacioglu and H. Dincer (ed.), *Managerial Issues in Finance and Banking*,
DOI: 10.1007/978-3-319-01387-9_18, © Springer International Publishing Switzerland 2014

18.1 Introduction

Today, in the transition of the economic system into a more comprehensive structure and the adaptation of the resources to the economic system practically in the most effective and productive manner, the financial services gradually reach new dimensions and go beyond borders and turn into different formations and organizations. Currently, the financial services industry underpins the economic growth and development with types of its application areas like banking, capital markets, insurance, consumer financing, factoring, leasing, individual pension, and may be characterized as the brain of an economy. On the basis of loan and financial services, not only do they help savers, investors and consumers get together for the purpose of maximizing their individual goals, it also fulfils the functions of providing general financial services to real persons, legal entities and other financial institutions within the economy. As of 1980s, the globalization process gained pace with the activities intended for the preparation and determination of common standards to constitute the building blocks of the international financial system in order to ensure the stability and robustness of the financial system at the global level. It is mandatory for the institutions and organizations operating within the financial services industry to develop new strategies and create new financial methods so that they could ensure their continuity under the ever-changing conditions. In today's business environment, the financial services industry still faces unique change pressures. The significant changes to the legal arrangements and the corporate governance, changing customer demands and technological developments have a giant impact on the organizations within the financial services industry. The conditions which undergo changes with the effects of internalization pave the way for the arising of new business opportunities for such organizations. The ability to turn the opportunities identified into advantages depends on the ability to develop strategies speedily and flexibly, as much as it depends on the experience the organizations have. While the right identification of customers and ensuring service perfection are still among the primary issues of the financial institutions intending to create a difference, reorganization of the operation units which provide support to the transmission of products to consumers and the prioritization of the employee satisfaction, which is maybe the most important component of this cycle, are some of the approaches that stand out on the way of ensuring stable growth.

18.2 The Evolution of Islamic Economic and Financial System

Tabakoğlu defines Islamic rationale as follows: *as an economic subject, a Muslim is a person who believes and trusts in Allah with rational behaviour, and submits to Allah without ignoring causes, and is an entrepreneur with a sense of service to*

the servants of Allah, respects rightful due and is abstinent without greediness (Tabakoğlu 1996). Nasr (2000) defines economy as applied morals and states that an economy lacking the implementation of moral principles will not be possible in Islamic terms. Zaim (1992) defines economy as *Islam's moral and ideological sub-unit*, and the methodology, shaping the system entirely around the axle of value judgment. However, this system is stated to be one of the basic characteristic that distinguishes Islamic economy from the secular one and the disciplines active in the secular area are criticized on grounds that they excluded value judgments. Eskicioğlu (1999) defines that Islamic economy is an economy which ensures ownership in the production, commonness in the consumption, liberality in saving and investment; liberty in import and export subject to taxation in commodities, that is, customs is not allowed; labour is sacred, and everyone can use it, that is, exploitation of labour by labour union headmen is not allowed; liberal market in exchange, supply and demand is essential, price fixing is not allowed and goods can be manufactured by individuals without requiring any permit from any authority, planning is essential in respect of land, planning income belongs not to individuals and land speculators, but to the entire society and alms (zakat) system is implemented in respect of taxation. Islamic economy is a system, which mainly seeks the consent of Allah, constituting the basis of the Islamic law, also applying to the economic system, and in which the rules are established accordingly.

The establishment of the Islamic economy's applications is based on the Noble Quran and Sunnah. It is an economic system, in which profit earning is liberal, commerce is encouraged but interest, uncertain transactions, non-ethical actions and speculation are banned. One of the most significant emphasis of the Islamic economy is that temporal change of money does not mean more money, in other words, earning money out of money is not deemed appropriate, which, as a matter of fact, creates a market in which an economic system based on real variables are adopted. Since the Islamic law has a people-oriented structure, any kind of action to the detriment of people is not allowed. Therefore, the facts that interest is at the absolute expense of one party, it is a profit earned with no risk and labour, and the fact that it is the main component of usury which led to social problems resulting in a great many tragic events throughout the history of man may be listed among the reasons for the prohibition of the interest. On the other hand, contracts which involve uncertainty such as the loss or possibility of loss of buyer or seller are banned. Gharar, that is, sales with high risk, fraudulent sales such as deceiving or being deceived with things the delivery of which is impossible are banned since they will create a party which earns unfair profit as a result of uncertainty and since it will lead to conflicts. Although the Islamic economics goes far back to the old ages, Islamic finance gained pace particularly after 1960s. In the world, free interest banking was first put into practice in 1960s in Egypt in form of a savings bank. These organizations, which are functional, fewer in numbers, and have a low level balance sheet, provided loan facilities to fund holders, small retailers and farmers by collecting funds from certain sources.

The increase of the Muslim population in the world, enhancement of the standard of living, raise of awareness and their desire to use their money in accordance with the Islamic rules and the increase in capital accumulation of the

gulf countries as a result of the rapid increase in the oil prices in 1970s may be enumerated among the primary developments that give pace to the development banking and the Islamic financial economy. The idea of depositing oil-dollar pool, which result from the high incomes from the oil prices, with the banks operating in accordance with the Islamic rules by means of using such money in the region rather than the interest-based traditional banking operating in the west has led to the arise of a new banking model called participation banking. Participation banks played, and still plays, a crucial role in that period in turning savings, which remained idle with a motive of not involving in interest related transactions beyond such functions.

According to *Ernst & Young,* an international audit and consultancy firm; it is predicted that international Islamic assets which are sharia-complaint will reach up to some total of \$1,8 trillion in 2013 and according to the calculations, at the end of 2016, this level may reach up to some total of \$5 trillion. In addition to the upheavals and conflicts suffered in the Middle East, in spite of the crisis in the euro region, the constant up trend of the Islamic bonds which are called sukuk, the involvement of new markets such as Egypt and Oman in the industry, the implementation of new legislation and regulations which eliminate legal barriers ensured great contribution to the development of Islamic banking in the Middle East. Today, sharia-complaint Islamic financial services and instruments are diversified. Structured products, project financing, venture capital and asset management are among the capital market fields that exhibit a rapid growth.

18.3 The Evolution of Turkish Islamic Financial Services Industry in Brief

Especially after the 2001 crisis, the banking sector experienced an alienation period, foreign capital held the majority of capital or qualified share in the said banks by purchasing the shares of national banks. While foreign capital entered into the banking industry by establishing new banks or opening branches in our country during the Ottoman Empire and 1980–2000, after 2000, foreign capital started to act in the banking industry without starting up a new bank by way of share purchase and enhanced its influence. Following 2001, eight national banks turned into foreign bank status. In the first half of 2012, the banking industry achieved a growth of 5 % and reached a balance sheet size of 1.3 billion liras. As of June 2012, the Turkish banking industry employs 198 thousand persons and about 11,000 branches carry on activities.

The total of debts borrowed by the industry from foreign banks increased up to 106 million dollars in the first half of 2012. It limited the share of Euro Region in the total foreign debts, and the share of funds obtained from financial institutions based in the Middle East and Asia within the total foreign debts increased.

Looking at the general view of the banking industry, the positive effects of the reorganization and macro-economic stability started to take effect as of 2012.

The Turkish financial sector continues to develop and has a high potential of growth. Although the global financial crisis had impacts on the Turkish financial sector like in the world, 2008 and following years achieved performance well beyond the expectations and the asset size reached up to TL 1.5 trillion at the end of the second quarter of 2011. The individual pension sector continued to grow both in respect of fund amount and the number of participators. We may argue that the individual pension sector increasingly becomes widespread in Turkey. The number of participators reached up to 2.65 million persons as of 2012, and the fund amount reached up to some total of TL 15 billion. In respect of the investments of the financial industry, 2012 was an active year in terms of the number of transactions.

18.4 The Instruments of Islamic Financial System and Sukuk

Islamic financial system (IFS) has come into existence with the emergence of Islamic banking which provides products and services not based on interest and in the course of time, many financial products which abide by the Islamic laws have been developed such as sukuk (Islamic bonds), *mudarabah*, *musharakah*, *murabahah*, *Ijarah*, *qard hasan*, *bey-i Selem*, *istisna* and *takaful*. The presentation of many aforementioned financial products has been carried out by the participating banks operating in Turkey pursuant to the Islamic laws. The key parts of the Islamic financial market are Islamic bonds which are known as sukuk.

The issuance of sukuk, which is compatible with the Islamic laws and which has been demonstrating a rapid growth in the last 10 year period, has reached almost 10 % of the Islamic financial industry at the present time. According to the recent research conducted by the Global Islamic Banking Centre of Ernst & Young, it has been foreseen that the global demand for sukuk shall rise from 300 billion dollars to 900 billion dollars in 2017.

The increase in appetite for reliable, sharia-conforming and liquid securities have also influence on these developments as an outcome of two-digit growth in the Islamic banking industry. The demand originates from the fund originators and the individuals with vast amounts of money in their hands as well as the Islamic financial institutions. Considering the research, Malaysia, Indonesia and Turkey are seen as the countries that will enlarge sukuk market and profit from this outcome to the greatest extent. Used as a significant Islamic financial instrument in recent years, sukuk has come into prominence in many countries, Malaysia being in the first place, as an interest free and a sort of securization tool. *Sukuk* is regarded as the securities issued on the basis of Islamic financing procedures and it is derived from the Arabic origin *Sak*. Sak, as lexical meaning, contains the

meanings of certificate or document in itself. As Sukuk is the plural form of the said word, it means certificates.

The term *Senet* is used for bonds and bills in Arabic language, whereas *Sukuk* is preferred for saks which are Islamic bills (Khan 2003: p. 129). Within this frame, sukuk, which is given the name of *Islamic Bonds* and specified as the Islamic equivalent for bonds in various studies with the meaning of *financial certificate*, has been accepted as a security in compliance with the Islamic laws due to its interest free characteristic. Therefore, Sukuk are the securities that forbid the interest payment or generating interest expense as in accordance with the principles of Islamic Law. They are the financial assets classified depending on whether they are traded in the secondary market or not (Jobst 2007: p. 18). Providing a regular income flow during the investment process due to the realization of easy and effective payment, sukuk bears the quality of being an interest free capital market product providing medium-long term fixed or variable proceeds; at the same time, it is a liquid instrument and traded in the secondary market. In its simplest form, sukuk points to owning an asset or the right to benefit from it. Within this context, the right specified under sukuk is not only the right of cash flow, but also the ownership right. This feature distinguishes sukuk from the conventional bonds. While the conventional bonds are comprised of securities with interest, sukuks are investment certificates basically composed of the ownership right in a basket of assets (Macfarlane 2007: p. 211).

The bond is a contract of debt obligation which, under a contract, secures the payment by the issuer of the interest and the principal to the bond buyer on specific dates. On the other hand, sukuk holder is entitled to a complete right of disposal under sukuk regarding the relevant asset. As a result, the sukuk holder is granted the right of participation in the income generated from the sukuk assets as well as the proceeds resulting from the sale of sukuk assets. The other distinctive feature of sukuk is that it points out the debt to the certificate holder.

Today's sukuk is slightly different from the sukuk used in the past. Sukuk bears resemblance to the securitization in which the asset ownership is transferred to a vast majority of investors through the certificates proportionally formed by the value of the relevant asset. Sukuk is considered within the comparison of conventional bonds as it provides its investor with the share out of income/profits obtained from the financed asset instead of interest. The certificate depending on bond debt can be described as the promissory notes issued in order to acquire loan, whereas sukuk can be qualified as the asset-based certificate (Asuaf 1993: p. 19). The conventional bonds are comprised of the securities with interest. On the other hand, sukuks are the securities basically consisting of the ownership right in a basket of assets. As a result, the sukuk holder is granted the right of participation in the income generated from the sukuk assets as well as the proceeds resulting from the sale of sukuk assets. Another distinctive difference between a sukuk and a bond is that the bond represents the issuer's debt, whereas sukuk is indicative of the proprietorship in proportion of its share on the relevant asset. *The conventional bonds* are promissory notes which secure the payment by the issuer of the interest and the principal to the bond buyer. The interest is not paid to the sukuk investors;

Table 18.1 Differences between the sukuk and the conventional bond

Factors	Sukuk	Conventional bonds
Issuer	Sukuk issuer can carry out business activities in accordance with the Islamic rules.	There are not any restrictions on business activities of the conventional bond issuers.
Ownership (proprietary)	The investor is entitled to a direct ownership right in an underlying substantive (principal) asset or basket of assets.	The conventional bond represents the issuer's financial debt only.
Administrative expenses	The consultancy expenses and additional legal fees are existent in the assessment of the compliance with the Islamic rules.	There are not any additional administrative expenses in connection with the conventional bond issuance.

Source Ernst & Young 2012

the proceeds generated from actual economic transactions are distributed on the basis of leasing or sharing the assets. From the perspective of issuers, the motives behind the sukuk issuance are providing finance, enlarging and diversifying the investor base, while these motives can be described as the opportunity of investment into a new asset and the procedure of using the capital in a more effective and efficient way from the investors' point of view Table 18.1.

18.5 Types of Sukuk

Sukuks vary depending on their usage in financing and business activities. Within this context, seven different types of sukuk (*mudabarah, musharakah, murabahah, Ijarah, salam, istisna and* hybrid) are currently realized.

18.5.1 Sukuk al-Mudarabah

Representing the shareholding (ownership) in the Mudarabah share at an equal rate, Sukuk al-Mudarabah is an investment sukuk in which the ownership is accurate; the names of murabahah buyers are registered; and the proceeds are distributed in accordance with the owned share. Such sukuk buyers (*the Rab al-Maal*) are the proprietors. Sukuk al-Mudarabah is used in order to enhance the participation of vast majorities in huge investment projects (Cole and Al-Sheikh, 2004: p. 144).

18.5.2 Sukuk al-Musharakah

Sukuk al-Musharakah is an investment sukuk which represents the ownership of Musharakah asset. In cases where the sukuk issuers constitute a committee of the sukuk buyers whom are shown as references in investment decisions, Sukuk al-Musharakah is the same with Sukuk al-Mudarabah, excluding the organization of the relationship between the sukuk holders and the sukuk issuers. Sukuk al-Musharakah is used in order to improve the financing of a present business or to establish a new project, both of which are based on the partnership contract. The certificate holders are entitled to the ownership of projects or activities at the proportion of their shares. Those Musharakah certificates are traded as endorsable instruments and they may be bought and sold in the secondary markets (Brown et al. 2007: pp. 85−110).

18.5.3 Sukuk al-Ijara

This type of sukuk offers its holder the right of usufruct concerning a real estate or the ownership of equal partnership for the real estate in rent. Sukuk al-Ijara ensures the proprietors the right to own the real estate, to receive the rental income and to dispose of sukuk, e.g. buying and selling, in such a way that the rights of lessee shall not be affected. The Sukuk al-Ijara holders undertake the maintenance costs of the said real estate. Sukuk al-Ijara provides its holders with the ownership right of the available and known assets that are specified under a lease contract and the rental is paid to the sukuk holder. Ijara rentals may not be associated with the period in which the lessee uses the right of usufruct. By the joint resolution of the parties, Sukuk al-Ijara can be issued prior to/during/after the leasing. That flexibility enables the development of various contracts and the use of Sukuk for various purposes (Kafh 1997: p. 29).

18.5.4 Sukuk al-Murabahah

These sukuks are typically issued by the seller of the Murabahah goods, while the sukuk holder becomes the owners of the underlying goods. Furthermore, the fund is the buying cost of the goods. The certificate holders become the owners of the underlying goods and they are entitled to receive its final sales price in the resale of the goods. The sukuk based on Murabahah can be legally valid only if it is traded in the primary market. The endorsement of sukuk or its trading in the secondary market is forbidden by the Islamic laws. Because the certificates represent the debt owned by the buyer of the goods to the certificate holders and thus, the deferred buying and selling of the debt is not allowed as it shall end up with the interest. Although it is a debt instrument, Sukuk al-Murabahah, most of which is comprised of endorsable instruments such as Sukuk al-Musharakah and Sukuk al-Ijara,

becomes endorsable in cases where it constitutes a small portion of the portfolio. Sukuk al-Murabahah is more common in Malaysia where the sale of debt (bai-al-dayn) is allowed on the basis of the agreed price.

18.5.5 Sukuk al-Salam

Sukuk al-Salam is the certificate of equal value which is issued in order to raise salam capital. The goods to be sold on the basis of Salam contract are owned by the certificate holders who buy these issued certificates through the accumulated capital thereof. Certificates are issued by the seller of goods thereof, whereas the subscribers act as the buyers of those goods. The subscription fees to be paid comprise the buying price of the goods. The Salam certificate issuers are the actual owners of the underlying goods and these owners of the goods are entitled to sell Salam goods through Sukuk al-Salam certificates issued on the basis of Salam (Küçükçolak 2008).

18.5.6 Sukuk al-Istisna

Sukuk al-Istisna is the certificate of equal value that are issued for the purpose of mobilizing funds to be used in the production of the goods owned by the certificate holder. The funds raised from subscription are the costs of product and the intended products become owned by the certificate issuers, producers (seller/supplier) and subscribers. The certificate holders own the product and they become entitled to the sale price of certificate or the sale price of the underlying product sold on the basis of a parallel istisna. Sukuk al-Istisna is very convenient for financing huge infrastructure projects.

18.5.7 Hybrid Sukuk

Considering the fact Sukuk issuance and trading are significant instruments of investment and taking into account the various demands of investors, a more extensive Sukuk – *hybrid* or *mixed asset sukuk* – has emerged in the market. In a hybrid sukuk, the pool of assets is comprised of Istisna, Murabahah and Ijara. Having a pool of assets comprising of instruments with different qualities allows for a higher mobilization of funds. Despite the fact that Murabahah and Istisna contracts cannot be traded in the secondary markets as securitized instruments, at least 51 % of the pool in a hybrid Sukuk must consist of Sukuk tradable in the market such as Sukuk al-Ijara (Fitchratings 2007: p. 8). Due the fact that the

Murabahah and Istisna are parts of the pool, the proceeds of these certificates can only be at a predetermined fixed rate (Iqbal and Mirakhor 2006: p. 127).

18.6 A Sukuk Model for Turkey

In the fundamental structure of Islamic Financial Industry lies the acquisition of income (profits) through the processing of the capital, exactly as in the Traditional Finance Industry. On the other hand, the most distinctive difference is that the interest (riba), which derives from *granting loan* only without any real economic activities or transfers of assets, is not available at all. Within this context, in the Islamic Financial Industry, the interest is replaced by *income* and *risk sharing* processes, or in other words, the direct participation in the performance of the financed asset and the sharing of risks and proceeds. In Muslim communities, it is a matter of fact that the activities based on interest are avoided and the intense speculative activities carried out to preserve or increase the value of assets in operational activities are found unfavourable.

The participation banking serves as the financial mediator mechanism that has been created within the consideration of all these variables. Within this context, the interest free banking system, as in other countries, has undertaken a very significant role like drawing the saving potential, which is excluded from the economy or oriented to unproductive fields, into the economy through the techniques it employs. The participation banks constitute the most important intermediaries of the Islamic banking system. In this context, interest-free banking, when viewed in terms of *relation between labour and capital*, may be considered to be a method of creating alternative source of financing in order to ensure the utilization of idle funds within the system as funds in the light of the thought that interest exploits labour and leads to corruptions in the income distribution. Since capital owners participate in the *profit and loss*, it does not include a capital flow that guarantees *firm profit* in the interest system.

The Turkish economy achieved considerable progress with the significant attempts made particularly in the last decade, when compared to the past periods. Moreover, it achieved great success which may be called as a high-level progress in certain areas of the economy. Particularly in the past 3 decades, the Turkish economy achieved significant progress in Gross National Product (GSMH), industrialization, export, the power-capacity of the private sector, tourism income and growth rate. However, this rapid economic growth and the implementation of the projects that arise in connection with this growth resulted in a financial need, and this also increased the financial need of Turkey and the debt stock in connection therewith. On the other hand, in the recent years, the efficiency of these Traditional Financial System (TFS) has been brought into question. Other than that, the cost of the funds from TFS instruments reached high amounts at least for Turkey. At this point, while the Islamic Financial System (IFS) which is now being applied nearly all around the world constitutes a small portion of the global

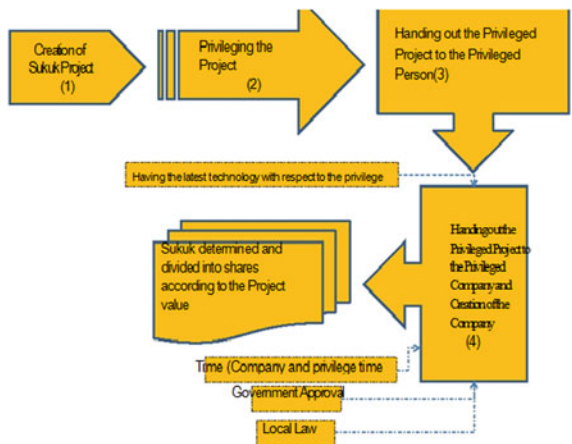

Fig. 18.1 Implementation of sukuk model and a proposed model

financial system, both due to the cost of implementing TFS model and for ethical reasons the system achieved rapid growth *as an alternative and/or complementary model*. At this point, *sukuk,* which represents the bond portion of the Islamic financial system, is considered as the most important instrument for the financing of Turkey's national and local projects. In this context, while the Treasury in Turkey issued sukuk amounting to 1.5 billion in September, it is stated that the demand is five times greater than the issued amount. Looking at the researches and the sector-wide ratios, Sukuk, with its increasingly high transaction volume in the recent years both locally and globally, seems to be a financial instrument which will continue to flourish in the following periods. On the other hand, sukuk market is still in its maturity and institutionalization period and increasingly attracts the interest of both issuers and investors.

Sukuk has established its recognition of validity as an alternative investment instrument for medium and long term savings. While several sukuks with different structures were put on the market in the past, the majority of sukuks, which were issued to date, have the characteristics of Sukuk al-Ijara. The ability to buy and sell sukuks in the secondary market has rendered the sukuk more attractive as an alternative investment instrument. In comparison with Sukuk al-Ijara, the other types of sukuk play a significant role for the investors in developing markets regarding the participation in some major projects such as the construction of airports, bridges and dams.

The Figure below projects an effective sukuk model. Firstly, a proper sukuk project is created by the government Fig. 18.1. Then, this project should be privileged, and the privileged project should be handed out to a privileged person or to the company that such person will start up. There should be qualified partners for the completion of the project (local and/or foreign) and the said partners should have experimental knowledge and information (*the best technology* etc.*)* in respect of the completion of the project. The project, which will be subject to the local law, should then be divided into shares and issued.

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Chapter 19
The International Competitiveness Analysis of the Islamic Financial Services Sector

Ismail Hakki Eraslan and Muaz Güngoren

Abstract Significantly developing in recent years, the Islamic Financial Services industry has been constantly increasing its importance in the national economy. It is predicted that this progress in this industry will continue in the years ahead. Subjecting the industry to a global comparison is of great significance for the industry so that the level of this development, the basic variables and dynamics could be understood and contribution could be made to the sustainable competitive advantage of the industry and strategies could be developed. The present study analyses the international competitive level of the industry by employing Porter's diamond model. In line with the analysis, the present study identified the competitive level of the industry and explained the basic characteristics of the competitive structure, and revealed macro level strategies required for its development to position itself in the regional and global competition.

Keywords Islamic Financial Services Industry · Financial Industry · Analysis of competitiveness · Strategy · Diamond model

19.1 Introduction

Globalization is the process of international integration of economic, political, social and cultural values beyond the local and national boundaries. Economically, the economic system adopted both in the developed and the developing countries and the economic policies put into practice in parallel therewith increasingly

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Ü. Hacioglu and H. Dincer (ed.), *Managerial Issues in Finance and Banking*,
DOI: 10.1007/978-3-319-01387-9_19, © Springer International Publishing Switzerland 2014

resemble one another. With the collapse of the Soviet Bloc, the liberal economic order in the world, that is, the free market economy has increasingly become more widespread. All around the world, attempts are made to re-define the roles and functions of the public economy. The views such as the limitation and contraction of the government and so adding functionality to the free market economy come into prominence. The world trade tends to become increasingly free. In international economic relations, liberal trade economy is adopted in substitution for the old conservative understanding. Not only in respect of foreign trade, but also in financial and monetary areas, it is advocated that the liberalization process be improved. It is argued that the government should use tools such as taxes, borrowing and money in a way not ruining the operation of the market economy.

As the economic system becomes more practical in the world, the economic policies gradually become more similar. In short, the global economy's acquiring of higher currency resulted in the liberalization which gained more importance. Politically, democracy becomes more prominent as a global value. The liberal economic order in the economic field and a democratic based political structure in the political field are recognized all around the world. A political and economic order called Liberal Democracy is gradually becoming widespread around the world (Republic of Turkey Ministry of Development 2000). To summarize, globalization has led to a rooted change in the socio-economic life of every nation. In this process, during which many positive and negative changes are experienced, access to technology and information has become more widespread and cheaper and easier. As globalization gained speed, it is argued that national borders lost its importance in economic terms, in other words, the economic globalization phenomenon. As a result of the economic globalization, one can observe that national boundaries lose their barrier role. As a matter of fact, another dimension of globalization is *financial globalization.* Financial globalization is the liberalization of international capital movements, and ease of fund supply, demand and trading by financial market participators without geographical boundaries in more proper markets. *Financial integration*, which stands out as the basic requisite of financial globalization, is the elimination of the difference between yield ratio/fund costs in the financial markets of different countries.

19.2 Financial Services Industry in General

From the beginning of the second half of the century, a different social structure which is called post-industrial or information society has started to replace the industrial society. During this process, the structure of employment has underwent a change in favour of the *services industry*, and thanks to this great development, the contribution of this industry to manufacturing and employment has come to serious levels, particularly in developed countries. The financial services industry which is one of the most significant branches of the service industry is considered a vital industry in terms of its role both in employment and economy.

The development of the financial system in a country occupies a unique position for the transformation of savings into investments and for the development of the country. A well-developed financial system contributes to the development of a country by ensuring the effective utilization of savings. Today, the level of financial development in a country is considered a good indicator in respect of economic growth rate that may be achieved in the future and of the increase in the effectiveness of investments. In the field of industry and firm, a great many empirical analysis covering national research and inter-country research verify a positive relation asserted to exist between a well-functioning financial industry and long-term economic growth.

A financial system can be defined as a whole consisting of financial market, tool and organizations/institutions through which a preference is made between the future and present consumption and the interest rates are determined. The transfer of funds from savers to investors is ensured through financial intermediary firms. The fund flow in the economy becomes easier and faster thanks to the financial intermediaries (Bain 1992, p. 5).

In the banking-based financial system, the coordination of resources which may be utilized for investments in the economy is basically ensured by the banks. In the capital market-based financial system, the savings are in a sense directed to firms directly through the financial markets without needing the involvement of financial intermediaries. In comparison, both systems have advantage and disadvantage aspects during this coordination. The bank-based financial system has a relative superiority in intertemporal hedging and in the financing of traditional industrial branches. However, the capital market-based financial system which uses the exchanges for the coordination centre of savings are more advantageous in the financing of innovations and in the financing of dynamic industrial branches.

The financial structure and the institutional framework of the banking-based and capital market-based financial systems take different forms. But, since neither of the systems have an absolute superiority over the other, the idea that an institutional infrastructure may be created which combines advantage aspects of the two systems arises. This idea is of capital importance both in terms of the problem about which system the region like European Union (EU), which incorporates both system, will be close to in the future and of structural transformation of the economies of old eastern bloc countries in the process of adaptation to the capitalist system as well as in terms of countries like Turkey, which is in the development process and which has not yet completed its process of transformation into the liberal market economy from the mixed economy. While the incomes of certain people and entities exceed their consumption, the incomes of certain persons and entities cannot afford their level of consumption.

The markets in which the savings of those with over-consumption are offered to use with consumption deficit are called *financial markets.* The exchanging of funds into other hands in these markets concludes with the submission of a document to those demanding and to those by offering. Consequently, the financial markets are the markets where these documents having the characteristics of valuable instruments defined as financial assets are traded. In an economy, the suppliers of funds

and demanders of funds, the institutions regulating the fund flow, the tools ensuring this flow and legal and administrative rules regulating them constitute the financial system.

Financial systems work in accordance with the written or traditional rules. *The suppliers* of funds are real or legal persons with oversavings. Such real and legal persons with oversavings transfer their savings to the demanders of funds through the agency of financial institutions. The demanders of funds are real or legal persons with saving shortfall. Financial instruments are instruments/securities that represent financial asset or financial liability of an economic unit. The main players in a financial system are *banks,* intermediaries, investment trusts, securities investment funds, securities exchanges, social security institutions, insurance companies, and cooperatives. These players fulfil the basic functions of the system.

19.3 The Evolution of Turkish Islamic Financial Services

Generally reviewed, the Islamic Financial System and the association participation banking evolved out of the demand of people in Muslim countries, who are not willing to work with classical banks operating on the basis of interest, to work with banks operating in compliance with Islamic principles. On the other hand, as a consequence of rapid increase of the oil prices, the idea that petrodollars accumulating in the gulf region and the amount of which reaches up to several trillion dollars should be deposited in the banks to be established in this region and to operate in compliance with Islamic principles rather than depositing the money to western banks. Also, the idea that mattress savings which are not brought into the economy due to the sensitivity in respect of interest should be brought into the economy was influential in arising of a new banking idea.

The Islamic scholars worked on a non-interest banking model that is compliant with Islamic principles for a long period. These efforts resulted in success at the end and it was concluded that banks which collect funds on the basis of participation in profit and loss, and makes funds available on the basis of murabahah, renting and partnership model would be compliant with the Islamic principles, and banks adopting such principles could be established. When we have a look at the historical process of non-interest banking based on participation in profit and loss, one can notice that the need for non-interest banking in modern period was driven by the industrialization movements in the Islamic countries in twentieth centuries and by the rapid increase of oil prices. Individually, the savings of individual savers would be utilized by the tradesman on the basis of participation in profit and loss; however, with the industrialization, there arose a need for a non-interest bank to pool such individual savings for the financing of large investment projects. Various organizations were initiated all around the world as the Islamic Banking started to operate in 1970s for the first time in the world. Today, the number of the Islamic financial institutions and banks operating in over 60 countries in five

continents is almost 300. 40 % of these financial institutions and banks are located in Arabian states, being the Gulf States, in particular.

The assets of these financial institutions and banks, today, reached up to over 500 billion dollars. The birth of participation banking in Turkey was in 1980s, during the process of according to international markets, when the country was experiencing a transition from closed economy to free market economy. Especially the resolutions passed and the regulations introduced after 1980, financial liberalization movement started. In 1983, as a continuation of these movements, this model of banking started operate as *Private Financial Institutions* with a foreign capital, and the foundations of Participation Banking were laid.

In Turkey, Islamic Financial Services Industry recalls *participation banks.* Participation banking services in Turkey started with Albaraka Türk and Faysal Finans, and another Gulf-origin organization Kuveyt Türk took its place within the industry in 1989, with the participation of General Directorate of Foundations (*Vakıflar Genel Müdürlüğü*). Having started to operate in 1995, Ihlas Finans faced liquidity problem in 2001, and as a result, the Banking Regulatory and Supervision Agency (BDDK) stopped the operations of İhlas Finans. In 1996, Asya Finans stepped in the market and Faysal Finans was later converted into Family Finans. Family Finans merged with Anadolu Finans, which stepped in the industry in 1991, and turned into Turkiye Finans today. Still, these 4 Participation Banks serve in Turkey.

19.4 Methodology of Research

The present study mainly intends to reveal the international competitive level of the Islamic financial services industry. Accordingly, the analysis is provided with input using the appropriate data collection techniques. As the analysis method, Michael Porter's, *from Harvard Business School*, Diamond Model was used. Particularly for data collection purposes, both main actors of the public industry and the private industry were visited, and inquired about their industry-oriented visions and the strategies they developed in connection thereto. An important part of the study is built upon the qualitative research approach.

The current numeric figures are used as the basic inputs of the qualitative research. Under the scope of primary research (*qualitative research*), a comprehensive study on literature was conducted and it was aimed to attain basic variables in respect of the financial services industry in general and the Islamic financial services industry under the scope of Diamond Model and competitive advantage. Thus, written and visual documentation of national and international organizations, non-governmental organizations and researchers (*articles on newspapers and magazines, scientific publications and books, reports, sectorial publications, sectorial statistics, booklets of non-governmental organizations, introductory brochures of the industry and companies, relevant internet sources*

etc.) were reviewed. As the primary research method, the qualitative research technique was employed.

In-depth interview and survey method was employed as the primary data collection technique. In-depth interview method was conducted by surveying business organizations active in the industry, managers and members of the relevant non-governmental organizations and opinions leaders in the industry in the light of questions attained by literature review. The survey questions were designed as structured, semi-structured and unstructured questions.

The structured questions were designed in the light of main and sub-variables of the Diamond Model. In the unstructured questions part of the survey, the relevant respondent was asked to provide his/her ideas and opinions about the sector. Survey questions were asked to main actors in the sector (*relevant leaders and members of non-governmental organizations, opinion leaders, entrepreneurs and experts*).

The respondents were determined using the secondary data and recommendations of the respondents and interviewees. Some of the surveys were conducted face to face, and some, via electronic mail. In addition to the information collected through the secondary research data, all information collected through the primary research data are first subjected to content analysis, refined and then used in the analysis. Especially the justification of each sub-variable of the main variables of the Model was shaped within the framework of the information collected through the said data. The evaluation of each sub-variable was based on the information from separate data collection techniques and high reliability was ensured.

19.5 The Analysis of Islamic Financial Services Sector in Turkey by Using Diamond Model

Porter, in his book *Competitive Advantage of Nations* published in 1990, created a new model called *diamond model* in order to answer the question of why certain countries are more competitive in comparison to others. In order to specify the determinants of national competitive advantage systematically, the model analyses the elements of global competition in a systematically approach.

The Diamond Model represents the total competitive position of an industry. Porter concentrated on specific industries to get to more valid paradigms, and argued that competitiveness was affected from the aforementioned attributes, but that the abundance of these attributes could stand as an obstacle in front of sustainable growth. Porter suggested that nations could create their own advanced pool of attributes such as skilled labor, powerful technology, knowledge and culture, and stated that this is created under specific conditions. The model designed in the shape of a diamond identifies four main attributes that have an impact on the competitive advantage of a nation, firm or organization. These main variables are attributed conditions, firm strategy, structure and rivalry, demand

conditions, related and supporting industries. And the government appears in the model as another variable which has an external impact on these four attributes.

The diamond model which determines the competitive advantages generates a system, and therefore, the main variables determine the competitive advantages not individually, but collectively. In other words, the attributes on the four corners of the model affect one another. Consequently, the system dresses on a dynamic structure. As shown in the Fig. 19.1, the government, as an external attribute, has an impact on the four attributes. Therefore, while the model has internal relation connection on twelve directions, it also has four external connections.

The degree of effect of these interaction connections to one another and the entire model varies from one region to the other and from one firm to the other. The diamond model explains how one determinant is affected by the other three determinants, and is used in determining the competitive positions of nations and industries. Government, as an external dimension with an external impact on these four attributes plays an indirect role in the creation of a relative advantage. With the practices such as the development of various standards and the prevention of monopoly formations have an impact on the competitive position over these four attributes.

To sum up, in Porter's Diamond Model, the entire system is continuously dynamic, and proves to be a process in which negative and positive effects are created. In this process, competitive advantages depend on the speed of renewal and innovations. The ability of one effect, resulting from one determinant, to turn into a beneficial one depends on the state of other determinants. If each factor is in the state of evaluating the effect reflected thereon, it will be impacted negatively therefrom. Arise of large and wide interaction depends on the quality and concentration of the mutual interaction between the entire systems, and while one single factor/attribute is generally insufficient, the existence of a dynamic and competitive environment where new information, skill and actors step in on a constant basis, produces the global competitive advantage (Porter 1990). The model is based upon the international benchmarking of each sub-variable, and it uses the following as grading for its competitive evaluations: (+) High (±) Average and (−) Low. As shown in the Fig. 19.1, the competitive level of the Islamic financial services industry in Turkey, which is assed in the light of data collected, is *low*.

19.5.1 Factor Conditions (−): Low

Factor conditions comprise of sub-variables such as labour, technological infrastructure, and capital accumulation.

- Condition of the Labour (±): Average
  Turkey has remarkable potential in terms of skilled labour. It has skilled and experienced manpower particularly in financial services industry. Furthermore,

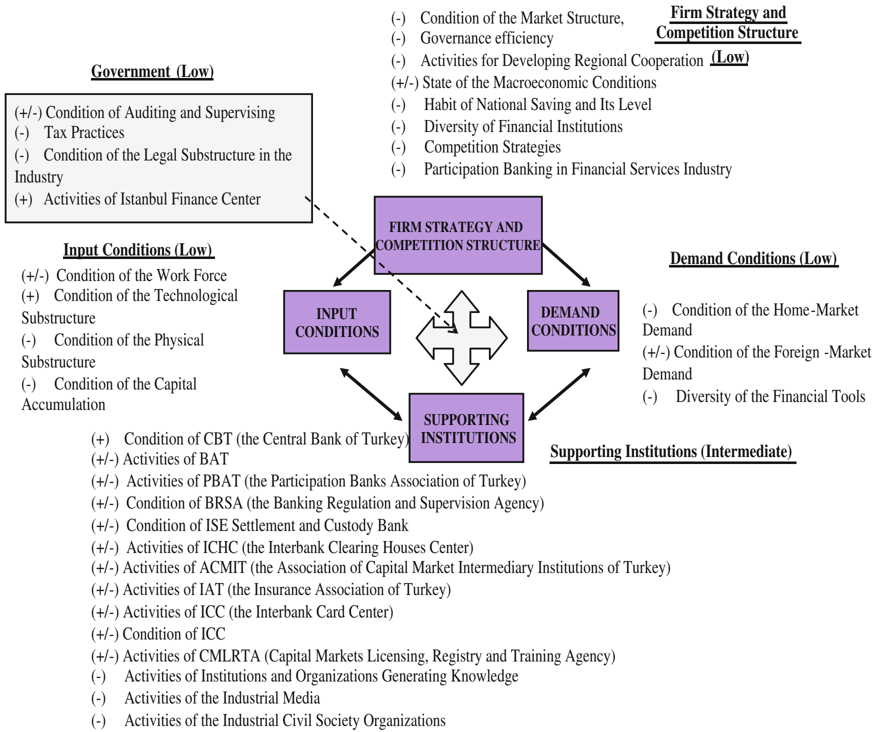

Fig. 19.1 Level of the international competitiveness analysis of islamic financial services sector in Turkey (Low)

employment is possible with lesser wages in comparison to competing countries. Nevertheless, the condition of the labour especially for the Islamic financial services industry is not at the desired level. The system has not developed satisfactorily, standing as a setback in respect of the experience of skilled labour.

- Condition of Technological Infrastructure (+): High
  Technology and infrastructure facilities deployed in the financial industry in Turkey are at a level, capable of competing with the developed countries. Institutions require secure networks and systems for the acquisition of data confidentiality and high performance particularly in the financial industry where security and reliability are critical. Financial institutions that benefit from the innovative financial network (Radianz Cloud) and IP-based unified trading communication (Unified Trading Netrix) as state-of-the-art technology product are able to meet the changing demands by gaining flexibility and agility.
- Condition of Physical Infrastructure: (−) Low
  There exists no specific place that renders services for the Islamic financial industry. A few players providing services operate in a scattered and clustered form.

- Capital Accumulation (−): Low
  In the industry, capital accumulation is a substantial deficiency that has been continuing for a considerable time. Generally, reaching a certain capital size is a requirement for the industry to compete at an international level. However, the status quo demonstrates that the size could not be achieved on the basis of both company and industry. Companies taking part in the industry should achieve the equity size required for sturdy activities.

19.5.2 Demand Conditions (−): Low

Demand conditions comprise of sub-variables such as domestic demand, foreign demand and protection of small savers, and level of saving.

- Domestic demand (−): Low
  Participation banks have a significant potential for the demands from the customers using the products and services of the conventional banking, in addition to the customers who wish to cover their banking needs in this system. Yet, today, there are many people in Turkey who do not use banking services. When such people start to use the banking system, the share the Participation Banks would receive from the system will also increase. The primary reasons limiting the growth of the financial industry in Turkey is found to be the low level of demand to financial instruments due to the low level of savings in parallel with the low level of income per capital, high inflation level continuing for long years, high and changing ratio of taxation of financial instruments and services. Personal pension system seems to be the instrument which attracts the greatest demand among these instruments. However, the current level of demand is not at a competitive level. That is, our country needs to make considerable progress in respect of investment culture. This also impacts the Islamic insurance industry. The same also applies this industry.
- Condition of Foreign Demand (±): Average
  After the crisis in 2001, the foreign interest in the Turkish financial industry increased and as a result, certain significant national banks were sold to foreign investors. It is expectable that this interest will also continue in the future. Particularly with the progress as will be shown by Turkish in the Islamic financial industry, it is expected that Turkey will attract great interest from the region.
- Diversity of Financial Instruments (−): Low
  While the diversity of intermediaries in the financial markets will lead to the increase of fund supply and demand, and to the meeting of a larger amount of fund demand, the diversity of financial instruments will also produce the same result. Therefore, as an indication of financial deepening, the diversity of financial instruments is significant as much as the diversity of financial institutions. Looking at the Islamic financial markets of Turkey, one can see that Turkey uses some of the main financial instruments trade at the Islamic financial

markets of developed countries. In this context, in addition to the fact that the diversity of financial institutions in the industry, and the diversity of financial instruments being supplied by a lesser number of institutions are the significant indicators that the financial deepening could not be completed.

19.5.3 Related and Supporting Industries (±): Average

Related and supporting industries/institutions comprise of the Central Bank of the Republic of Turkey, the Banks Association of Turkey, the Banking Regulatory and Supervision Agency, IMKB Saklama ve Takas Bankası A.Ş. (ISE Clearance and Custody Inc.), Chambers of Interbank Clearance, Interbank Card Centre (BKM), the Association of Capital Market Intermediary Institutions of Turkey (TSPAKB), Insurance Association of Turkey (TSRŞB), and sub-variables such as the diversity of financial institutions.

- Central Bank of the Republic of Turkey (TCMB) (+): High
  The Central Bank of the Republic of Turkey is the monetary authority in Turkey. By an amendment made to the Law on the Central Bank of the Republic of Turkey, the bank is provided with instrument independence. The same law rearranged so that the personal benefits and term of office of senior officers of the Bank will be free from political influence. The Law states that primary duty of the Bank is to ensure price stability.
- Activities of the Banks Association of Turkey (TBB) (±): Average
  The Banks Association of Turkey was founded in 1958. It is a legal entity representing all banks operating in Turkey, pursuant to the Banks Act. The aim of the Association is to defend the rights and interests of banks within the frame of the principles of free market economy and full competition in direction of the principles and rules of the regulation of banking; to carry out studies and researches for the enhancement and healthy functioning of banking system, for the development of banking, for the improvement of competitive power; to adopt/to have adopted, practice and demand to be practiced such resolutions as are required to introduce a competitive environment and avoid unjust competition. All banks operating in Turkey are to register as a member of the Association and to follow the Status provisions and to apply the decrees adopted by the authorized bodies of this Association. Under the frame of the works conducted by the Risk Management and Practices Principles Work Group, operating within the Banks Association of Turkey with the participation of risk management representatives of banks, the developments in the own risk management systems of the bank are closely followed and joint works are coordinated.
- Activities of Participation Banks Association of Turkey (±): Average
  The participation Banks Association of Turkey is a professional public institution with legal personality that has been established as per the Banks Law. All the Participation Banks operating in Turkey are to register as a member of the

Association and to follow the provisions of this Statute and to apply the decrees adopted by the authorized bodies of this Association.

- Banking Regulatory and Supervision Agency (BDDK): (±) Average
  A Steering Committee on Basel II was formed with the representatives from BRSA Risk Management and Supervision Techniques Office as well as the representatives of banks, which are member to the Banks Association of Turkey, with a view to ensure that banking system is informed about the New Basel Capital Accord (Basel II) with respect to capital adequacy, that banking system actors could express their opinions about the regulations and that a common strategy could be identified. In the light of the results of Quantitative Impact Study (QIS-TR) conducted with the participation of a great majority of banks in order to identify the possible impacts of Basel II on the Turkish banking system, the activities initiated by the Turkish banks within the frame of Basel II intended to ensure a more precise calculation of the risks still continue.
- ISE Settlement and Custody Bank Inc. (IMKB Takasbank A.Ş.): (±) Average
  While the settlement of securities traded were performed among members at time when Istanbul Stock Exchange (ISE) started operate, as of 1988, this settlement service started to be performed by a department formed within the organization of the Exchange. In January 1992, the power relating to the settlement and custody of securities with respect to the transactions performed in Exchange was granted to IMKB Takas ve Saklama A.Ş. (ISE Settlement and Custody) which was established with the partnership of ISE and its members, and then the incorporation started to operate. As of January 1996, this incorporation turned into a sector bank with its name Takasbank—IMKB Takas ve Saklama Bankası A.Ş. Takasbank was recognized by the Capital Markets Board as the *Central Custodian Bank* of Turkey. The settlement of all securities traded on ISE is performed by Takasbank. Takasbank ensured by Takasbank Electronic Transfer System (TETS) that intermediaries could be included in EFT system of the Central Bank of the Republic of Turkey as a sub-member, and in this way, still successfully serves as the bridge that allows fund transfer between capital markets and money markets in the fastest, cheapest and the most reliable manner.
- Activities of the Centre of Interbank Clearing Houses (BTOM): (±) Average
  Pursuant to the power vested to the Central Bank of the Republic of Turkey by the Article 55 of the Law no. 1211 on the Central Bank of the Republic of Turkey, the Article 8 of the Cheques Law and Article 6 of the repealed Law on Protection of Cheque Holders and Regulation of Payments By Cheques, the Centre of Interbank Clearing Houses (BTOM) was established in 1985 under a legal entity in order to settlement of cheques by approximation between bank branches.
  Cheque clearing activities are conducted at Istanbul and Ankara clearing houses in accordance with the principles of BTOM Regulation and the Explanation Note concerning this Regulation. Clearing activities and transactions have been performed in electronic environment in Istanbul Interbank Clearing House as of October 18, 1993 and in Ankara Interbank Clearing House as of June 16, 1997.

With a practice initiated at Interbank Istanbul Clearing House in April 16, 1998 cheque clearing is—if requested by participants, performed only through the cheque details without physical submission of cheques in addition to the cheques physically submitted, by signing a protocol drawn up by Centre of Interbank Clearing Houses in order to reduce the transaction charges per cheque and the risks as may be faced in the transfer of cheques as well as to enhance the speed of transactions.
The banks which participate in this system may transact cheques, which may be subject to clearing from all their branches nationwide, at Interbank Istanbul Clearing House. As a result, as of December 31, 2011, cheque clearing transactions have been performed at Istanbul Clearing House, except for an ignorable portion of cheques.

- Activities of the Association of Capital Market Intermediary Institutions of Turkey (TSPAKB): (±) Average
The Association of Capital Market Intermediary Institutions (Association) was established to act as a self-regulatory organization, in form of a public institution, in January 11, 2001, as per the Capital Markets Law and started to operate in April 2001. All financial intermediary institutions which are authorized for capital market operations must be registered to the Association as member. As of November 2011, the Association has a total of 143 members, 102 of them being intermediary institutions, one of them being derivatives brokerage firm and 40 being bank. TSPAKB intends to contribute the development of capital markets and intermediation activities, facilitate solidarity among the members of the association, safeguard the prudent and disciplined conduct of business of its members, prevent unfair competition and to ensure the information of its members in respect of professional subjects.
- Activities of the Insurance Association of Turkey (TSRŞB): (±) Average
The vision of the Association of Insurance and Reinsurance Companies of Turkey (TSRŞB) is to conduct researches, generate information, perform publicity and training activities, coordinate all stakeholders within the sector to a common goal, serve as a neutral and reliable authority and to become a reference institution in Turkey in the field of insurance.
- Activities of the Interbank Card Centre (BKM): (±) Average
The activities of the Interbank Card Centre (BKM) which was established in 1990 with the partnership of 13 public and private Turkish banks are to create, operate and develop systems, platforms and infrastructures which ensure or support any kind of payment or money transfer without the use of cash. Serving as an example in the World thanks to its productive operations and high transaction volume, BKM continues to operate with a view to provide the best possible payment system services to its members, retail sector, public and individuals with its highly advanced technical equipment, infrastructure and human resources. Among the main activities of BKM are developing procedures applicable among the banks within the credit card and bank card application, adopting decisions by conducting activities aimed at ensuring standardization, creating national rules by practices around Turkey, conducting clearing and

settlement between the banks, establishing relations with international organizations and commissions and, where necessary representing the members before such organizations, and performing the transactions still continued by each bank in a more reliable, fast and cost-effective manner from within a single centre.

- Activities of the Capital Market Licensing, Registry and Training Organization (SPL): (±) Average
- Knowledge Producing Institutions: (−) Low
  There is no knowledge producing institution that operates specific services for Islamic Financial Service Sector in Turkey.
- Activities of Sectorial Media: (−) Low
  There is no sectorial media that operate specific services for Islamic Financial Service Sector in Turkey.
- Activities of NGOs: (−) Low
  There is no sectorial NGO that operate specific services for Islamic Financial Service Sector in Turkey.

19.6 Concluding Remarks

As shown in Fig. 19.1, global competitive power of Islamic financial services sector in Turkey, which has been evaluated regarding 5 main sectors, is low. In fact, Turkey's conventional financial services sector is small and narrow compared to developed countries. Islamic financial services sector is at birthstage.

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Chapter 20
ShamGen as a Regional Financial Integration of Islamic Countries

Yasar Bulbul

Abstract With ShamGen, which is a project similar to European Schengen, and a step toward creation of a common market between Turkey, Syria, Lebanon and Jordan, it is aimed to establish strong and consistent financial relationships among Syria, Jordan, Turkey, and Lebanon by developing cooperation in banking and then by setting a single market. The potential GDP of the region is estimated at about 900 billion USD. And it is estimated that once financial cooperation among the ShamGen countries is established, the trade and investment in the region would increase. Turkey as the seventeenth biggest economy in the world will be the leading economy in the group. Istanbul as an international financial centre will be the centre of finance for the ShamGen. It is hoped that economic success of the process will bring peace and political stability to the region. The evaluation of the project will be made using SWOT analysis. This analysis will determine the feasibility of the project.

Keywords ShamGen · Regional cooperation · Financial cooperation · Istanbul international financial centre project

20.1 Introduction

The "Zero problems" policy with its neighbours initiated by the new Turkish government of Justice and Development Party (AKP) in 2000s landmarked a new era for the Turkish government inheriting a huge legacy of common history and culture from the Ottoman Empire for the Middle East region. Also, under this new political climate, a new project called Shamgen -a term fusing the name of the old

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Ü. Hacioglu and H. Dincer (ed.), *Managerial Issues in Finance and Banking*,
DOI: 10.1007/978-3-319-01387-9_20, © Springer International Publishing Switzerland 2014

Ottoman Sham province with Europe's visa-free Schengen area- aiming at creating regional cooperation in the area has been started. The purpose of this chapter is to determine whether the ShamGen established as a regional financial cooperation in the beginning is feasible, with the help of SWOT analysis.

The paper consists of two main parts. The first deals with the development of the ShamGen project, and the second part tries to determine the potential opportunities for trade between Turkey and Syria, and challenges using a SWOT analysis.

20.2 Literature Review

Since this topic is fairly new and has been interrupted because of the civil war in Syria, it is not being studied fully. Therefore, there is limited literature. Among them, Aydin and Yanar (2011) discuss the viability of ShamGen project using the gravity equation. Albarracín (2012) gives an important role to Turkey and ShamGen for rebuilding the Middle East. Kirişci (2011) studies the transformation of the Middle East emphasizing the importance of visa-free travel thanks to ShamGen.

The most important contribution to the topic has come from a conference held in Turkey in 2011 with the participation of central bank governors and experts from four ShamGen countries (Turkey, Syria, Jordan, Lebanon), and representatives from private and public financial sectors, which has not been published yet.

All the publications above attempt to define the ShamGen project as a usual regional cooperation project except Bülbül and Çeviker's paper (2012) focusing on ShamGen project's feasibility. In this study, the possibility and possible effects of financial cooperation will be studied.

Other studies including *SWOT Outlook* made by Statistical Economic and Social Research and Training Centre for Islamic Countries (SESRIC) in 2011 providing a SWOT profile on OIC Member Countries, as a group, in different socio-economic fields and sectors; a study carried out by the European Union in which strengths, weaknesses, opportunities and threats of each ShamGen country for innovation, technology and development are determined individually make SWOT analyses.

This paper making a derivation from these studies aims at making a special SWOT analysis for the ShamGen project.

20.3 Methodology

Strengths, **W**eakness, **O**pportunities, **T**hreats (SWOT) analysis provides information that is helpful in assessing the impacts of major factors (internal and external) on the performance of an entity that could be a company or an industry or even a country or a group of countries with a common objective. Scanning the

internal and external environment of an entity is an important part of the strategic planning process. In this context, SWOT analysis is very critical in matching the resources and capabilities of an entity to the competitive environment in which it operates, and, thus, it is an instrumental tool in strategy formulation and policy making. Internal factors, which are attributes of the entity itself, can be classified as Strengths (**S**) or Weaknesses (**W**). On the other hand, external factors, which are attributes of the outside environment and are out of the control of the entity, can be classified as Opportunities (**O**) or Threats (**T**). In this paper a SWOT analysis of the ShamGen process will be made.

20.4 Middle East Policy of Turkey: The Road to ShamGen

Turkey actively seeks to assume a leading role in the whole region. As a result, Turkey's economic ties with the Middle East have strengthened, and manifested in efforts to expand trade, capital flow and the movement of people (Aydin and Yanar 2011, p. 84). In yet another sign of deepening ties, Turkey announced the creation of an economic council to work toward creating a free-trade zone between itself, Syria, Jordan and Lebanon. This is considered as the cornerstone of a new regional order, one based on more open borders and the free flow of goods and people (some Turkish pundits and officials even started talking about the creation of a "ShamGen" zone—a term that fuses the name of the old Ottoman Sham province, which encompassed modern-day Syria, with Europe's visa-free Schengen area) (Schleifer 2012).

In addition to this, Turkey signed Free Trade Agreement with many countries in the Middle East (Syria 2007; Egypt, 2007; Tunisia 2005; Morocco, 2006 and Jordan 2011). Hence Turkey's trade volume with the Middle East and North Africa (MENA) has increased.

Table 20.1 obtained from Turkish Foreign Trade Statistics shows that foreign trade of the ShamGen countries with Turkey has increased in this period. For example Turkey's export to Syria has increased over 500 % compared to 2001. Likewise trade with Lebanon and Jordan has increased too (Aydin and Yanar 2011, pp. 86–87). It is expected that volume of trade between the two countries, in a short time, will reach to 5 billion dollars from 800 million dollars thanks to the Free Trade Agreement.

Turkey's trade volume reached 1.85 billion dollars as of 2009. This number surpassed 2.2 billion dollars in the first 11 months of 2010 and it is envisaged to reach to the target of 5 billion in a short period of time (Ministry of Foreign Affairs of Turkey 2012).

In parallel, the Turkish government moved to waive visa requirements for Lebanese and Jordanian citizens visiting Turkey. In addition, Turkey led in the establishment of a free trade zone to include Syria, Lebanon and Jordan creating a market of more than 100 million people (Kösebalaban 2011, p. 105). In 2008 the total GDP of Arab countries with which Turkey has signed free trade agreements

Table 20.1 Turkey's trade with ShamGen countries (million USD)

	2001		2004		2007		2010	
	Export	Import	Export	Import	Export	Import	Export	Import
Syria	281	463	395	358	798	377	1.849	663
Lebanon	184	26	234	147	393	116	619	229
Jordan	119	14	229	14	389	12	572	42

and is aspiring to achieve deeper economic integration with was only less than 55 % of Turkey's GDP. These countries in 2008 and 2010 ran a foreign trade deficit amounting to USD 2.9 and 4.8 billion (Kirişci 2011, p. 48). In 31 July 2010 a multilateral regional free trade agreement was signed between Turkey, Syria, Jordan and Lebanon, the so-called "Close Neighbours Economic and Trade Association Council (CNETAC)". The council envisages establishing a free-trade and visa free area. In addition it aims improving the cooperation in trade, transport, tourism and energy (Aydin and Yanar 2011, p. 84). It is still difficult to substantiate the net impact of visa liberalization. However, the increase of entries from the Arab world was average 62 % between 2008 and 2010 (Kirisçi 2011, p. 45).

CNETAC establishes as a medium-term objective the free movement of capital, goods and people through the creation of what has been called the "Middle Eastern ShamGen Area." To achieve this area, a High-Level Strategic Cooperation Council (HLSCC) between the four countries has been set up to ensure and oversee the Project (Albarracín 2012). The HLSCC provided a concrete mechanism that sought further cooperation in many areas. The Council decided to meet at least once a year with its high level members as the Prime Ministers and other important government officials. In addition to that, within the mechanism the ministers responsible for Foreign Affairs, Energy, Trade, Public Works, Defence, Interior Affairs and Transportation from both sides have been scheduled to meet at least twice every year with the aim at building common action plans. In the first meeting of the cabinet members (13 September 13 2009), it was decided to work on 40 protocols and agreements in the political, economic and social realm. In the second meeting of the Council in December 2010, another 11 agreements were signed and both sides agreed on many documents about cooperation in a wide range of areas. Therefore the HLSCC has served as a mechanism for both sides to manipulate economic and social structural changes in the other country. The two states agreed on building a joint dam called as "Asi Friendship Dam" at the Turkish-Syrian border over the Asi (Orontes) River in the December 2009 meeting of the HLSCC (Güneylioğlu 2011, pp. 159–160).

Through this agreement, the 'Levant Quartet'—as the four countries are now known—aims to create a common market and monetary union by launching a visa-free zone and establishing a free-trade zone. The agreement also provides the backbone for future financial cooperation, specifically touching on cooperation in intra-regional investment and project financing (Kamhiyah 2011).

Table 20.2 Banking sector in ShamGen area (2010)

Indicator	Lebanon	Syria	Turkey	Jordan
Number of banks	65	20	45	23
Number of local branches	885	501	9.645	619

The Deputy Governors of the Central Banks of the ShamGen Region representing a financial power is given below met in Istanbul on March 27, 2011 (Table 20.2).

Across the ShamGen countries, the banking sector is still heavily dominated by the conventional banks. In Turkey, the share of the four participation banks representing the Islamic banking sector went up from 2.13 % in 2000 to 4.13 % as of the end July 2010. Additionally and according to the Islamic Financial Centres Competitive Review conducted by the Kuwait Finance House Research, which measures the competitiveness of 20 selected countries across the Globe, Turkey ranked ninth. The successful launch of the first Sukuk created interest within the Turkish investment community to consider raising capital through Sukuk issuances in international markets. In Jordan, the share of the two Islamic banks from the total assets went up from 7.59 % in 2000 to 11.38 % at the end of 2009 and the Central Bank granted a third bank the license to operate in the kingdom. In Syria, the market share of the two Islamic Banks from the total assets went up from 2.67 % in 2008 to 4.48 % in September 2010. In Lebanon, the market share of the four Islamic Banks from the total assets has been for the past five years around 1 % (Charafeddine 2011).

A regional cooperation agreement was signed by the banks association by each of Turkey, Lebanon, Jordan and representatives of the Syrian banking sector. They made the following decisions upon the existing poor situation:

- Banking cooperation between Syria and Turkey: Isbank of Turkey granted a license to open a representative office in Syria. Ziraat Bank, Akbank and Kuveyt Turk of Turkey expressed interest in the Syrian Banking sector.
- Banking cooperation between Lebanon and Turkey: Lebanese bank BankMed owns 50 % of Turkey's T-Bank.
- Banking cooperation between Jordan and Turkey: Jordan domiciled Arab Bank plc. and other entities of the Arab Bank group own 50 % of Turkey's T-Bank (Soueid 2011).

The decisions are:

1. Cooperation on payment systems
   Establishing a working group
   Nominating representatives for the working group from ShamGen countries
2. Organizing a workshop on "Reserve Management"
3. Supporting cross-training initiatives between central banks and also facilitating this for commercial banks.

4. Encouraging ShamGen Bank Associations to cooperate and build mechanisms for information sharing with the region.
5. Creating a mechanism to coordinate the ShamGen countries for a better representation of the Region at the international or multilateral institutions
6. Giving particular attention to the work of Islamic banks in the ShamGen countries due to tremendous and growing role played by these banks; the adoption of the IFSB's (Islamic Financial Services Board) standards for Islamic banks to guarantee the safety and soundness of the Islamic financial industry.

While the Islamic financial services industry currently represents fewer than 3 % of global financial markets, it has been growing by more than 20 % annually since 2000. It is estimated that Islamic banking assets will reach USD 1600 billion, with annual revenue of USD 120 billion by 2012.

A recent survey of the top 500 Islamic financial institutions showed that the assets held by fully Sharia-compliant banks, including the Islamic banking windows of conventional banks, rose by 28.6 % in 2008 from USD 639 billion to USD 822 billion. During this period, the world's top 1000 conventional banks achieved an annual asset growth of 6.8 %.

These developments of the Islamic financial institutions during the recent crisis symbolize the inherent strengths of Islamic finance (Youssef 2011).

7. Establishing banking networks with join capital in order to establish a ShamGen regional bank.
8. Signing additional agreements between banks especially regarding cross border finance, financial stability, payment and clearing solutions.

Initially, the agreement emphasises the economic building blocks of trade, transport, tourism and energy, designating one country in each case to lead and coordinate progress in the field under its own responsibility. The CNETAC is comprised of three pillars of cooperation: political, cultural and economic. The economic pillar is the one set out in the most rigorous detail and the one for which the most tangible and immediate objectives and deadlines have been established. The three pillars, in turn, encompass fourteen objectives, which range from promoting SMEs to food security, by the way of cooperation in third markets, the joint definition and implementation of new infrastructure, educational cooperation and cultural exchanges (Albarracín 2012). Scholars have pointed out the relationship between economic development and democracy while the research has also shown a strong relationship between the level of development and sustainability of democracy. Economic development transforms societies in a number of ways. Most importantly it enlarges the middle class, making it difficult to sustain the concentration of political power in the hands of narrow elite, and encourages social capital to emerge thereby enriching civil society (Kirişci 2011, pp. 36–37). In addition, free trade and economic integration help reduce political conflicts and tension between neighbouring countries, hence contributing to international peace and stability (Aydin and Yanar 2011, p. 95).

The ShamGen project is quite complementary to the bigger project of Istanbul International Financial Centre of Turkey in which it is aimed at becoming the financial centre of the Middle East. Istanbul is hoped to be the financial centre of Middle Asia-Middle East and Europe triangle.

Istanbul is preparing herself for the new international financial centre, which will bring new opportunities for the region, and utilize from the potential. The developed and competitive banking sector which could successfully manage the global economic crisis will be an experienced guide for the sector in the region, and Istanbul Stock Exchange which was the most profitable stock exchange in the world in 1993, and the second most in 2012 will be a role model for the establishment and development of the region's stock exchanges.

The outbreak of the Arab democratic revolts in the winter of 2010–2011 caused a dramatic rupture in this regard by forcing a revision of foreign policy, according to which Turkey emerged as the supporter of democratization in North Africa and Middle East. The victim of this revision, however, was the ShamGen project together with the strategic partnership with the Syrian regime that Turkey had built in the last decade (Kösebalaban 2011, p. 95).

20.5 Swot Analysis

SWOT Outlook made by Statistical Economic and Social Research and Training Centre for Islamic Countries (SESRIC) in 2011 highlights the strengths and weaknesses of the OIC countries (of which ShamGen countries are members) with a view to enhancing their competitiveness globally as well as the level of their cooperation as a group. It also indicates major opportunities to be utilised for further growth and development in OIC countries as well as potential threats that they may face in the future. Having a young population, possessing a significant portion of the world's crude oil and natural gas reserves, accumulating increasing international reserves and being among the top producers of agricultural commodities are major strengths of the OIC countries, as a group. The increasing trends in foreign direct investment, intra-OIC trade, and tourism receipts together with the declining trend in external debt burden are opportunities for OIC Member Countries that should be transformed into higher economic growth and development levels.

On the other hand, the high unemployment rate, weak participation in labour force, inadequate agricultural mechanization and inefficient use of water in agriculture, and lack of adequate funding for scientific development are the weaknesses that should be overcome. Water scarcity, low agricultural productivity, high trade deficit in food, low access to improved water resources and sanitation facilities and inadequate information and communication technology (ICT) infrastructure are threats that are likely to impose serious challenges and, thus, necessitate urgent countermeasures (Sesric 2011).

In another study made by European Union, strengths, weaknesses, opportunities and threats of each ShamGen country for innovation, technology and development

are determined (Crehan and Jones 2003, pp. 68–69). And in a conference held in Istanbul, Turkey in 2011 with the participation of central bank governors and experts of four ShamGen countries and representatives from private and public financial sectors, strengths, weaknesses, opportunities and threats ShamGen project have been analysed. Following table has been derived from these entire swot analyses.

Strengths	Weaknesses
Historical and cultural ties make financial integration much easier. With no cross-cultural barriers and the benefit of a common history, the cooperation and association among the ShamGen nations appears nothing but a most natural and logical family re-union (Youssef 2011)	Turkey is the largest economy in the region (17th in the world). Despite high growth rate in the last decade, Syria, Lebanon and Jordan GDP's are quite small. This creates scepticism of small countries in the bloc about economic domination by big players
Istanbul international financial centre project initiated by the Turkish government will help the success of ShamGen financial integration. Istanbul international financial centre will bring new opportunities for the region	
Istanbul Stock Exchange which is the second most profitable stock exchange of the world in 2012 will be a role model for the establishment and development of the region's stock exchanges	There is a low level of complementarity of trade, poor investment climates, weak political commitment to economic integration, lack of a common vision, and ongoing conflicts in the region (Aydin and Yanar 2011, p. 88)
Being neighbour countries will bring some transaction cost advantages	A lack systemic vision and organisational skills as well as the ability to cooperate (Crehan and Jones 2003, p. 32)
The financial cooperation in the region will be likely to support the development of the Islamic financial institutions which proved the inherent strengths of Islamic finance during the recent global financial crisis	To be able to increase the economic returns of the integration, insertion of some other countries having larger economies such as Egypt, Saudi Arabia and Iraq into the region is required
Jordan, Syria, Lebanon and Turkey have signed a lot of agreements in recent years to foster economic cooperation in trade, tourism, and investment. These agreements make creating investment friendly environment and incentives	
Once ShamGen countries can develop the financial cooperation, they can easily attract Islamic financial industry by adopting the Islamic Financial Services Board (IFSB's) standards. A very strong Diaspora especially in the US and the Middle East (Crehan and Jones 2003, p. 40) will make great financial contributions to the process	

(continued)

(continued)

Opportunities	Threats
With the peace and political stability, the region underinvested in structural and infrastructural investment will attract foreign investments, mainly from Islamic countries	The total liberalization of trade between two countries at different levels of development imposes on the less developed country forms of specialization, which severely restrict the possibilities for organizational evolution and development in those branches of production that characterize the developed economies (Petrakos 2012, p. 2)
Although intra-regional trade in ShamGen has increased rapidly since 2000, intra-regional share in the total trade has very low (3.98 %). The financial cooperation will help the increase	
To establish reciprocal currency arrangements, or "swap lines", between countries' central banks should facilitate foreign currency transactions between the banks particularly in time of crisis as it reduces the cost of foreign currency liquidity and decreases foreign exchange risk (Saqqaf 2011).	
Central banks have a particular interest in the oversight of central securities settlement systems because they provide services which are necessary for the implementation of monetary policy, and they settle securities transactions whose value and importance to financial market participants make them crucial for financial stability. The smooth operation of payments systems promotes efficiency and effectiveness in the financial system	Safety of commercial relations and investment is very important for regional integration. In the region, such risks are still higher and sometimes unaffordable. Legislative restrictions on investment and ownership still exist in some countries. Credit bureaus which are crucial to expanding foreign banks that are not familiar with local borrowers in other countries are rarely available (Kandah 2011)
Trade liberalization will enhance competition, thus allowing access to finance at competitive costs, expand firms' capacity and export opportunities, enhance efficiency through foreign banks participation, create spillover effects of modern financial techniques and benefit small and medium enterprises (Kandah 2011)	Ongoing conflicts and permanent threat for political changes and instability in the region will increase the transaction costs

When we compare the positive side to the negative, we can conclude that strengths and opportunities are superior to the weaknesses and threats. The countries are strong enough to overpower the weaknesses; and the opportunities the project offers are greater than the threats to it. Positive sides are of greater economic value: common history and common cultures will make financial and economic cooperation easier; being neighbours will bring some transaction cost advantages; being on the gateway to Europe from the Middle East will bring some strategic advantages; possible inflow of Islamic finance will help the investments, etc.… And it is hoped that this value will encourage the parties to implement it. And it can be said that the success of the project will bring advantages not only to the region, but also to a greater area including Middle East and Europe.

20.6 Concluding Remarks

It is quite possible that the ShamGen project, which first phase is financial cooperation among member countries led by Turkey can bring stability and peace in the region since we can observe from the SWOT analysis that the positive sides of the project are superior to negative ones. While the strengths and opportunities are of greater value, the countries should eliminate the weaknesses and overcome the threats for their own interests. In the first run, the great increase in the volume of intra-regional trade from the beginning has met the expectations and encouraged the parties for sustaining the project. The big increase in the intra-travel indicates the interest and participation of the people.

Although the ShamGen process seems to have come to an end following the civil war in Syria, Turkey and Syria have proved before that they are able to repair the long-time broken relationship as in the beginning of 2000. We can expect that they will continue the process after overcoming the problems. Since the economic results of this cooperation are satisfactory, the people involved will not abandon it. The success in the near past is evidence of irreversibility of the process.

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Ü. Hacioglu and H. Dincer (ed.), *Managerial Issues in Finance and Banking*,
DOI: 10.1007/978-3-319-01387-9, © Springer International Publishing Switzerland 2014

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