

Süleyman Demirel Üniversitesi  
İktisadi ve İdari Bilimler Fakültesi  
Y.2005, C.10, S.2 s.327-342.

**ANALYSIS OF BANKING SYSTEM AND CAUSES OF  
RECENT PRIVATE BANK CRISIS IN TURKEY  
CASE OF PAMUK BANK**

**BANKACILIK SİSTEMİNİN ANALİZİ VE  
YAKINLARDA MEYDANA GELEN ÖZEL BANKA  
KRİZLERİNİN NEDENLERİ  
PAMUKBANK DURUMU**

**Meltem İNCE\***  
**Prof.Dr.Dr.M.Hulusi DEMİR\*\***

**ABSTRACT**

*The aim of this article is to analyze the Turkish banking system, which is based on universal banking system. This legally gives the opportunity to commercial banks to operate in all financial markets. However, in this project, only private banks of Turkey are analyzed. As it is difficult to analyze all private banks of Turkey, Pamukbank, which is private bank that went bankrupt recently and merged with Halk Bank is taken for case analysis. It was claimed and briefly explained that banks have gone bankrupt because of having liquidity and profitability problems. In addition, there have been many financial changes such as increase in inflation and interest rates, devaluation of the currency and economic collapse in Turkish economy from 1994 till today. Banking system was much affected from these changes and they restructured the financial institutions very recently. Although lots of problems come out from these financial institutions, they continue to make wrong investments and ended with banking crises. As Turkey is affected from external pressure, like economic conditions of the world and due to globalization and also its unstable political system, unfortunately it is possible to experience new bank crises in Turkish Banking system.*

**ÖZET**

*Bu çalışmanın hazırlanmasındaki temel amaç, universal bankacılık sistemine dayalı olan Türk finansal sektörünü analiz etmektir. Bu sistem, ticari bankalara tüm finansal pazarlarda çalışma fırsatını yasal olarak*

---

\* PhD Assistant, Department of Economics, Eastern Mediterranean University, Gazimagusa, TRNC.

\*\* Prof.Dr.Dr., Department of Business Administration, Eastern Mediterranean University, Gazimagusa, TRNC.

*tanımıştır. Bu çalışmada yalnızca özel Türk bankaları analiz edilmiştir. Türkiye'deki özel bankaların tümünün analiz edilmesinin çok kapsamlı bir çalışma içermesi nedeni ile, yakın zamanda iflas eden Pamukbank örnek olarak seçilmiştir. Bu bankaların likidite ve karlılık oranlarının ayarlanamadığı için battığı iddia edilmiş ve ayrıntılı biçimde açıklanmıştır. Ayrıca son dönemde, özellikle Türk Lirasının devalüasyona uğraması, faiz ve enflasyon artışı ve ekonomik çöküntüler ile birlikte türlü finansal değişiklikler ortaya çıkmıştır. Bu değişikliklerden kimileri bankacılık sistemini etkilemiş ve mali kurumların kurulmasına neden olmuştur. Bu dönemlerde ülkedeki bankacılık sorunlarının birçoğu kuruluş aşamasından kaynaklansa da, yanlış yatırımların sürdürülmesi banka krizleri ile sonuçlanmıştır. Bu krizlerin nedenlerinin hepsi bankacılık sisteminin kendi içinde yer almaktadır. Türkiye, globalleşen dünya ekonomisinin etkisi, ülkedeki değişken siyasi yapı gibi dış öğelerden etkilendikçe, ne yazık ki bu gibi krizlerin yeniden yaşanması olasıdır.*

---

*Turkish banking Systems, bank failres, causes of bank crisis,  
Türk Bankacılık Sistemi, Banka Yetersizliği, Banka Krizlerinin Nedenleri*

## 1. INTRODUCTION

Banks are very important for the Turkish Economy. The increase in number of commercial banks and private banks over the years shows that competition increased in the sector. The growing importance of the Turkish Banking Sector shows that bank regulations have become very important for the country. Banks carry most of their activities in money and capital markets. As a result, Turkey's economic and historical development proves that financial system and banking sector are always improving systematically. After liberalization movement in 1980s, continuous changes and modern processes took place in all economy and this was highly reflected by reforms made in financial system. Some of the reforms were established to introducing new tools to regulate liquidity and other risks. Legal arrangements are made to promote the development of capital market. Reforms made in banking sector offer new services by using new instruments in addition to the banking activities. Turkish banks increased their operations in international markets and started to use tools like swaps and forward instruments. Using new financial techniques, such as leasing and factoring, has also increased the efficiency of banking system. (Boratav and Yeldan, 2002) Turkish Banks also increased control and service organization quality. Individual and retail banking have become very important in business sector. This also affected the competition among Turkish commercial banks; because they decide to develop a high quality service aiming to satisfy clients needs better. Within the light of these developments, Pamukbank that went bankrupt recently is tried to analyse. It is a private bank, which failed because of having liquidity and profitability problems in devaluation of TL. On the other hand, it took a major hit from the devaluation of the Lira and from sharp rise in real interest rates precipitated by financial crisis. This

result was a sharp fall in credit expansion and rapidly growth of non-performing loan portfolio.

## 2. TURKISH BANKING SYSTEM

The new liberal economic policy put into effect in January 1980 aimed at integration with world economy by establishing a free market economy. As a reflection of this economy, 1980s were witness to continuous legal, structural and institutional changes and developments in Turkish banking sector. Series of reforms were undertaken to promote financial market development. The main aim of these reforms was to increase the efficiency of the financial system by fostering competition among banks. (Ertugrul and Selcuk, 2001) The Turkish financial system is based upon a universal banking system, which legally enables commercial banks to operate in all financial markets. The only things that commercial banks are not allowed engaging in trading goods for commercial purposes and leasing. Most commercial banks have ownership linkages with non-financial corporations. Holding companies had control in the management of some banks as well as those of industrial corporations. Banks do not have any effective competition with financial institutions. Most of insurance and leasing companies are affiliated to banks. (Munir, 1999)

Table 1: Turkish Banking crises and its results after 1980s

Name	Nationalization	Merger	Bankruptcy	Liquidation	SDIF
Anadolu Bank	x				
Bağ Bank		x			
Bank Express-1994			X		
Bank Express-1998				X	
Denizcilik Bank		x			
Dış Bank			X		
Ege Bank-1994			X		
Ege Bank –1999					X
Es Bank					X
Eurocredit Bank			X		
Hisar Bank		x			
Inter Bank					X
Istanbul Bank		x			
İşçi kredi Bank			X		
Marmara Bank			X		
Sümer Bank					X
Türk Bank					X
Yaşar Bank					X
Yurt Bank					X

Source: TCMB Publications, [2000]

Turkish banks have begun developing strategies to replace unprofitable services and activities, increase in profitability and competitive strength through better control of operating costs. In the 1990s, the Turkish

Banking System experienced several bank failures. In 1994, three small banks were closed and sent into liquidation. Eurocredit Bank, İsci Kredi Bank and Marmara Bank were gone bankruptcy. Bağ Bank, Denizcilik Bank, Ege Bank- 1994, Hisar Bank and Istanbul Bank merged with other banks. From 1997 to early 1999, Es Bank, Inter Bank, Sumer Bank, Turk Bank, Yasar Bank and Yurt Bank were transferred to the Saving Deposit Insurance Fund, thus fully protecting depositors and creditors. A large number of additional banks also faced financial difficulties because of macro economic volatility, unexpected external conditions, and regulatory and supervisory tolerance.

### 3. BANK FAILURES AND SYSTEMATIC RISK

Technological advances made international financial community to be high by sophisticated as well as efficient. Efficiency is of managing of funds providing very high growth in participant nations. . However, as system evolves in itself, problems that arise in one part of world have immediate or chain responses in global community. (Boulton, 2000) For example, Thailand was initial point that faced problems of lacking perfect infrastructure and operational efficiency in a system of rejecting fundamentals in valuation. In a few weeks, Thailand transmitted its problems to neighboring countries such as Russia, Latin America and Turkey. (Özbay, Salman and Şahinbeyoğlu, 1998) On the other hand, fall in prices of primary goods result in negative effect on current account balances of countries depending on exports of such commodities such as Russia and Venezuela. In this respect, international investors became more careful in investment in financial markets and became more reluctant to provide credit to these markets. As a result, international investors changed funds to `developed markets` where is considered more safe. (Burhan, V. and Mustafaoglu) With high capital account liberalization in 1990s, economy is increased very high, especially in South East Asia economy. Because financial sector was able to provide necessary funds to real sector, equilibrium rate of interest was also determined within the system and as inflow of capital was managed by private sector, government did not have high controls on short-term foreign borrowings and central bank of countries had no high control on interest rates. Afterwards, interest rates went up as overnight interest rates; however, since South Asian government had little control in interest rates than private sector, rise in interest rates was not enough to stop foreign exchange purchase. In this respect, government could not control the interest rates. Cause of rise in interest rates was not sufficient, government choose depreciation of currency as an effective policy option. IMF advised countries for a depreciation of their currencies to restore competitiveness and go for further fiscal contraction. (Corsetti, Pesenti and Roubini, 1998) In almost transition countries, major banks incurred large losses as a result of high and fluctuating inflation and the loss of traditional enterprise clients. Current events in East Asia have reminded the world once again of how rapidly and forcefully banking crises can erupt and of how difficult is to anticipate the

full ramifications of these dramatic events, In all cases, banking crises resulted, at a minimum, in large losses of wealth and disruptions in the supply of credit for investment and commerce. Resolving the credits often involved large outlays of public funds. (Hardy, 1998)

Table 3: Some banking Crises and their costs to economy

<b>Countries Name</b>	<b>Years of Banking Crises</b>	<b>The Cost of Crises To the Country (Million \$)</b>
USA	1984-1991	7.5
Argentina	1980-82-85	13 - 55
Brazil	1994-96	4 - 10
Indonesia	1994	2
Philippines	1981-87	3 - 4
Finland	1991-93	8 - 10
Spain	1977-85	15 - 17
Sweden	1991-93	4 - 5
Japan	1990s	3
Malaysia	1985-88	5
Mexico	1994-95	15 - 16
Norway	1988-92	4
Chile	1981-85	19 - 41
Thailand	1983-87	1
Turkey	1982-85	3
Uruguay	1981-84	31

Source: TCMB Publications, [1997]

Alexandra Bibbee comments on Turkey's crisis, where Turkey plunged back into financial crises less halfway through a three-year programme to end decades of high inflation. In general, a weak banking system and an over-reliance on inflows of hot money made the country highly vulnerable to crises of confidence, so that when the inevitable tensions of rapid adjustments emerged, the currency peg could not hold. The devaluation shock will delay the achievement of single-digit inflation and with a simultaneous interest rate shock, implies large bank balance sheet losses. Whatever the strength of new strategy, they will face higher costs and greater risks because of the credibility that has been lost. If the risk materializes, it would be unequivocally negative for Turkey. It would imply large terms of trade and real income losses for clients, real balance sheet losses in the banks and corporate sectors a growing public debt as such losses are nationalized. (Bibbee, 2000)

Özlem Oral makes comment on recent financial crisis in Turkey as well. Starting that it is apparent that Turkey is going through a hard economic

recovery period. Since the main reason for the two recent financial crises was rooted in the banking system's failure in complying with a sound credit mechanism, a radical banking reform facilitating the re-integration of the Fund banks into the system to restore the deficiencies observed in collecting banks' receivables became primary targets of the legislatures in promulgating the amendments to the Banks Act No: 4389.

### 3.1 Systematic Risk

Bank failures are more serious than other failures; individual banks are viewed as more susceptible to failure or more "fragile" than other firms. Banks are viewed as more fragile for three reasons. They have:

1. Low capital-to-assets ratios (high leverage), which provides little room for losses,
2. Low capital-to-assets ratios (fractional reserve banking), which may require the sale of earning assets to meet deposit obligations,
3. High demand debt and short-term debt-to-total debt (deposits) ratios (high potential for a run), which may require hurried asset sales and non-liquid earning assets with potentially large fire-sale losses pay off running deposits.

The adverse implications of this fragility are intensified by the fear that banks invest in assets that are opaque and difficult to market, contain private information and can change in market value, and that depositors may run "irrationally" on banks, forcing unnecessarily large fire-sale losses. Thus, the greater fragility is believed to lead to greater failure. (Kaufman, 1995) Systematic risk is perceived to occur because all economic agents are interconnected. This interconnection provides a chain along which shocks to any one agent are transmitted to others. The personal or institutional balance sheet of each agent includes assets that are either liabilities of other agents or whose values depend on the behavior of other agents. If an agent suffers a decline in the value of its assets, the value of its capital will decline. This will reduce the spending behavior of the agent and thereby also income values were sufficiently large to exceed an agent's capital, it would cause the agent to default on its debt obligations. This will reduce the values of assets on the balance sheet of the agent's creditors and ignite a chain reaction of reduced spending and defaults. (Davis, 1992)

Because of their continuous lending to and borrowing from each other and their need to pay other banks for third-party transfers, banks tend to be more tightly financially interconnected with each other than are most other types of firms. Thus banks are widely perceived to be particularly susceptible to systemic risk, and shocks at any one bank are viewed as likely to be quickly transmitted to other banks, which in turn can transmit the shock down the remaining chain of banks. The adverse cumulative effects of the initial shock are intensified because bank deposits make up of the larger part of most countries' money supply. As a result, depositors experiencing losses are likely to cut back on their spending by more than they would for an equal dollar reduction in other, less liquid forms of wealth. Any impact of the

reduced money supply, however, may be offset by deposit expansion by solvent banks that now have excess reserves or by Central Bank through the injection of additional reserves. (Kaufman, 1995)

### **3.2 Role of Central Bank**

Main objective of Central Bank is to maintain stability in financial markets. For countries that are aiming price stability through exchange rate adjustments, it is important to monitor foreign exchange markets and pursue an exchange rate policy that would be in line with monetary policy goals. An important instrument of Central Bank is to take control of foreign exchange markets and use Central Bank reserves. (Hsieh, 1999)

Any change in expectations will result in very high inflows and outflows of capital. This result increases the volume of foreign exchange markets and also Central Bank reserves. This is due to Central Bank's continuous intervention in markets. Central Bank has basically two tools to slow increase in this volume. First one is, purchase and sale of foreign exchange or rise and fall in interest rates. It is expected that relationship between interest rates and reserves will be negative. (Levy, 2000)

Because of ineffectiveness of rise in interest rates to halt capital outflows during periods of crises, it represents alternative cost of holding reserves. An important implication of volatility in an emerging market's, sharp volatility is seen in reserves, which is not common in developed markets. Secondly, Central Bank make forecast for future and policy makers will have to determine level of reserves and take necessary actions with monetary policy goals. This model improves our forecasting ability in short-run. Findings of this research show that growth rate of reserves is negatively affected by exchange rate volatility as expected. However, we are not able to find any significant relationship between growth rate of reserves and volatility in stock market. Confidence in stock market, which is reflected by return, is significantly related to reserves. Overnight interest rates are negatively related to growth rate of reserves. (Ercel, 1999) If interest rate represents alternative cost of holding reserves than a positive relationship is occurred with measure of variability. However, import sign could not be determined. This is mainly due to level of imports showing degree of country. (Frenkel, 2000)

## **4. CAUSES OF RECENT CRISIS**

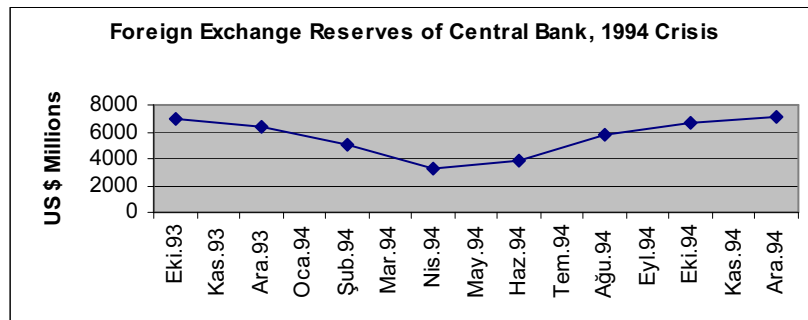
Prevailing conditions of Turkish economy can change activities and priorities of Turkish Banking Sector. High rate of inflation, failure in maintaining macroeconomic stability, low depth of financial sector and immature nature of non-bank financial intermediation are among the major obstacles that negatively affect the Turkish Banking System. (Ercel, 2000)

It is obvious that the decrease of the inflation and interest rates has been the first target to stabilize the economy. Therefore the Turkish government aimed to reduce the high inflation rate to abolish its disruptive

effects on the income distribution in Turkey. Also, they have tried to decrease the inflation rate in order to satisfy the required criteria for being a candidate country for EU. For this reason, government has attempted several times to decrease the high level of inflation and interest rate, which were also supported by IMF.

Turkish economy has experienced with two major economic crises in 1994 and 2001, called as a balance of payment crises. In 1994, the government thought that higher interest rates could not be continued forever. In order to reduce the interest rate, it changed its deficit financing policy and started to use Central Banks reserves heavily. This caused money supply to increase in the economy, which led to decrease in interest rate. At that time the excess money has gone to foreign exchange market and led to increase in the demand for foreign currency, which in turn resulted in depletion of the Central bank's foreign currency reserves. This anticipation triggered a sudden speculative attack to get rid of TL to prevent excessive losses and to benefit from the significant depreciation. The huge demand for foreign currency was followed by a large capital outflow from the country. As a result, in 1994 the TL depreciated severely against dollar. After 1994 crisis, the main problems of the Turkish economy have remained the same at the beginning of 2001. In order to stabilize the economy, they made structural reforms and privatizations. But government could not achieve the structural reforms as it was expected at the beginning of stabilization program. At the same time, the expectations increased that stock exchange market would collapse and government could not survive any more. Then these expectations brought huge outflow from stock market and increased demand for foreign currency, which in turn decreased the central bank's reserves. At the same time, problems in banking sector came out. Turkish private banks had borrowed huge amount of loans from abroad and bought TL –denominated government bills with these funds. Since the banks have been left with unhedged borrowings, their demand for foreign currency to cover their contributed in depreciation of TL further. As a result, so many banks had gain problems and some of them went bankruptcy. (Taskın, Ozgun and Al-Shewey, 2001)

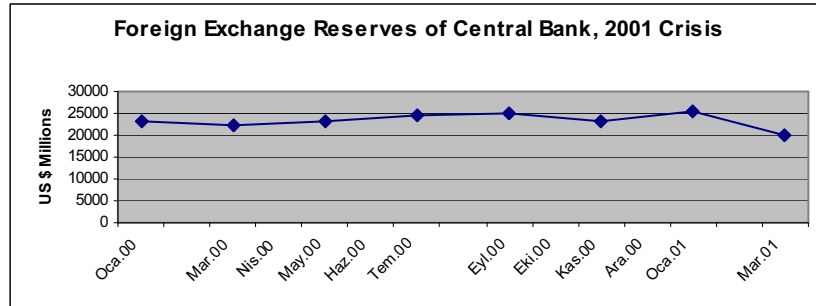
Table4: Foreign Exchange Reserves of Central Bank, 1994 crisis.



Source: TCMB Publications, [1995]



Table 5: Foreign Exchange Reserves of Central Bank, 2001 crisis.



Source: TCMB Publications. [2002]

When a bank is facing possible bankruptcy, its owners and managers may take greater risks if they except to avoid are held accountable. As a result, problems that can ordinarily be contained may be magnified, and sooner or later the banking system will run into difficulties. Furthermore, complex relationship and mutual dependency typically develop between banks and their clients, as well as among banks, so that difficulties that are initially localized can spread throughout the banking sector and into the economy as a whole. As panics and runs hit a banking system, government play a critical role in containing the crisis. The primary objective of the government is to contain the damage, restore confidence to the public, and avoid or contain contagion. Bank regulators often have a choice in how to intervene and for how long. They often make use of a bank holiday (usually around a weekend), during which to intervene in a bank. This time is to use assess the damage and either suspend or revoke the bank's charter. As regulators come to terms with the scope and nature of the problems, they can assess what to do: either close the bank and liquidate the assets or make the intervention temporary, inject capital, and put into place new management intending to eventually re-privatize the bank. (Hardy, 1998)

Authorities have no choice now but try to limit damage with judicious macroeconomic policies, find a solution for banking system problems and re-establish market confidence by continued implementation of structural reform and privatization program. But main challenge will be to contain local fall of monetary strength and adjustment process is equitable. Perhaps European Union could serve as a focal point for new social affect and new political commitment to reform. Worry about crisis in late November 2000 was mainly in Turkey's economic system, but immediate cause was a combination of portfolio losses and liquidity problems. When Central Bank decided to put liquidity into system against its board rules, they worry that program and currency was no longer sustainable and extra liquidity flow out by capital account and reserve. Government continue its attempt to previous inflation targets, by speed up privatization and banking reforms, took over a major bank that had been at origin of liquidity problems and announced a guarantee of all bank liabilities. (Joyce, 2000)

More crises followed. However, this time Central Bank had board rules and rejects to act, as lender of last resort, with hope that banks would turn in their dollars in order to obtain Lira. As a result of recording overnight interest rates, it was peaked at close to 5000% on February 21. The banking system, already greatly weakened by first crisis, faced breakdown as inter-bank payments system ceased to function altogether. The next day government decided to float Lira. (Ercel, 2000)

Under these circumstances, currency was probably only solution available. Market confidence that would have been required to sustain peg strategy was not present. Whatever strength of new strategy, they will face higher costs and greater risks because of creditability that has been lost. Major risk comes from weak currency beside high country risk due to be unable to re-establish confidence quickly. If risk took long period, it would result in negative affect for Turkey. It would need large terms of trade and real income losses for consumers, real balance sheet losses in bank and corporate sectors, a growing public debt as such losses are nationalized and renewed debt due to growing interest costs on public debt. (Balaban., 1999)

In such environment, rise of political and social problems could become weaker and need new reform. Also, inflation affect following currency devaluation could easily become renewed inflation linked wage rises, especially if fiscal situation was out of control. Resolving this problem will require strict adherence to privatization goals and structural reform program in banking and state enterprise sectors, which would help to drive down country risk and attract more stable forms of foreign finance such as direct investment. Exercising tight control must impose fiscal discipline. (Kaminsky and Reinhart, 1998)

Major challenge to authority is to build again social aware for adjustment given that monetary credibility has been balanced. Depositors, banks and businesses can claim with some justifications that are suffered precisely because they believed much in program. An income policy must be worked out with social partners, but this was never fully accepted when program was credible. It will be hard to ask for further sacrifice of these businessmen, as real wage cuts due to devaluation or more lay-offs due to structural reforms. (Willianson and Mahar, 1999)<sup>1</sup>

However, without some kind of social reorganization, it might be very difficult to find a new solution for inflation. And purpose of Turkey to join EU might result in big crisis for public of Turkey because of their reform. Also, need for economic stabilization and institution modernization is necessary for going forward Europe, and remains essential for finding a solution to Turkey's problems. (Dziobek and Pazarbasioglu, 1998)

Similar to situation at end of year 2000, banking sector experienced a negative performance in profitability during first half of 2001. But they realized some recovery in third quarter. In first half of year, because of maturity and currency mismatches, banking sector was affected from depreciation of TL and increasing interest rates following November and

February crisis. Banking sector which had a profit of 25 trillion in first half of 2000, ended first half of 2001 with a loss of 4.9 quadrillion. In dollar terms, while profit of banks was 41 million in first half of 2000, loss of banks in this year was 3.9 billion dollars. (Yeldan, 2001)

Pamukbank was Turkey's sixth-biggest private bank and it was stopped from operation by banking regulatory authority following discovery of a \$2 billion black hole in its balance sheet. Moves came following from audit of Turkish banks by Turkish Central Bank aimed at assessing sector's liquidity in order to implement an international Monetary Fund (IMF) re-capitalization process. A new IMF- sponsored banking law passed early this year had been intended to bring sector in line with international norms. But regularly authority announced by Pamukbank had failed to take measures show in law and according to a Central Bank audit it was showing a capital deficit of around \$2 billion as of Dec 31,2001. Stopping Pamukbank from operation brings 20 private banks taken over by authority since its establishment in 1999. Because of these some had become unstable as a result of deliberate hollowing out by their owners, but more commonly thanks to their being used as a source of 'soft' loans or companies within same group. Given strong links between business and political interests in Turkey, cancel of operation of Pamukbank is particularly significant. As it clearly indicates power can be considered above law, a situation has not always been seen to be case over past two decades. Cukurova announced that it intended loss-making Pamukbank with a bank, which is Turkey's third largest private bank, Yapi Kredi. Cukurova Corporation will also be sued for \$2 billion missing from Pamukbank's balance sheet, which is believed to have gone in 'soft' loans to Cukurova Companies. Whether Karamehmet or senior company directors will face prosecution for their part in crash of Pamukbank remains to be seen. It is also unclear how soon they will be expected to divest their interests in Yapi Kredi.

Some analysts warn that a regulatory authority board will be obligated to run bank on a 'less risk' basis, which will harm bank's profits and its chances of finding a buyer, as well as deep credit squeeze which is already affecting Turkey's ability to invest its way out of past year's economic crisis. Most problems may result from ownership within Cukurova Corporation. Pamukbank and Yapi Kredi Bank hold 8% and 11% stakes respectively in Cukurova Company, and also Turkcell which is Turkey's largest mobile telephone operator with around 70% of market belongs to Cukurova Corporation. Now seem certain to be sold as regulators seek to recover part of \$2 billion lost from Pamukbank, and if Yapi Kredi prove un salable in short term, regulatory authority may also oblige Cukurova to sell its own 24% stake in Turkcell to cover remainder of its debts. Two years ago, when Turkcell public offer appear on Istanbul and New York stock exchanges, both company and its parent Cukurova could do no wrong. (Munir, 2001).

Table 8: Financial Ratios of Pamukbank

<b>Ratios for Pamukbank</b>					
(%)					
	2000	1999	1998	1997	1996
<b>Capital Ratios</b>					
Standard Capital Ratios	17.1	14.1	9.7	9.8	8.7
(Shareholders Equity+Net Earnings)/Total Assets	19.4	13	8.7	10.6	8.4
(Shareholders Equity+Net Earnings)/(Deposits+Non-deposit Items)	25.4	16.1	10.4	12.8	9.9
<b>Quality of Assets</b>					
Total Credits/Total Assets	59.1	57.6	62.3	62	61.4
Loan Loss Provisions/Total Credits	0.8	0.7	0.6	0.6	1.2
<b>Liquidity</b>					
Current Assets/Total Assets	21	29.4	22.8	23.5	20.6
Current Assets/ Current Liabilities	27.4	36.4	27	28.3	24.2
<b>Profitability</b>					
Net Earnings (Losses)/Average Total Assets	4.3	3	2.5	2.4	1.6
Net Earnings (Losses)/ Average Shareholders Equity	31.5	32.2	32.6	28.3	22.9
<b>Structure of Income and Expenses</b>					
Interest Income/ Interest Expenses	140	123	129	128	127
Non-Interest Income/ Non-Interest Expenses	59.6	10.7	-10.4	-20.4	-48.3
Total Income/ Total Expenses	123	110	110	108	105

<b>Group Shares</b>					
Total Assets	9.5	9.1	8.1	7.4	7.3
Total Credits	14.8	15.7	12.3	10.2	10.3
Total Deposits	10.5	10.7	10	8.9	8.6
<b>Sector Shares</b>					
Total Assets	4.5	4.5	4.3	4.1	3.8
Total Credits	8.1	8.6	7.1	5.5	5.5
Total Deposits	4.6	5	5.3	5.1	4.6

Source: TCMB Publications, [2001]

As we see from table, standard capital ratios are increasing from 1996 to 2000. The reason of this is increasing capital and expanding as a bank. On the other hand, total assets are not changing but ratio is increasing as years past. The reason of this is increase in net earnings. So we can say Pamukbank increase its loans, securities and other interest incomes while decreasing its expenses. So its net earnings are increasing. But this result does not help Pamukbank for not going bankruptcy. Because of having flowing line of deposits from 1996 to 2000, it increases its capital ratio, too.

Also deposits and non-deposit items are low in 1999 and 2000. That is another reason of increase in shareholders equity and net earnings. If banks get less funds from Interbank market to asset and liability, then, the result will not be the same. Total credits/total assets are having its high value in 1998 and it has started to decrease from this year. They might give less credit or their total assets might increase. Also, this ratio is increasing. In every year, banks separate Provision for loan losses. Because sometimes loans that they have given will not come back. So according to such loans they have given, they decreased the amount of loan losses provisions. As a result, it becomes more stable. Total assets shares are similar. Deposits are low because of assets. So Bank has to increase its assets to increase their ratios. Interest earnings are good, too. It is increasing. That means, they are getting the money they have given to their borrowers. On the other hand, from 1996 to 1998, they have a problem with non-interest income. Because ratios are negative here. They have a low interest income according to the money they have given. But later on, they decrease their non-interest expenses while increasing their non-interest income. So they make a good earning in 2000. We can say for total interest ratio that they increase their incomes while expenses are increasing.

Foreign exchange income is included in this part. As we know there was devaluation in our country in 2001, Pamukbank makes a huge loss in foreign exchange income. As a result, they separate provision for loan losses more than they expected. When we look at the table 16, shareholders equity+ net earnings/ total assets ratio is decreasing in 2001. Also, shareholders equity+ net earnings/ deposits +non-deposit items ratio is decreased, too. That means its net earnings are decreasing and shareholders equity is not enough to raise the ratio. On the other hand, quality of assets ratios is decreasing. Pamukbank separate so many provisions for loan losses in 2001 because of foreign exchange losses caused by devaluation. Therefore, their liquidity ratios are started to decrease. Because they made a loss in their credits because of devaluation in foreign exchange and liquidity problems are started in Pamukbank as of 2001.

Banks are major players in financial system and are affected by international banking regulations. They have made significant progress in investments and organizations. They opened branches and made strategies to increase their shares in international markets. Also, they started to increase their qualified personnel by using Human Resources Techniques.

On the other hand, Pamukbank is the bank, which had followed these strategies. It has opened new branches in Turkey and find new strategies to increase its shares in banking sector. But 1994 crises affected this bank. In that period, because of group risk it had, pressure of liquidity was increased as a result of dulled assets and it had to bear high cost sources. The best thing to do was to liquidate expensive sources that banks had while quality of assets of banks were well. But Pamuk Bank could not find any opportunity of selling its sources because of low quality of assets welded by group risks and holding these expensive sources made the loss increasing as

years past. Therefore, the most important problem for this bank was not getting the credits it had given to their clients' and other firms. Credits were not paid in maturity date and banks paid them. Also, it could not get the interest of these credits. It only made interest discount and the degree of change in an exchange rate. Discounts were put under credits and/or other assets in the balance sheet. So its balance sheets were made more profitable and banks shareholders equity was made seen better.

Because of defaulted credits that it had given to firms and clients', its assets were seen dulled and bring nothing to the bank. It affected its financial structure and caused instability in revenue-expense. It could not get the interest collection for long years. So it has put discount to these credits. These discounts were put into capital and made discount again. So it has created revenue for banks. By this method, banks are making a huge loss and although loss is increasing, balance sheets of both banks are shown profitable.

Banks, which are holding group risks and the degree of change in an exchange rate, have a low quality of assets and inadequate shareholders equity and liquidity. As a result of these, financial structure of banks has gone. Although they have been informed to repair their financial structure since 1995 by Saving Deposit Insurance Fund, they did not apply the right steps of strengthening their financial structure and the steps that are followed by Pamukbank, to decrease group lending could not be successful. These are the reasons of bankruptcy of Pamukbank.

## 5. CONCLUSION

Turkish economy is influenced by economic and political problems. These problems cause instability that discourages long-term savings and leads to increase in interest rates and weaken the currency. Poor credit quality with weak credit risk management is a dominant factor in bank failures and banking crisis. Turkish banks face with great restrictions to engage the securities activities and will have a high probability of having banking crisis. Turkey must first begin with reforms to structural and financial institutions. Structural reforms such as privatization, changing the financial support system and reforming the Turkish banks will straighten the Turkish Banking Sector. In addition, government must continue to contract fiscal policy and inhibit the devaluation of the Lira.

Banking System must be sound for having a credible currency. Also, an increase in supervisory regulations will help to control many of the past losses. In 1994 and 2001 banking crisis, Turkish Banks cannot operate their financial positions due to the economic changes in the country. They cannot measure their deposits, loans and credits. On the other hand, some of Turkish banks were in a very weak financial position when devaluation of Lira occurred. So Pamuk Bank could not stand against these problems. In addition, Turkish Banks have to repair their financial structure according to the changes in the economy. So they can balance their liquidities and increase

their profitability if these measurements are done. But if nothing is done, then, there will be more bankruptcies in Turkey.

#### REFERENCES

1. Balaban, E., Day of week effects: new evidence from stock market, *Applied Economic Letters*, 2, 1999, pp: 139 – 143.
2. Bibbee, A., Turkey's Crisis, *Journal of Economics*, 225, 2000, pp: 7 – 9.
3. Boulton, L., IMF begins Turkish Banking Crisis, *Financial Times*, 2000, p: 24-47.
4. Burhan, V. and Mustafaoglu, Z., Rusya Krizi ve Türkiye üzerinde muhtemel etkileri, DPT.
5. Corsetti, G., Pesenti, P. and Roubini, N., What caused Asian currency and financial crises?, 1998, pp: 8 – 27.
6. Davis, E. P., *Debt, Financial Fragility and Systematic Risk*, Oxford: Oxford University Press, 1992
7. Dziobek, C. and Pazarbasioglu, C., Lessons from Systematic Bank Restructuring, IMF Publications, *Journal of Banking and Finance*, 18, 1998, pp: 648 – 692.
8. Ercel, G., Central Bank in Turkey, pp: 1 – 12, 1999.
9. Ercel, G., Globalization and International Financial Environment, At the Central meeting of 17<sup>th</sup> Asian Banking Association, 2000, pp: 1 – 16.
10. Ertugrul, A., and Selcuk, F., A brief history of Turkish Banking Sector: 1990-2000, *Russian and East European Finance and Trade*, forthcoming, 2001.
11. Frenkel, J. A., A conditional heteroskedastic time series model for speculative prices and rates of return, *Review of Economics and Statistics*, 69, 2000, pp: 542 – 547.
12. Hardy, D. C., Are Banking Crisis Predictable?, *Journal of Finance*, 35, 1998, pp: 32 – 35.
13. Hsieh, D. A., Modeling Heteroskedasticity in daily foreign exchange rates, *Journal of Business and Economic Statistics*, 7, 1999, pp: 307 – 317.
14. Joyse, J., Global Financial Crises, *Journal of Finance*, 2000, pp: 1 – 15.
15. Kaminsky, G., and Reinhart, C., Leading indicators of currency crises, IMF Staff papers, 1998, 45, pp: 1 – 48.
16. Kaufman, G., Comments on Systematic Risk, In G.G Kaufman (ed.), *Research in Financial Services*, 7, Greenwich, JAI Press, 1995, pp: 47 – 52.

17. Levy, V., Demand for International Reserves and exchange rate intervention policy in an adjustable-peg economy, *Journal of Monetary Policy*, 7, 2000, pp: 147 – 164.
18. Munir, M., Turkey's banks and its economy, *Journal of Economics*, 38, 1999, pp: 260 – 268.
19. Munir, M., Turkey's banks and its economy stand on the brink'', *Euromoney Publications*, 389, 2001, pp: 260 – 278.
20. Oral, Ö., Turkey: response to the recent financial crisis, *International Financial Law Review*, 20, 2001, pp: 137 – 140.
21. Özbay, P., and Salman, F., and Şahinbeyoğlu, G., North-west Asian Crisis and Turkey, Central Bank of Turkish Republic, Unpublished manuscript, 1998, pp: 274 – 292.
22. Taskın, M., Ozgun, D., and Al-Shewey, W., The case of Turkey, *Journal of International Finance*, 2001, pp: 1 – 9.
23. Williamson, J., and Mahar, M., A survey of Financial Liberalization, *Journal of Money, Credit and Banking*, 1999.
24. Yeldan, E., Küreselleşme Sürecinde Türkiye Ekonomisi: Bölüşüm, Birikim ve Büyüme, *Istanbul: İletişim Publications*, 2001, pp: 26 – 42.