

Exploring the Demand Side Issues in Participation Banking in Turkey: Questionnaire Survey on Current Issues and Proposed Solutions

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Abstract

Since 1980s, Islamic finance has exhibited a significant growth in Turkey, whereas problems related to regulation, competition, products and the public perception of Islamic finance institutions continues to exist. This paper aims to discover the current issues and to develop solutions. In addition to our previous research, an extensive questionnaire is utilized to help mature our opinions. Questionnaires were sent to 1045 businessmen to investigate the perception of Islamic finance in Turkey. Findings indicate that problems can be classified into four main categories: problems related to the interpretation and implementation of Islamic principles and rules, problems related to competition with conventional banks, problems related to local law and regulations, and problems related to human capital and corporate governance. Possible solutions include developing a sound understanding of Islamic economics, making the Islamic supervision process more effective and transparent, easing the regulations for Islamic financial institutions to develop and implement original structures based on Islamic principles, providing fair competition opportunity with the conventional banks, promoting education programs especially in universities both to develop the theoretical framework and to provide qualified human capital to the industry.

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Introduction

Since the 1980s, Turkey has gone through significant social, political and economical transformations and developments. Especially toward the end of 1980s, the rise of a new middle-rich class became obvious. The primary characteristic of this new middle-rich class has been a more pious and Anatolian identity, in contrast with Eurocentric and secular characteristic of the conventional middle-rich class of the Turkish Republic. Along with this trend, Islamic finance institutions came into existence in the form of *Special Finance Houses*. Subsequently, Islamic finance has registered a significant growth in Turkey, whereas problems related to regulation, competition, products and public perception of Islamic finance institutions continues to exist. This paper aims to discover the current issues and to develop solutions. In addition to our previous research, an extensive questionnaire is utilized to help mature our opinions. The perception and evaluation of Islamic banking in Turkey from the businessmen perspective is investigated through an elaborate survey.

The structure of the paper is as follows. Next section provides a brief review of the evolution of Islamic finance in Turkey. The survey methodology and key findings are presented, followed by a general assessment and our proposed solutions.

A Chronological Overview of Islamic Economics and Islamic Finance in Turkey

The concern with Islamic economics in Turkey began with the appearance of books and articles which had been translated into Turkish in the 1970s and became essential items in the agenda of rising political Islam. As a result of the significant liberalisation process initiated by Ozal government in 1980s, the interest-free “special finance institutions (SFI)” were introduced, among many other new structural changes in the Turkish economy.

The Turkish government, one of the founding members of the Islamic Development Bank (IDB), increased its capital share in 1984 and became one of its major shareholders. This entitled Turkey to maintain a permanent member on the board of the IDB. Consequently, Turkey has played a more effective role in the IDB that has helped realise cooperation programs among Islamic countries, supported international trade and infrastructure projects, and developed new financial instruments (Bulut and Er, 201, p. 17).

The events and processes that took place in the world and Turkey in 1990s caused the search for Islamic Economics as a distinct theoretical field to cease or to be put aside. However, as the number of SFI increased, so did their weight in the banking sector. This development may well be described as a result and cause of the rise of a class of religious businessmen. The “Anatolian capital” represented by the businessmen organizations have become a major determinant in the economic and political arena. They have been accepted as one of the building blocks of “new Turkey”.

The development process of Islamic finance in Turkey can be chronologically summarized as follows:

1983: The Ozal government signed the decree of SFI that allowed the establishment of financial institutions operating in compliance with Islamic principles.

1985: The first SFI began to operate.

1985-1999: Significant growth in the sector: two new SFI were established and the market share reached 2%.

1999: These institutions were included in the new Banking Act.

2000: Banking crises in Turkey: an SFI went bankrupt along with many other conventional banks (CB).

2001: The SFI Security Fund came into effect.

2006: The SFI are transformed into “Participation Banks (PB)” and the SFI Security Fund was transferred to the Saving Deposit and Insurance Fund.

2010-2013: Four Participation Banks present with 43 billion TL asset size corresponding to 4,3% of the banking sector, 33 billion TL participation funds corresponding 5,4% and 32 billion TL loan size corresponding 6% (Yahşi, 2010).

Issuance of Sukuk and facilitating Private Pension system for PBs.

Lately, the Central Bank of Turkey, the Turkish Capital Markets Board, and the Istanbul Stock Exchange have begun to participate in or

initiate some international cooperation and collaboration processes in Islamic finance.

The Survey

The Sample

Hypothetically, the vast majority of PB customers are those people who closely observe Islamic principles. Along with these two groups, a third group includes those who use only common banking services such as money transfer, bill payment, credit and debit card etc. However, this group constitutes a minority. This assumption played a major role in our sample selection process. The focus of the survey is to investigate the current status and future of Islamic finance in Turkey from the perspective of businesses that actually utilize such services.

We have followed a practical approach to reach a sample that sufficiently represents pious businessmen. We contacted five associations of businessmen of which the members consist of those businessmen who observe Islamic values and practices to a more than average degree. These associations are MÜSİAD, TUSKON, ASKON and TÜMSİAD.

MÜSİAD, short for Independent Industrialists and Businessmen's Association, founded in May 1990, is the first association among these four. It currently has 33 branches with 105 contact points in 45 countries. According to figures provided in the association's website, it has about 3,300 members producing 15% of GDP. TUSKON, short for Confederation of Businessmen and Industrialists of Turkey, was formed in 2005 by 7 different regional business federations. There are 172 businessmen association within TUSKON. ASKON, short for Anatolian Lions Businessman Association, that was founded in 1998. Its members are mainly in Istanbul but it has been trying to reach out and form branches in Anatolia, a process that has not been completed yet (www.askon.org.tr). TÜMSİAD, short for All Industrialists and Businessmen Association, founded in 2006, is the youngest among these four.

We contacted either the owners or the CEOs of the firms. The total number of participants is 1.045. However, we excluded those questionnaires with too many unanswered core questions and carried out analyses using remaining 941 observations. The composition of the participants with regard to the association is as follows: MÜSİAD 38%, TUSKON 18%, TÜMSİAD 17%, ASKON 7% and other 18%. Those participants classified within "other" category consist of those businessmen who declared themselves a subsidiary of confederation, instead of the confederation itself.

A Five-point Likert scale was used in the questionnaire. The respondents chose the agreement level they considered their own views best corresponded to, from ‘definitely agree’ to ‘definitely disagree’.

Findings

Demographics and Firm Size Profile

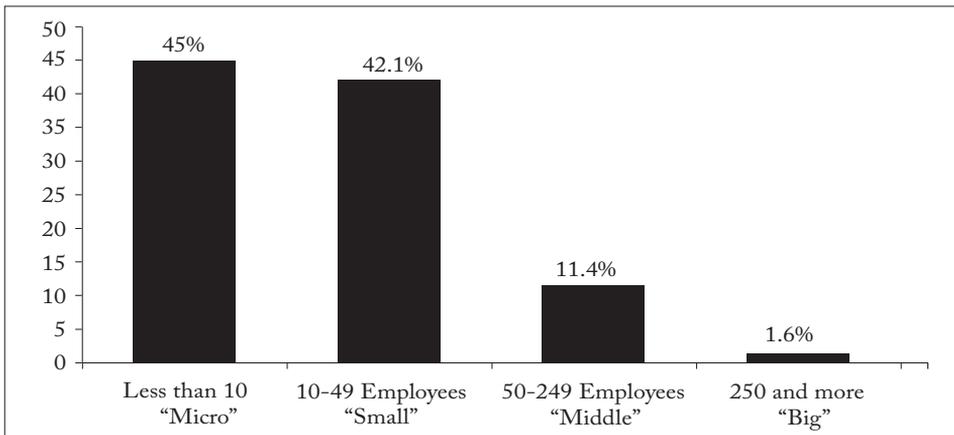
Table 1. shows the key demographic data of the participants and Figure 1 exhibits the composition of the participants with regard to firm size as measured by the number of employees.

Table 1. Key Demographics of the Participants

| Education | Percent | Age | Percent | Experience | Percent |
|------------------|--------------|--------------|--------------|--------------|--------------|
| Primary School | 10,2 | 18-30 | 17,7 | Up to 5 yrs | 13,1 |
| High School | 37,2 | 31-40 | 34,8 | 6-10 yrs | 21,3 |
| Vocational | 10,3 | 41-50 | 35,8 | 11-15 yrs | 19,7 |
| Bachelors Degree | 35,2 | 51-60 | 10,6 | 16-20 yrs | 14,8 |
| Masters and PhD | 7,0 | 60 + | 1,2 | 20 yrs + | 31,1 |
| Total | 100,0 | Total | 100,0 | Total | 100,0 |

As can be seen from Figure 1, participants are mostly small-size firms. This result confirms the fact that the economic weight of those firms owned and managed by pious class in Turkey is still behind those owned and managed by the more secular class, despite an obvious rise in the former group over the last 20 years.

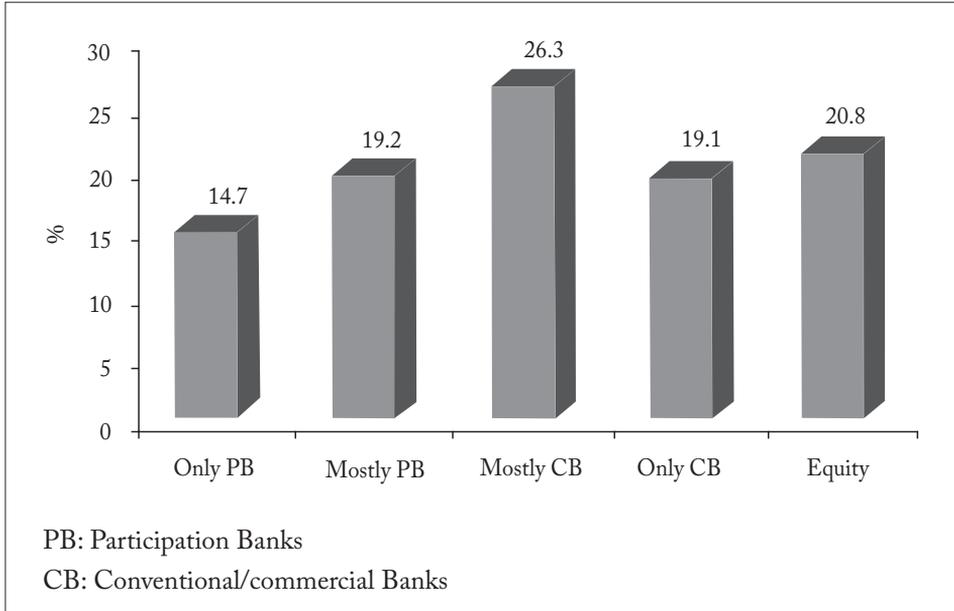
Figure 1. Composition of Participants With Regard to Firm Size



Assessment of Participation Banks

a. Financing Policy (Source of Financing): “Which of the Following Do You Prefer in Your Financing Activities?”

Figure 2. Preferences in Source of Financing



The aggregate percentage of conventional/commercial banks (CB) (i.e., those who say “only CB” and “mostly CB”) is 45, while the aggregate percentage of participation banks (PB) is 25. At first sight, it might indicate that the majority of religious businessmen prefer interest-bearing banks to finance their businesses more than participation banks. When we consider those using equity financing only (21%) together with those using only PB (15%), we see that only 36 percent of the participants never use interest-bearing financing. However, when we aggregate those using equity financing with the “only PB” and “mostly PB” group, we may have a meaningful coalition of 55% that appears distant from CB.

Note that these findings do not reflect the entire composition of the firms’ liabilities on the balance sheet. In other words, these findings do not mean that the firm uses 20% equity and 80% debt financing in their operations. Participants should have perceived this question as to how they finance their “new investments only”.

b. Banking Services: “What type of banks do you prefer for banking services?”

Figure 3. Preferences in Other Banking Services

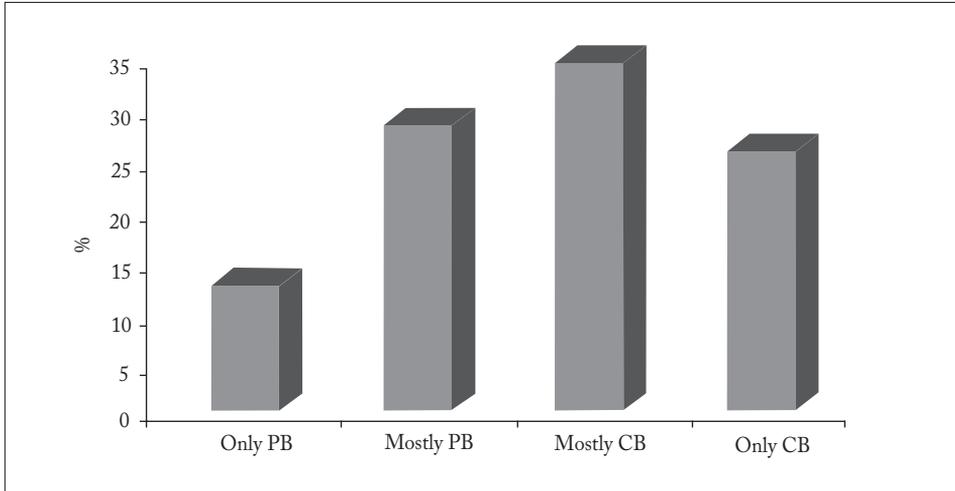
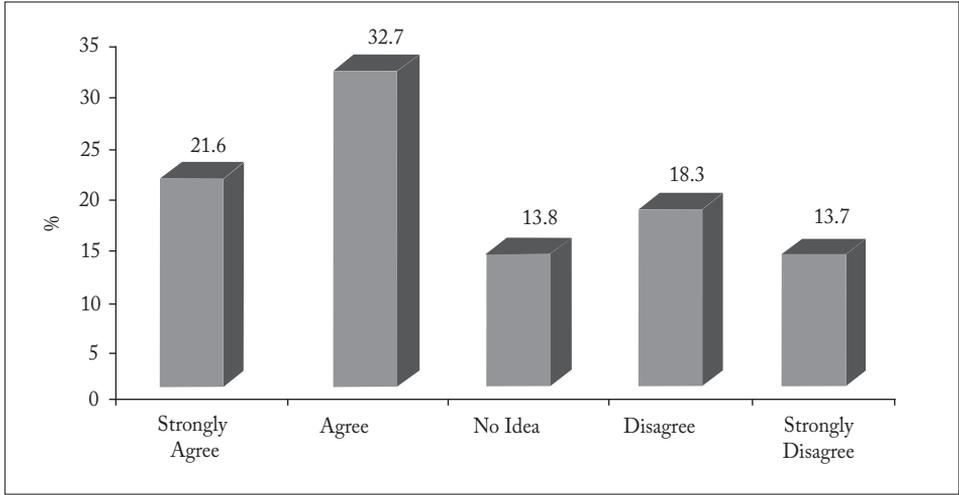


Figure 3 shows the distribution of preferences of the participants with regard to banking services other than financing, such as collections, payments, fund transfers, checking accounts, credit cards, insurance etc. The results indicate that 40 percent prefer PB while 60 percent prefer CB. The primary reason behind this result is that CB have advantages over PB in terms of widespread organization (having branches everywhere), service quality, human capital and diversification in banking products. Participants probably do not hesitate in using such services from CB as long as they do not involve interest-bearing transactions. The primary implication of this finding for PB executives might be the necessity to develop the service quality of PB.

c. The Importance of Financing Cost: “Among Financing Alternatives, I Prefer the Less Costly Source Regardless of The Bank Type”

Figure 4 indicates that more than half of the participants, namely, 54 percent stated that they take the cost as the only criterion in financing decisions regardless of the bank type. That is, they may well prefer interest-bearing loan of the CB if it is cheaper than financing from the PB. The proportion of those who would always prefer the PB so as to avoid interest

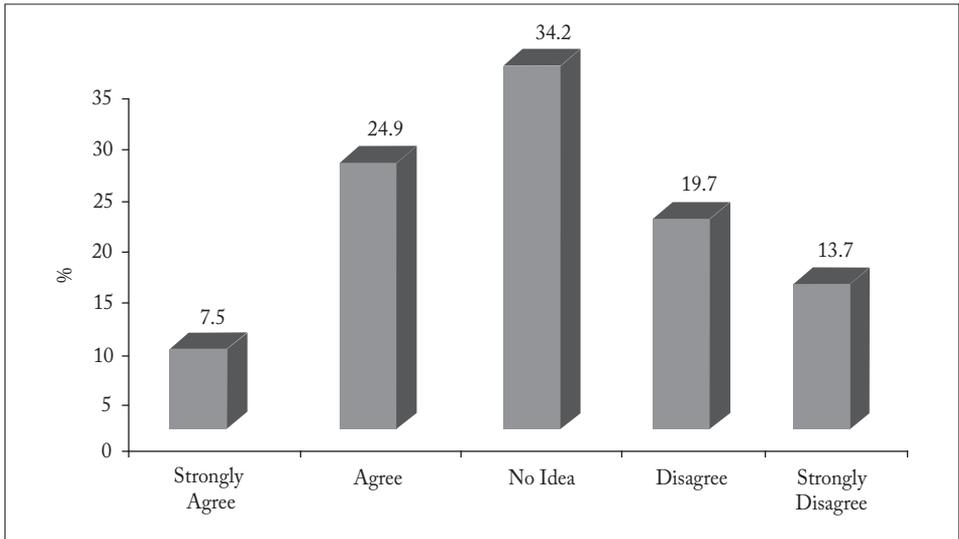
Figure 4. Considering the Cost of Financing as Only Criterion Regardless of The Bank Type



even if it is more expensive is 32 percent. This result may imply that piousness does not necessarily affect the commercial manner. In other words, it seems that a considerable portion of Turkish businessmen segregate their faith and commercial activities.

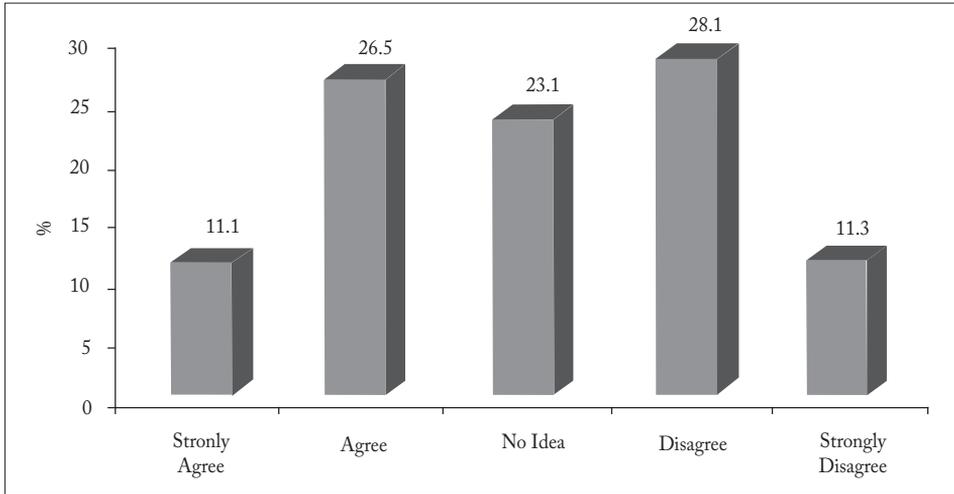
d. Are PBs Shariah-Compliant? “I Think That Participation Banks Work In Compliance With Islamic Principles”

Figure 5. Perception of the Shariah-Compliance of PBs



e. The Difference Between PB and CB: “There is No Difference Between The Operations of PB and CB With Regard to Islamic Principles”

Figure 6. The Difference Between PB and CB



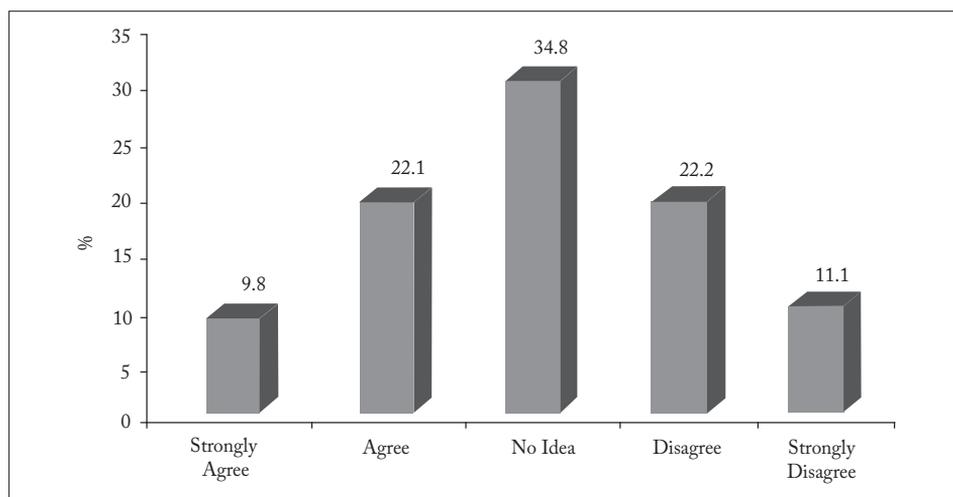
The two questions above aim to discover the same fact through reverse ways. The most striking finding in Figure 5 is the high percentage of those who have no clear idea as to whether PB work in compliance with Islamic principles and rules. The weight of those who think that PBs work in compliance with Islamic principles and rules is almost equal to those who think adversely. When the proportion of those who undecided is aggregated with total proportion of those who disagreed, it can be concluded that more than 60 percent do not believe that the PBs are Shariah-compliant. The results exhibited in Figure 6 confirm these results.

The reason behind this conclusion arise due to both absence of an effective Shariah supervision process in Islamic finance sector and lack of sufficient knowledge on Shariah within the society.

f. The Service Quality of PB: “The Service Quality of PB is Better Than That of CB ”

Finally, participants are asked to assess the service quality of PB in comparison with CB. The results indicate another problem; that is one the professionals in the Islamic finance sector should consider seriously. Only

Figure 7. Comparison of PB With CB in Terms Of Service Quality



one third of the participants think that the service quality of PB are better than that of CB. The high proportion of those who have no idea indicates a lack of customer satisfaction as well. This problem is especially important because of the future prospects of the Islamic finance sector.

Analysis of Variety of Banking Choice Between Groups

This section is devoted to providing more of an insight with information provided with regard to the bank-type preference of participants. Cross tables are utilized to find out the differences between certain categories in terms of bank type preference. These categories include businessmen association, scale, education level, cost comparison attitude and belief in Islamic finance.

a. The Businessmen Associations

Cross tabulation 1, along with Figure 8 illustrating its findings, indicate that the preference of PB in financing is most among ASKON members. The sum of “only PB” and mostly PB” answers is 47%. It is followed by TUSKON with 42%, and then by MÜSİAD and TÜMSİAD with 33% each. Chi-Square test indicates that membership of one of the four organizations matter in the choice of bank at a 1 percent level. The degree in this relationship is not very strong but significant.

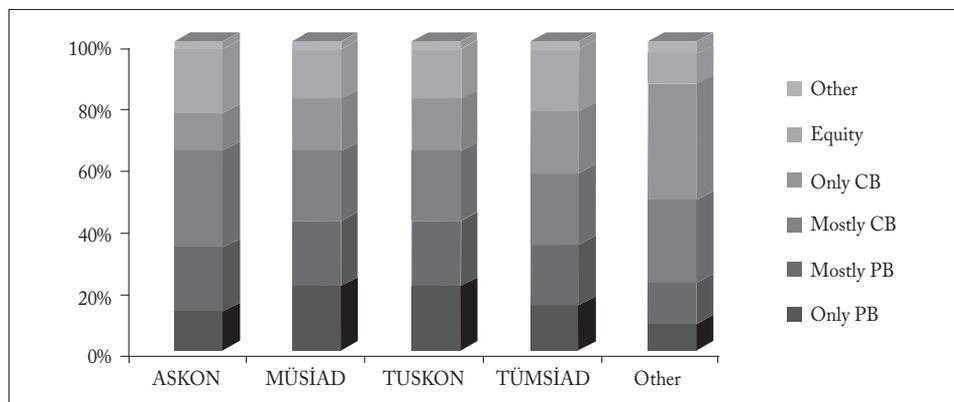
Cross Tabulation 1. Source of Financing by The Businessmen Organization Membership

| | | Which of the followings do you prefer in financing your firm? | | | | | | Total |
|-------------------------|---------|---|-----------|-----------|---------|--------|-------|-------|
| | | Only PB | Mostly PB | Mostly CB | Only CB | Equity | Other | |
| Businessmen association | ASKON | 26% | 21% | 18% | 12% | 23% | - | 100% |
| | MÜSIAD | 12% | 21% | 31% | 12% | 21% | 3% | 100% |
| | TUSKON | 21% | 21% | 23% | 17% | 16% | 3% | 100% |
| | TÜMSIAD | 14% | 19% | 23% | 20% | 20% | 3% | 100% |
| | Other | 8% | 13% | 27% | 38% | 10% | 4% | 100% |
| Total | | 15% | 19% | 26% | 19% | 18% | 3% | 100% |

PB: Participation Banks, CB: Conventional Banks

| | |
|--|---|
| Chi-Square Value = 83.69 (Sig.= 0.000) | Contingency Coefficient = 0.291 (Sig.= 0.000) |
|--|---|

Figure 8. Source of Financing Classified by The Businessmen Organization Membership



b. The Scale

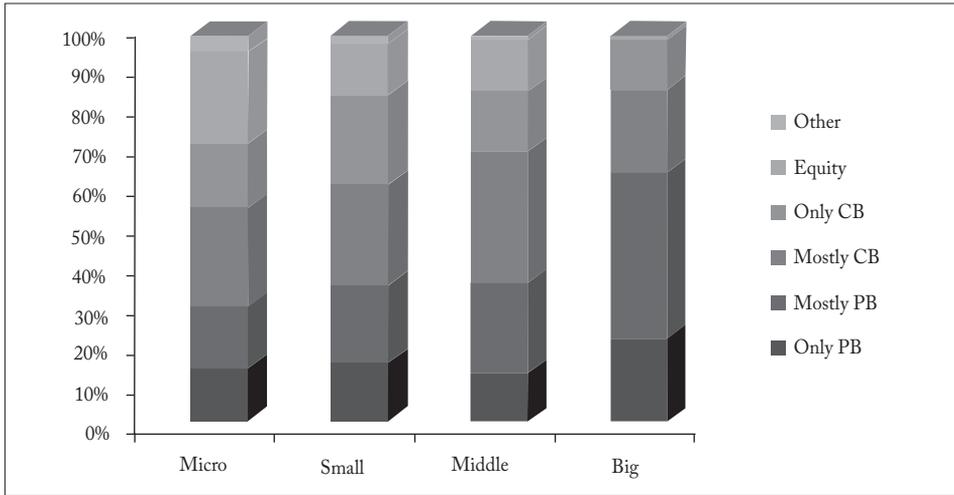
Cross Tabulation 2. Source of Financing By Firm Scale

| | | Which of the followings do you prefer in financing your new investments? | | | | | | Total |
|------------|--------|--|-----------|-----------|---------|--------|-------|-------|
| | | Only PB | Mostly PB | Mostly CB | Only CB | Equity | Other | |
| Firm Scale | Micro | 14% | 16% | 26% | 16% | 24% | 4% | 100% |
| | Small | 15% | 20% | 26% | 23% | 13% | 2% | 100% |
| | Middle | 13% | 23% | 34% | 16% | 14% | 1% | 100% |
| | Big | 21% | 43% | 21% | 13% | 1% | 0% | 100% |
| Total | | 15% | 19% | 27% | 18% | 18% | 3% | 100% |

PB: Participation Banks, CB: Conventional Banks

| | |
|--|--|
| Chi-Square Value = 37.18 (Sig.= 0.001) | Contingency Coefficient = 0.20 (Sig.= 0.001) |
|--|--|

Figure 9. Source of Financing by Firm Scale



Cross tabulation 2 implies that the means of financing significantly differs within the size categories. Equity financing is greater in small firms. As the firm size gets bigger, use of bank funds increases. This implies that smaller firms do not have enough access to the banking system. It is quite reasonable that banks would be reluctant to work with small firms as such firms are unable to provide sufficient collateral and reliable financial statements. The shift from CB to PB is obvious only in the “big” category. The excessively small percentage of equity financing in big firms, on the other hand, should be a result of a miscommunication of the questionnaire. The result here may be interpreted as if big firms finance their entire assets with 1% equity on average, which is impossible. As noted earlier in the paper, respondents should have perceived this question as to how they finance their new investments only. The Chi-Square test verifies the existence of meaningful relationship. The contingency coefficient also indicates a significant relationship between the two variables.

c. Assessment of Participation Banks in Terms of Shariah Compliance by Groups

Here we cross tabulate bank preference attitudes against the assessment of participation banks in terms of Islamic principles. This table is expected to show how the perception/assessment of participation banks differentiates among the groups classified by financing preferences. Those

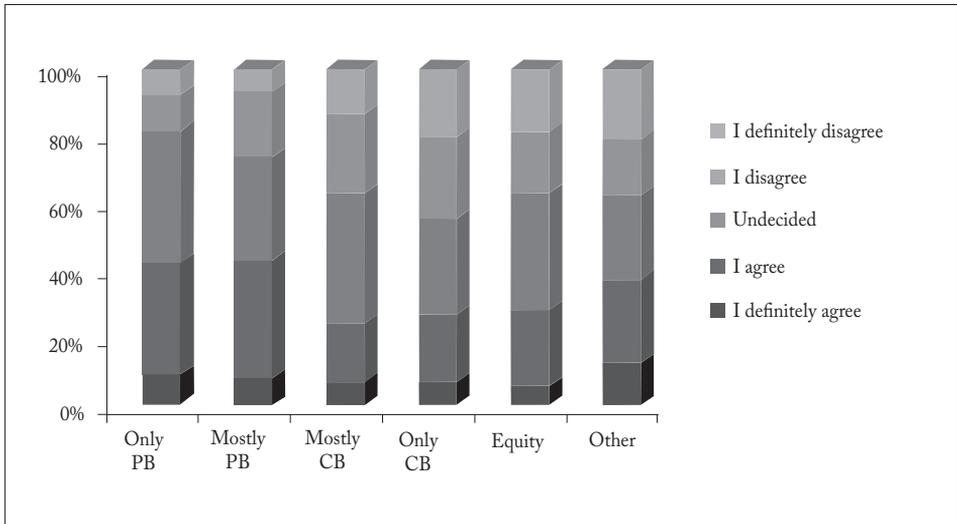
Cross Tabulation 3. Assessment on Shariah Compliance and Choice of Bank in Financing

| | | <i>"I believe that participation banks operate in compliance with Islamic principles"</i> | | | | | Total |
|-----------------------------|-----------|---|-------|-----------|----------|---------------------|-------|
| | | Definitely agree | Agree | Undecided | Disagree | Definitely disagree | |
| Choice of Bank in Financing | Only PB | 9% | 33% | 39% | 11% | 7% | 100% |
| | Mostly PB | 8% | 35% | 31% | 19% | 7% | 100% |
| | Mostly CB | 7% | 17% | 39% | 24% | 13% | 100% |
| | Only CB | 7% | 20% | 29% | 24% | 20% | 100% |
| | Equity | 6% | 22% | 35% | 18% | 19% | 100% |
| | Other | 13% | 25% | 25% | 17% | 21% | 100% |
| Total | | 7% | 25% | 34% | 20% | 14% | 100% |

PB: Participation Banks, CB: Conventional Banks

| | |
|---|---|
| Chi-Square Value = 54.078 (Sig.= 0.000) | Contingency Coefficient = 0.236 (Sig.= 0.000) |
|---|---|

Figure 10. Assessment on Shariah Compliance and Choice of Bank in Financing



who believe that participation banks work in accordance with Islamic principles are expected to heavily prefer PB in financing. The findings indicate that 42% of those who prefer PB (only & mostly) believe so. This is less than the hypothesized level. On the other hand, those who believe that the PB do not work in accordance with Islamic rules are expected to abstain from the banking sector and to prefer equity financing. The figures do not verify this hypothesis as well.

The main problem with this issue is the high proportion of “undecided” groups. The “undecided” answer constitute the highest proportion in all bank preference groups. This implies that there is a lack of knowledge and consciousness regarding Islamic finance / fiqh muamalat (Islamic commercial law) among conservative businessmen in Turkey.

Conclusion

Findings indicate that problems can be classified basically into four categories: problems related to interpretation and implementation of Islamic principles and rules, problems related to competition with conventional banks, problems related to local law and regulations, and problems related to the human capital and corporate governance. Possible solutions include developing a sound understanding of the Islamic economics, making the Islamic supervision process more effective and transparent, easing the regulations for Islamic financial institutions to develop and implement original structures based on Islamic principles, having the Islamic banks adopt better governance, providing fair competition opportunity with the conventional banks, promoting education programs especially in universities both to develop the theoretical framework and to provide qualified human capital to the industry.

Finally, the ultimate success in the Islamic banking sector will not be achieved unless all stakeholders understand and internalize the very goals and principles of Islamic moral economics. As revealed by the survey, the ambiguousness and inefficiency will continue if both depositors and borrowers of participation banks do not have the same moral concern, along with the banks.

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