EFFICIENCY OF ISLAMIC BANKING IN TURKEY

Mohammad Tayeb KHAN

Master of Science Thesis

Eskisehir, 2016

# Efficiency of Islamic Banking in Turkey

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**Master of Science Thesis**

**Department of Business Administration**

**Supervisor: Doç. Dr. Murat Ertuğrul**

**Eskişehir**

**Anadolu University, Graduate School of Social Science**

**July, 2016**

# JÜRİ VE ENSTİTÜ ONAYI

**Mohammad TAYEB'in "Türkiye'de İslami Bankacılığın Etkinliği (Efficiency of Islamic Banking in Turkey)"** başlıklı tezi **18 Temmuz 2016** tarihinde, aşağıdaki jüri tarafından Lisansüstü Eğitim Öğretim ve Sınav Yönetmeliğinin ilgili maddeleri uyarınca toplanan **İşletme (Finansman)** Anabilim Dalında, **yüksek lisans tezi** olarak değerlendirilerek kabul edilmiştir.

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# ABSTRACT

## Efficiency of Islamic Banking in Turkey

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Islam is complete code of life. It provides guidance to its followers in each field of life. It has its own educational, judicial, social and economic systems, and requires its believers to lead their lives accordingly. One of the important components of Islam is its financial system. Islamic financial system is unique in the sense that it provides guidance not only on the economic aspect but also covers the moral and ethical aspect of the transactions. Banking system is crucial constituent of any financial system. Islam recognizes the importance of banking and requires that the banking system must adhere to the principles of Islam.

This thesis is written to show the development of Islamic finance and banking in Turkey, and to analyze which banking sector (Islamic/Conventional) is more efficient. The thesis consists of three chapters, the first chapter of the thesis answers two questions; what is Islamic finance and what are the modes of Islamic banking and finance. The Islamic modes of finance for retail, partnership and enterprises are explored with the capital market products of Islamic finance. The second chapter is about the development of Islamic finance and banking in Turkey, 4 participation banks with their products and services are explained in this chapter. This chapter also focuses on social responsibilities of the participation banks and their contribution to the Turkish economy. In chapter three of the thesis, DEA Data Envelopment Analysis model is used to measure the efficiency level of both sectors. Data from 3 participation banks and 26 conventional banks are used between 2010-2015. In the study, it was found out that participating banks in Turkey are more efficient than conventional banks for the period.

**Keyword**: Islamic finance, Participation Banking, Islamic finance in Turkey, Islamic Banking

# TEZ ÖZÜ

**Türkiye'de İslami Bankacılığın Etkinliği**


**Mohammad Tayeb KHAN**

**İşletme Anabilim Dalı**

**Anadolu Üniversitesi Sosyal Bilimler Enstitüsü, Temmuz, 2016**

**Danışman: Doç. Dr. Murat ERTUĞRUL**



İslam tam bir hayat kılavuzudur. Hayatın her bir alanında inananlarına rehberlik eder. Kendine özgü eğitim, adalet, sosyal ve ekonomik sistemleri vardır ve inananlarının hayatlarını bunlara göre sürdürmelerini gerektirir. İslam'ın önemli parçalarından biri finansal sistemidir. İslami finans sistemi, sadece ekonomik yönden rehberlik etmesiyle değil, işlemlerin ahlaki ve etik boyutunu da kapsaması münasebetiyle eşsiz bir sistemdir. Bankacılık sistemi, tüm finans sistemlerinin hayati öğesidir. İslam, bankacılığın önemini tanımakta ve bankacılık sisteminin, İslam prensiplerine bağlı kalmasını gerektirmektedir. Bu çalışma Türkiye'de İslami finans ve bankacılığın gelişimini göstermek için yazılmıştır ve üç bölümden oluşmaktadır. Çalışmanın ilk bölümü iki soruya cevap vermektedir; İslami finans nedir ve İslami bankacılığın ve finansın yöntemleri nelerdir? Perakendecilik, ortaklık ve girişimler için İslami finans yöntemleri, İslami finansın temel piyasa ürünleriyle keşfedilmektedir. İkinci bölüm Türkiye'de İslami finans ve bankacılığın gelişim süreçten bahsedilmektedir, Türkiye'de faaliyetlerini sürdüren 4 banka üzerinde durulmuştur. İkinci bölümde aynı zamanda İslami finansın Türkiye toplumuna ve ekonomisine katkısı da ele alınmıştır. Tezin üçüncü bölümünde Veri Zarflama Analizi kullanılarak, hangi sektörün daha etkin olduğu ortaya konmuştur. Veri Zarflamada 3 katılım bankası ve 26 ticari banka ele alınmış ve 2010-2015 arası altı yıllık veri incelenmiştir. Çalışma sonucunda genel olarak incelenen dönem için katılım bankalarının geleneksel bankalardan daha etkin oldukları gözlemlenmiştir.



**Anahtar kelimeler:** İslami finans, katılım bankacılığı, Türkiye'de İslami finans, İslami bankacılık.

# ETIK İLKE VE KURALLARA UYGUNLUK BEYANNAMESI

Bu tez/proje çalışmasının bana ait, özgün bir çalışma olduğunu; çalışmamın hazırlık, veri toplama, analiz ve bilgilerin sunumunda bilimsel etik ilke ve kurallara uygun davrandığımı; bu çalışma kapsamında elde edilmeyen tüm veri ve bilgiler için kaynak gösterdiğimi ve bu kaynaklara kaynakçada yer verdiğimi; bu çalışmanın Anadolu Üniversitesi tarafından kullanılan bilimsel intihal tespit programıyla tarandığını ve hiçbir şekilde intihal içermediğini beyan ederim. Her hangi bir zamanda, çalışmamla ilgili yaptığım bu beyana aykırı bir durumun saptanması durumunda, ortaya çıkacak tüm ahlaki ve hukuki sonuçlara razı olduğumu bildiririm.

Mohammad Tayeb KHAN

# ACKNOWLEDGMENTS

I would like to thank to my beautiful Family for the motivation and courage that they give me through every single step of my life.

I am very thankful to my supervisor for his support, help, advice and all other kind of help he provided to me.

A special thank to brother Falamur Kacio and Ayşenur Dizkara for providing their technical support.

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# ABBREVIATION LIST

**AAOIFI:** Accounting and Auditing Organization For Islamic Financial Institutions

**CIBAFI**: General Council for Islamic Banks and Financial Institutions.

**IIFM**: International Islamic Financial Market

**IFSB**: Islamic Financial Service Board

**IICRA**: International Islamic Center for Reconciliation and Arbitration

**OCC**: Office of the Comptroller of the Currency

**UBK:** United Bank of Kuwait

**AMF:** Autorité des marchés fi nanciers

**GCC:** Gulf Cooperation Center

**SFH:** Special Finance House

**NCB:** Saudi National Commercial Bank

**CGF:** Credit Guarantee Fund

**SMEs:** Small and Medium Enterprises

**IIRA:** Islamic International Research Agency

**GDP:** Gross Domestic Products

**CAGR:** Compound Annual Growth Rate

**SDIF**: Saving and Insurance Deposit funds

**GCC:** Gulf Corporation Council

**TKBB:** Türkiye Katılım Bankalari Birliği (Participation Banks Association of Turkey)

**AK Party:** Justice and Development Party

**DEA**: Data Envelopment Analysis

# CHAPTER ONE: INTRODUCTION TO ISLAMIC FINANCE

## 1.1. Introduction

Islam is complete code of life. It provides guidance to its followers in each and every field of life. It has its own educational, judicial, social and economic systems, and requires its believers to lead their lives accordingly.

One of important components of Islam is its financial system. The system is unique in the sense that it provides guidance not only on the economic aspect but also covers the moral and ethical aspect of the transactions. Banking system is crucial constituent of any financial system. Islam recognizes the importance of financial transactions and requires that the banking system must adhere to the principles of Islam.

Islamic banking is different from conventional banking system in many ways. One of the unique features of Islamic mode of banking is the prohibition of interest. (Hassan, Kayed, & Oseni, 2013) The Islamic world is seriously thinking for adoption of Islamic banking system in Islamic countries. But it is a fact that majority of the people in these countries especially in Turkey, have very little information about it. People need to be educated on the subject.

The first modern experiment with Islamic banking was undertaken in Egypt (El-Gamal, 2006) under cover, without projecting an Islamic image, for fear of being seen as manifestation of Islamic fundamentalism, which was anathema to the political regime. The pioneering effort led by Ahmad El Najjar, took the form of a savings bank based on profit sharing in the Egyptian town of Mit Ghamr in 1963. (Uusmani, 2002) This experiment lasted until 1967. (Usmani, The Concept of musharakah and its application as an Islamic method of financing, 1999) by which time there were nine such banks in the country. These banks, which neither charged nor paid interest, invested mostly by changing in trade and industry, directly or in partnership with others, and shared the profits with their depositors. Thus, they functioned essentially as saving investment institutions rather than as commercials banks. Nasir school bank, established in Egypt in 1971 (Mohammed, 2015) was declared as interest–free commercial bank, although its charter made no Islam or Shariah. (Anderson Graduate School of Management, 2001)

The Organization of Islamic Countries (OIC) established the IDB (Islamic Development Bank) in 1974 (Mohammed, 2015) but it was primarily an inter governmental bank aimed at provide funds for development projects in member countries. The IDB provides fee-based financial services and profit-sharing financial assistance to member countries. The IDB operations are free of interest and are explicitly based on principles of Shariah. (Islamic Development Bank, 2016)

After Islamic Development bank Establishment, a number of Islamic banks, both in letter and spirit, came into existence in the Middle East, e.g., the Dubai Islamic Bank (1975), the Faisal Islamic bank of Egypt (1977), and the Bahrain Islamic bank (1979), to mention few.

The Asia pacific region was not oblivious to the winds of change. Presidential Decree as specialized banking institutions established the Philippine Amanah Bank (PAB) in 1973 without reference to its Islamic character in the bank's charter. However, the primary task of the PAB was the assist rehabilitation and reconstruction in various parts of the country. The PAB however is an Islamic bank, since interest- based operations continue to coexist with the Islamic modes of financing. Nevertheless, efforts are underway to convert the PAB into a full-fledged Islamic bank.

Islamic banking made its debut in Malaysia in 1983, with the establishment of bank Islam Malaysia Berhad (BIMB) which represents a full-fledged Islamic commercials bank in Malaysia. Reference should also be made to some Islamic financial institutions established in countries where Muslims are in a minority. There was a proliferation of interest –free savings and loan societies in India during the seventies. (Usmani, An introduction to Islamic finance, 2002) The Islamic banking system (now called Islamic Finance House), established in Luxembourg in 1978, represents the first attempt at Islamic banking in the western world. Today UK own the largest Islamic finance shares in the western world, around 6 Islamic banks are operating in UK. There is also an Islamic bank international of Denmark, in Copenhagen and the Islamic investment company has been set up in Melbourne, Australia.

Islamic finance is emerging as a rapidly growing part of the financial sector in the Islamic world. Islamic finance is not restricted to Islamic countries, but is spreading wherever there is a sizable Muslim community.

Interest is prohibited as it leads to injustices (zulm) and Islam is against all forms of injustices and exploitations and pleads an economic system, which aims at securing extensive socio-economic justice. The Islamic law of prohibition of riba, which includes interest, was originally not based on economic theory but on Divine Authority which considers the charging of interest as an act of injustice.

The growth in Islamic finance initially coincided with the current account surpluses of oil-exporting Islamic countries. But its continued growth in the face of eroding oil revenues reflects the influence of other factors, such as the desire for sociopolitical and economic systems based on Islamic principles and a stronger Islamic identity. In addition, the introduction of broad macroeconomic and structural reforms--in financial systems, the liberalization of capital movements, privatization, and the global integration of financial markets--have paved the way for the expansion of Islamic finance.

There could be no one denying the fact that under the interest-based system of banking or in a system not strictly based on the principles and spirit of Shariah, depositors as well as borrowers are exploited in one form or the other. It is however, significant to note that, as in the case of conventional banking, the depositors are being exploited most under the system and practices enforced by banks and financial institutions operating world-wide under the banner of Islamic banking.

Today Islamic finance desire and implementation are not seen just in Islamic world, but specially western and American financial institutions and investment firms take Islamic finance as their first priority because of secure investment and profitability approach of Islamic Institutions in the past crucial decade of 21st century. Many European and

American banks has Islamic banking windows to offer Islamic finance services through theirs banks and these Islamic Banking windows become a good income source for these banks. Islamic finance attracts attention of world financial institutions especially after 2008 financial crises, where Islamic finance with its Asset-Based Application has zero percent lost in the crises. In 2010, total values of Islamic finance assets were 195 Trillion USD and it's estimated to increase to 315 Trillion USD in 2015, this high increase in Islamic finance became an attraction point to international financial institutions to invest on Islamic finance. (Financial Islam, 2015) Islamic Developing countries; United Arab Emiratis, Algeria, Morocco, India, Lebanon, Saudi Arabia, Syria, Jordan and Turkey are the important countries in world economic growth that is why these countries are  focal point of investment for international Investors. Presence of Islamic finance in these countries opens door for international investment institutions to think about Islamic finance.

In Turkey, Islamic Banking is called participation banking. Compared to other Islamic developing countries, Malaysia, Saudi Arabia, Indonesia and Pakistan, Turkey has limited Islamic banks and institutions. Currently Turkey is home to six Islamic (Participation) Banks representing approximately 5.6 % of total financial assets as of 2016. (Participation Banks Association of Turkey, 2015) (Participation Banks Association of Turkey, 2015) However, growth within Islamic banking sector is heading the conventional financial sector in 2012.with announcement of the new sukuk legislation on June 7, 2013 that has introduced new types of structures to boost Turkey's Islamic capital market; it's projected that that Islamic finance sector will keep its continuous growth. However there are other areas that still need further development including takaful, SME Financing, funds management, micro finance, and Zakat. (Thomson Reuters, 2014)

## 1.2. What Is Islamic Finance

The financial industry has historically played an important role in the economy of every society. Banks mobile funds from investors and apply them to investments in trade and business. The history of banks is long and varied, with the financial system as we know it today directly descending from Florentine bankers of the 14th-17th century. However, even before the invention of money, people used to deposit valuable such as grain, cattle and agricultural implements and, at a later stage, precious metals such as gold for safekeeping with religious temples (Iqbal, 1997). In Islamic history the example of prophet Muhammad (PUH) is a good example, the people of Madina used to deposit there precious metals and money for safekeeping to prophet Muhammad (PUH). (Iqbal, 1997)

Around the 5th and 6th centuries BC, the Investment opportunities included to banking operations by ancient Greek. Temples and Religious leaders still offered safe-keeping, but banks and other entities started financial transactions including deposits, loans, and exchange of currency and validation of coins. Financial services were typically offered against a share of the profit the same concept with Islamic finance, where profit and loss is shared. Prohibition of Interest (Islam) Usury (other religions) is not limited to only Islam, but all other religions basically prohibit Interest. By the passage of time for other religions prohibition of interest remains only in theory, in practice they do all types of interest. As far for the Islamic financial System from 1400 years, interest is prohibited by Quran, Hadith and Ijma. (Khan, An Introducton To Islamic Economics, 1994)

Despite being seen as a modern phenomenon, Islamic finance is as old as the religion itself with its principles primarily derived from Quran, which was revealed some 1400 years ago. Some principles of Islamic finance stem from prior Abrahamic traditions, whilst some historical Islamic finance instruments have been adopted into modern conventional products such as letters of credit and cheques (Mohammed, 2015).

During the eighteenth, nineteen and the first half of the twentieth centuries almost all the Muslim countries were colonized by European countries. In colonization period, western economic models were implemented in Muslim countries. The birth of Islamic

Economic system idea was between 1940s and 1960s. Between these two dates, Muslim majority countries became independent. Islamic Economists and Islamic Scholars started thinking about Islamic Economic system according to Sharia complaints transactions in Muslim countries. Theoretical work on the subject appeared during 1940s through 1960s in Urdu, Arabic and English (Anderson Graduate School of Management, 2001).

The first Islamic Institution started practically Islamic transaction in 1963 in Mit Ghammr (El-Gamal, 2006) in the Nile valley in Egypt but suspended by government after short time. Same year's Muslim world observed establishment of Tabung Haji in Malaysia, The Philippine Amanah Banks, and an interest free bank in Karachi, Pakistan which did not survived for long too. Later on Dubai Islamic Bank the first profit-lost share and investment Bank was established with establishment of Dubai Islamic Bank Islamic Banks were started engagement in business Enterprises. Within the next ten years, i.e. by 1985 there were around 27 Islamic Banks in Gulf Countries. (El-Gamal, 2006) The daily progress of Islamic Banking and finance persuade conventional banking sector to start Islamic products within their banks, Citi- Islamic in Bahrain and Grind lays in Karachi were followed by the National Commercial bank in Saudi Arabia establishing over 50 Islamic branches by 1990s. (El-Gamal, 2006) Islamic Insurance companies, Islamic Investment companies, and number of Islamic Mutual funds appeared in 1990s which many of them at the beginning managed by western firms.

By the year 2000, there were 200 Islamic Banks and institutions with over US$ 8 billion in Capital, over $100 billion in deposits, managing assets worth more than $160 billion. About 40% of these are in the Persian Gulf and the Middle East, another 40% in south and south-east Asia, the remaining equally divided between Africa and Europe in one hand and Americas on the other hand (Anderson Graduate School of Management, 2001).

Today Islamic Banking and finance is projected to exceed $2.5 trillion of assets by the end of 2015 as the Islamic industry extends its products and services reach into new international markets (Pinsent Masons, 2015). While this number was 2.1 trillion in 2014, it is supposed that the Islamic Finance industry will move into markets in Europe, Australia, and china. Currently there are more than 1,500 financial organizations working for Islamic banking, finance, takaful, sukuk, Islamic funds and micro-finance in more than 90 countries, some 40% of which are non-Muslim nations, Muslim countries, which have a 76% share of the global Islamic banking market, include Qatar, Saudi Arabia, the United Arab Emirates, Malaysia, Pakistan, Indonesia and Turkey. (Pinsent Masons, 2015)

Islamic Financial System was first introduced in turkey in 1983 and the first Islamic Institution was “Special Finance houses”. Just one year later in November 1984 Al Baraka Turk and Islamic banking was established. Following Al Baraka, Kuveyt Turk (1989) Anadolu Finance (1991), and Banks Asya in (1996). Today there are six Islamic Banks presented in turkey which representing approximately 5.6 % of total financial assets (2016). (Participation Banks Association of Turkey, 2015) The growth of Islamic Banking sector is two times more than conventional banking sector. However there are some areas that still need further development including Takaful ( Islamic Insurance), SME Financing, Funds management, Microfinance and Zakat.

## 1.3. Instruments of Islamic Banking & Finance

Islamic finance has been defined as finance in consonance with the ethos and value system of Islam and governed, in addition to the conventional good governance and risk management rules, by the principles laid down by Islamic Shariah.

The objective of Islamic financial system is to make a positive contribution to the fulfillment of socioeconomic objectives of the society in all spheres, including trade, industry & agriculture etc. in general, is to promote, foster and develop the application of Islamic principles, law and tradition to the transaction of financial, banking and related business affairs and to promote investment companies. Islamic banks accept deposits which they can either commit to investment or general deposits. They also have investment accounts with or without authorization. Banks engage in investment activities based on Musharakah (equity participation) Mudarabah or Qirad (agencies), Murabaha, Bai' Salam (post delivery sale) and/or leasing arrangements especially for equipment. On the lending side, Islamic banks issued a number of new lending instruments such as Al Muqarada profit bonds to finance large projects and Al-Mudarabah certificates which are not issued for specified projects. Islamic finance practice conventional short term financing on a profit/loss basis. Takaful (Islamic Insurance) is another latest product of Islamic finance where investors guarantee their investments through a pool of fund and shareholders participation if any party of the pool make loses.

## 1.4. Major Instruments f Islamic Banking And Finance

### 1.4.1. Musharakah

Musharakah means a relationship established under a contract by the mutual consent of the parties for sharing of profits and losses in the joint business. It is an agreement under which the Islamic bank provides funds, which are mixed with the funds of the business enterprise and others. All providers of capital are entitled to participate in management, but not necessarily required to do so. The profit is distributed among the partners in pre-agreed ratios, while the loss is borne by each partner strictly in proportion to respective capital contributions. (El-Gamal, 2006)

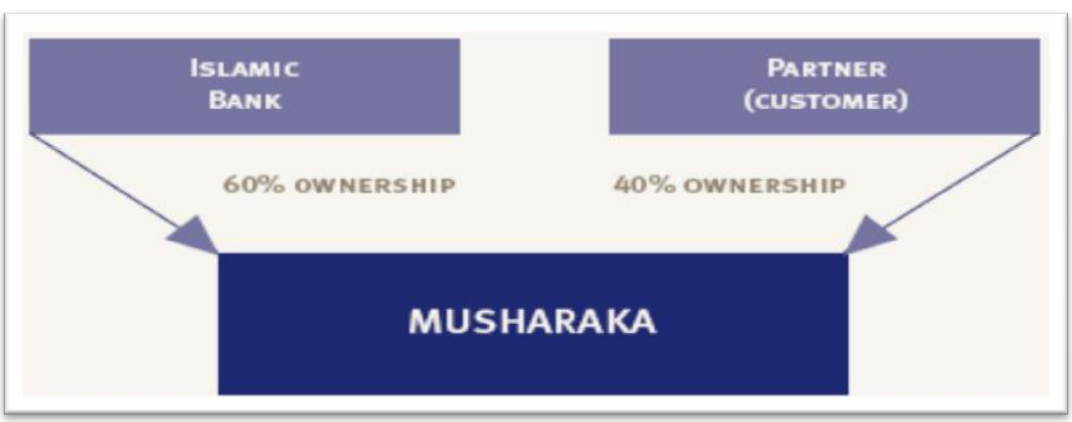



*Figure 1.1 Musharaka*

**Source:** *Al Baraka, 2015.*

### 1.4.2. Mudarabah

A form of partnership where one party provides the funds while the other provides expertise and management. The latter is referred to as the Mudarib. Any profits accrued are shared between the two parties on a pre-agreed basis, while loss is borne only by the provider of the capital. In Mudarabah contract the distribution of profit must be pre-determined by two parties. The only determination of profit distribution that is permissible is based on the actual Profit earned by the financial industry. The shariah is leaving the specification of proportions to be distributed between the parties, for the best judgment of the two independent parties. (Khan, An Introducton To Islamic Economics, 1994)

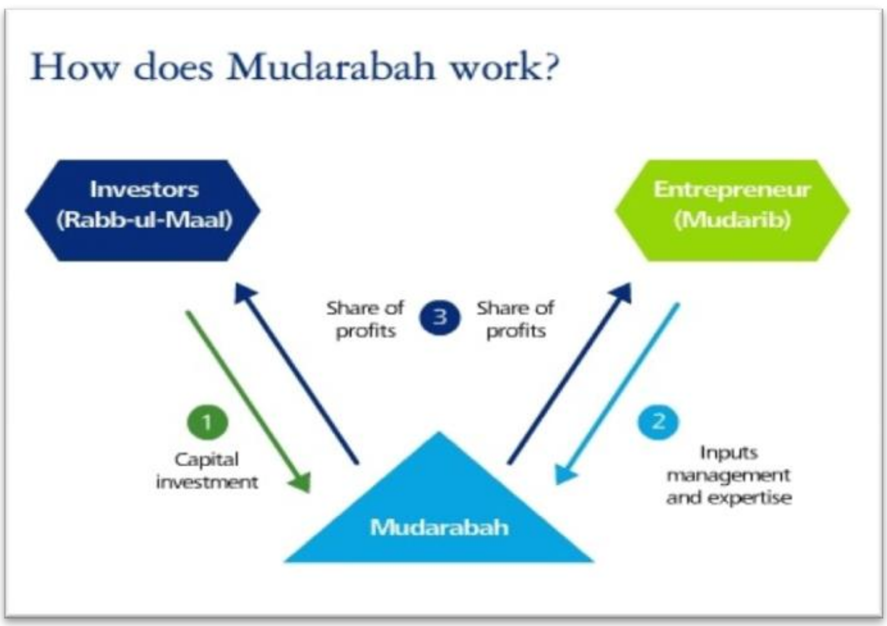



*Figure 1.2 Mudarabah*

**Source**: *Knowledge Hub, 2011*.

### 1.4.3. Murabaha

Literally it means a sale on mutually agreed profit. Technically, it is a contract of sale in which the seller declares his cost and profit. Islamic banks have adopted this as a mode of financing. As a financing technique, it involves a request by the client to the bank to purchase certain goods for him. The bank does that for a definite profit over the cost, which is stipulated in advance. (Hassan, Kayed, & Oseni, 2013)

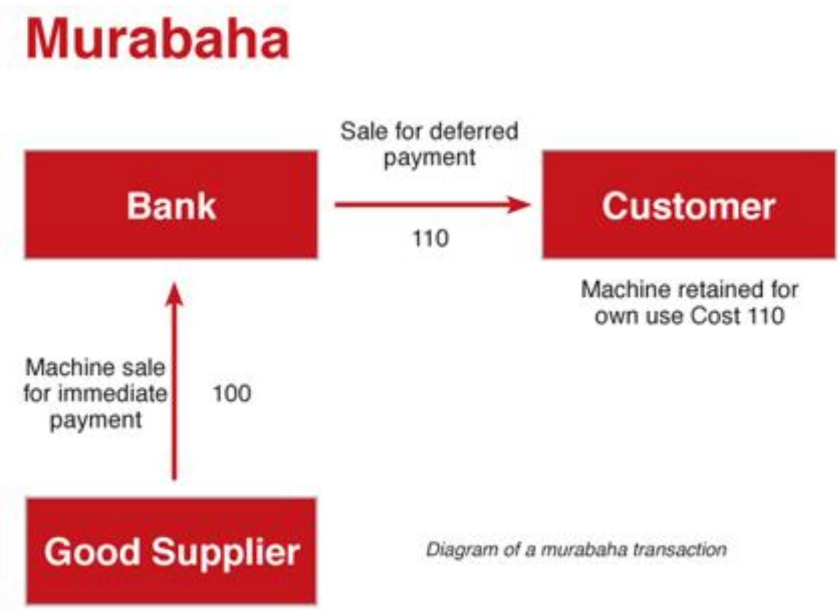



*Figure 1.3 Murabaha Transaction*

**Source**: *Financial Islam, 2015.*

### 1.4.4. Ijara (leasing)

Ijara is a contract of a known and proposed usufruct against a specified and lawful return or consideration for the service or return for the benefit proposed to be taken, or for the effort or work proposed to be expended. In other words, Ijara or leasing is the transfer of usufruct for a consideration which is rent in case of hiring of assets or things and wage in case of hiring of persons. (Usmani, An introduction to Islamic finance, 2002)

### 1.4.5. Ijarah-Wal-Iqtina

A contract under which an Islamic bank provides equipment, building or other assets to the client against an agreed rental together with a unilateral undertaking by the bank or the client that at the end of the lease period, the ownership in the asset would be transferred to the lessee. The undertaking or the promise does not become an integral part of the lease contract to make it conditional. The rentals as well as the purchase price are fixed in such manner that the bank gets back its principle sum along with profit over the period of lease. (Usmani, An introduction to Islamic finance, 2002)

### 1.4.6. Istisna (Pre-Production Financing)

It is a contractual agreement for manufacturing goods and commodities, allowing cash payment in advance and future delivery or a future payment and future delivery. Istisna'a can be used for providing the facility of financing the manufacture or construction of houses, plants, projects and building of bridges, roads and highways. (Usmani, An introduction to Islamic finance, 2002)

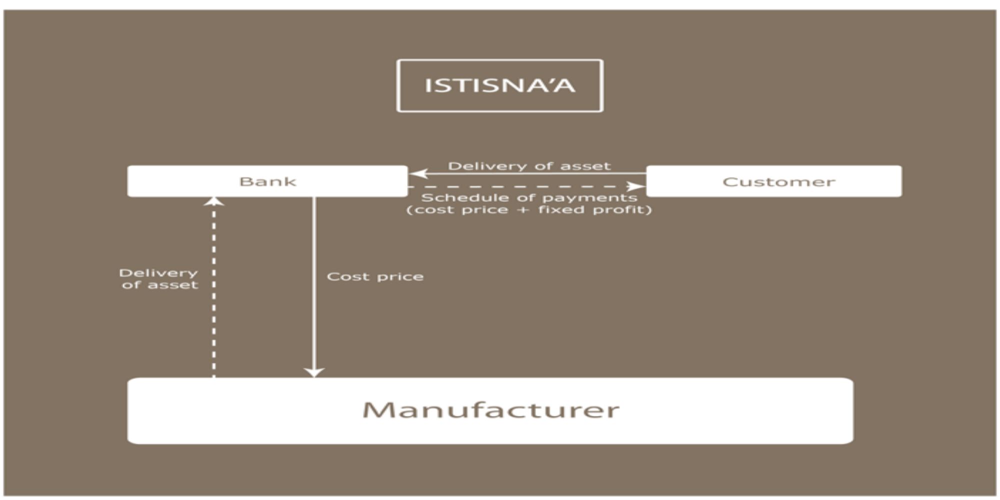



*Figure 1.4 Istisna*

**Source**: Cantax, 2015.

### 1.4.7. Bai Muajjal (Credit Sale)

Literally it means a credit sale. Technically, it is a financing technique adopted by Islamic banks that takes the form of Murabaha Muajjal. It is a contract in which the bank earns a profit margin on his purchase price and allows the buyer to pay the price of the commodity at a future date in a lump sum or in installments. It has to expressly mention cost of the commodity and the margin of profit is mutually agreed. The price fixed for the commodity in such a transaction can be the same as the spot price or higher or lower than the spot price. (Iqbal, 1997)

### 1.4.8. Bai Salam (Pre Paid Sale)

Salam means a contract in which advance payment is made for goods to be delivered later on. The seller undertakes to supply some specific goods to the buyer at a future date in exchange of an advance price fully paid at the time of contract. It is necessary that the quality of the commodity intended to be purchased is fully specified leaving no ambiguity leading to dispute. The objects of this sale are goods and cannot be gold, silver or currencies. Barring this, Bai Salam covers almost everything, which is capable of being definitely described as to quantity, quality and workmanship. (Khan, An Introducton To Islamic Economics, 1994)

### 1.4.9. Qard Hassan (Good Loan)

This is a loan extended on a goodwill basis, and the debtor is only required to repay the amount borrowed. However, the debtor may, at his or her discretion, pay an extra amount beyond the principle amount of the loan (without promising it) as a token of appreciation to the creditor. In the case that the debtor does not pay an extra amount to the creditor, this transaction is a true interest-free loan. Some Muslims consider this to be the only type of loan that does not violate the prohibition on riba, since it is the one type of loan that truly does not compensate the creditor for the time value of money. (Zaher & Hassan, 2001)

### 1.4.10. Sukuk (Islamic Bonds)

Sukuk in general may be understood as a shariah compliant ‘Bond’. In its simplest form sukuk represents ownership of an asset or its usufruct. The claim embodied in sukuk is not simply a claim to cash flow but an ownership claim. This also differentiates sukuk from conventional bonds as the latter proceed over interest bearing securities, whereas sukuk are basically investment certificates consisting of ownership claims in a pool of assets.

Sukuk (plural of word sak) were extensively used by Muslims in the Middle Ages as papers representing financial obligations originating from trade and other commercial activities. However, the present structure of sukuk are different from the sukuk originally used and are akin to the conventional concept of securitization, a process in which ownership of the underlying assets is transferred to a large number of investors through certificates representing proportionate value of the relevant assets.

A bond is a contractual debt obligation whereby the issuer is contractually obliged to pay to bondholders, on certain specified dates, interest and principal, whereas, the sukuk holders claims an undivided beneficial ownership in the underlying assets. Consequently, sukuk holders are entitled to share in the revenues generated by the sukuk assets as well as being entitled to share in the proceeds of the realization of the sukuk assets.

A distinguishing feature of a sukuk is that in instances where the certificate represents a debt to the holder, the certificate will not be tradable on the secondary market and instead is held until maturity or sold at par.

Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) defines sukuk as being:

“Certificates of equal value representing after closing subscription, receipt of the value of the certificates and putting it to use as planned, common title to shares and rights in tangible assets, usufructs and services, or equity of a given project or equity of a special investment activity”.

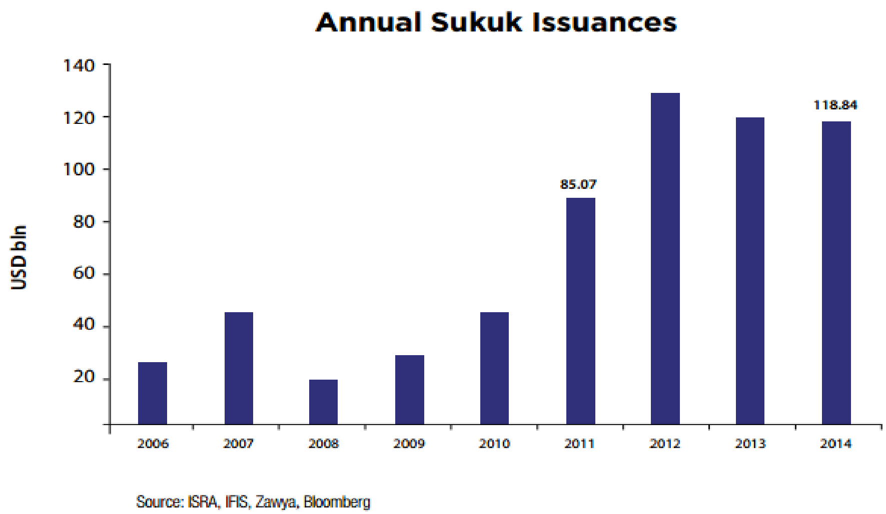



*Figure 1.5 Annual Sukuk Issuances*

**Source**: *Uddin, Sultan, Hosen, & Ullah, 2015.*

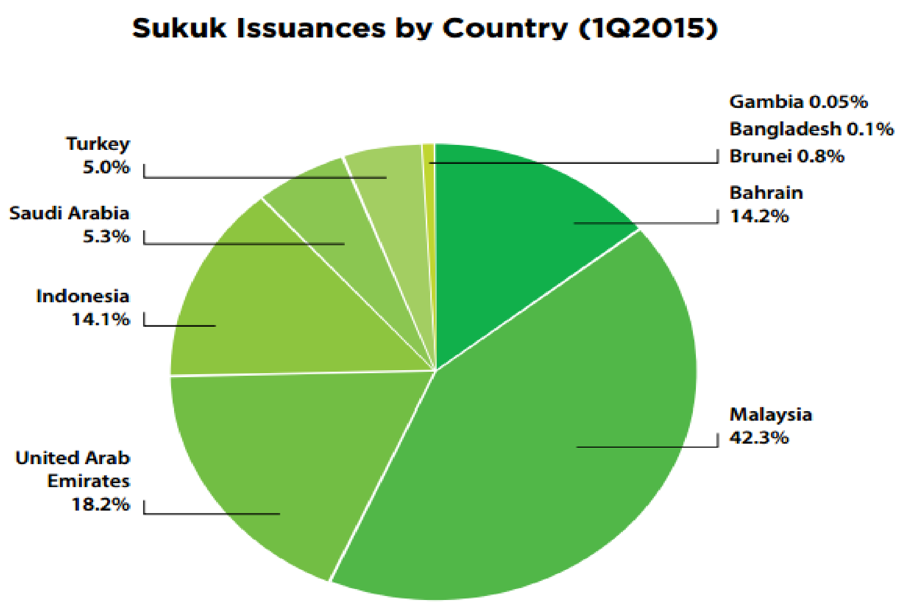



*Figure 1.6 Sukuk Issuances by Country*

**Source**: *Saudi Gazette, 2015.*

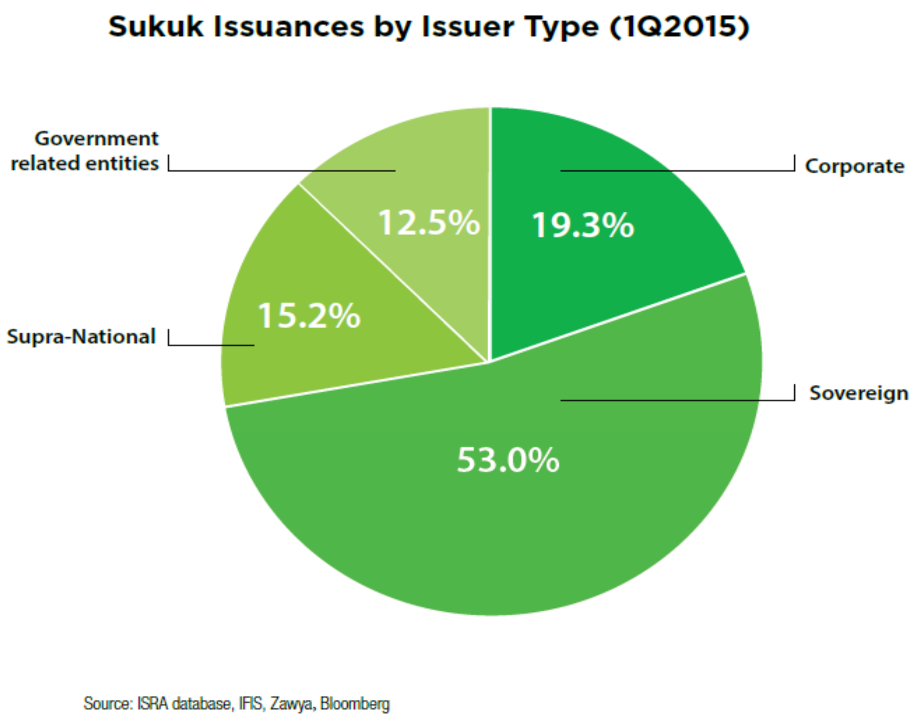



*Figure 1.7 Sukuk Issuances by Issuer Type*

**Source**: *Saudi Gazette, 2015.*

#### *1.4.10.1. Sukuk-al-Ijara*

The Ijara is a shari'a compliant lease. It is a hybrid between an operational lease and a finance/capital lease with certain 'ownership' risks, such as the obligation to undertake capital maintenance of the leased asset and the obligation to insure the asset, remaining with the lessor. The lessor may appoint an agent, usually the lessee itself, to carry out these duties on its behalf under a servicing agreement. In a simple Sukuk-al-Ijara the originator will sell certain physical assets to a special purpose vehicle (SPV). The SPV will finance this acquisition by cash raised by the issue of sukuk notes. The SPV will then lease the same physical asset to a third party, often the originator itself or a third party connected to the originator. The lease rental payments will 'mirror' the coupon payments under the sukuk and the cash flow from the lease rentals will be used to service the coupon payments under the sukuk. This structure, given its relative simplicity and ease of understanding, has been used in a number of earlier sovereign sukuk issues. As there may be legal and public policy considerations involved in a sovereign or quasi-sovereign disposing of public assets there has been a preference for sovereigns and quasi-sovereigns to use an underlying headlease - sublease structure rather than a salelease structure. The critical issue from a shari'a perspective is that the SPV should have ownership rights prior to granting the lease (or sub-lease), a sufficiently long headlease will be deemed, from a shari'a perspective, as akin to ownership. Each investor would therefore own a proportionate interest in the underlying asset and any revenue being generated by that asset. (Nisar, 2009)

#### *1.4.10.2. Sukuk-al-Musharaka*

Given the lack of flexibility inherent in the Sukuk-al-Iajra, another sukuk product known as the Sukuk-al-Musharaka has been developed. This sukuk variant permits greater flexibility in the asset transfer to cash to be raised ratio as the amount of cash to be raised does not need to correspond to the value of the assets available for transfer into the musharaka. A Musharaka constitutes a form of a joint venture and may, depending on its precise terms, also be a partnership. Although the Shari'a perceives the musharaka as an independent entity it is not a legal entity in its own right under English law and would simply be construed as an agreement between two parties. In a musharaka two partners/sponsors will agree to combine their resources for a joint enterprise, often with one party contributing the cash and the other contributing the expertise or some other contribution-in-kind. In a simple Sukuk-al-Musharaka the two partners would be the originator and a SPV. The originator will contribute assets to the musharaka and the SPV will contribute cash raised from the issue of sukuk notes. As the musharaka is not a legal entity, the partners will appoint a managing agent to act on behalf of the musharaka and this managing agent will often be the originator itself. The contributed assets, also known as the musharaka assets, are then employed by the managing agent to generate a cash return to service the coupon payments. The originator upon maturity of the sukuk may retain any cash generated in excess of the coupon payments.

### 1.4.11. Takaful (Islamic Insurance)

Takaful is derived from the Arabic root-word “kafala”, a verb, which means guarantee, bail, warrant or an act of securing one`s nee. Therefore, takaful (in its reciprocal form) means joint guarantee, whereby a group of participants agree to mutually guarantee each other against a defined loss.

In the context of Islamic insurance, takaful refers to an arrangement for mutual indemnity in providing protection and compensation to the participants who suffered from perils or hazards. (Institute of Islamic Banking and Insurance, 1995)

According to Section 2 of the Malaysian Takaful Act 1984:

“Takaful is a scheme based on brotherhood, solidarity and mutual assistance which provides for mutual financial aid and assistance to the participants, in case of need whereby, the participants mutually agree to contribute for the purpose”.

The AAOIFI`s Accounting, Auditing and Governance Standards for Islamic Financial institutions Shari`ah standard 26 (2) of 2007 Provides:

“Islamic Insurance is an agreement between persons who are exposed to risks to protect themselves against harms arising from the risks by paying contributions on the basis of “commitment to donate” (iltizam bi al-tabarru). Following from that, the insurance fund is established and it is treated as a separate legal entity (shkhsiyyah itibariyyah) which has independent financial liability. The fund will cover the compensation against harms that befall any of participants due to the occurrence of the insured risks (perils) in accordance with the terms of the policy.”

#### *1.4.11.1. Why Takaful and Not Conventional Insurance*

Despite having the same noble and islamic objective of providing protection and coverage to the policy holders, conventional insurance suffers from fundamental problems in its modus operandi, mainly due to the occurrence of Sharia non-compliant elements, i.e., gharar (Uncertainity), riba (Interest) and Maysir (Gambling). (Merdad, 2012)

In 1985, the council of the Islamic Fiqh Academy under the auspices of the organization of Islamic Conference in its Resolution No. 9(2/9), in its second meeting resolved that:

- **First**: The Commercial insurance contract with a fixed periodical premium, which is commonly used by commercial insurance companies, is a contract which contains major elements of deceit, which void the contract and therefore is prohibited (Haram) according to the Sharia.
- **Second:** the alternative contract, which conforms, to the principles of Islamic dealings is the contract of co-operation. Similarly is the case of re-insurance based on the principles of co-operative insurance.
- **Third:** the academy invites the Islamic Countries to work on establishing cooperative insurance institutions and cooperative entities for the reinsurance in order to liberate the Islamic economy from exploitation and put an end to the violation of the system which Allah has chosen for this ummah.

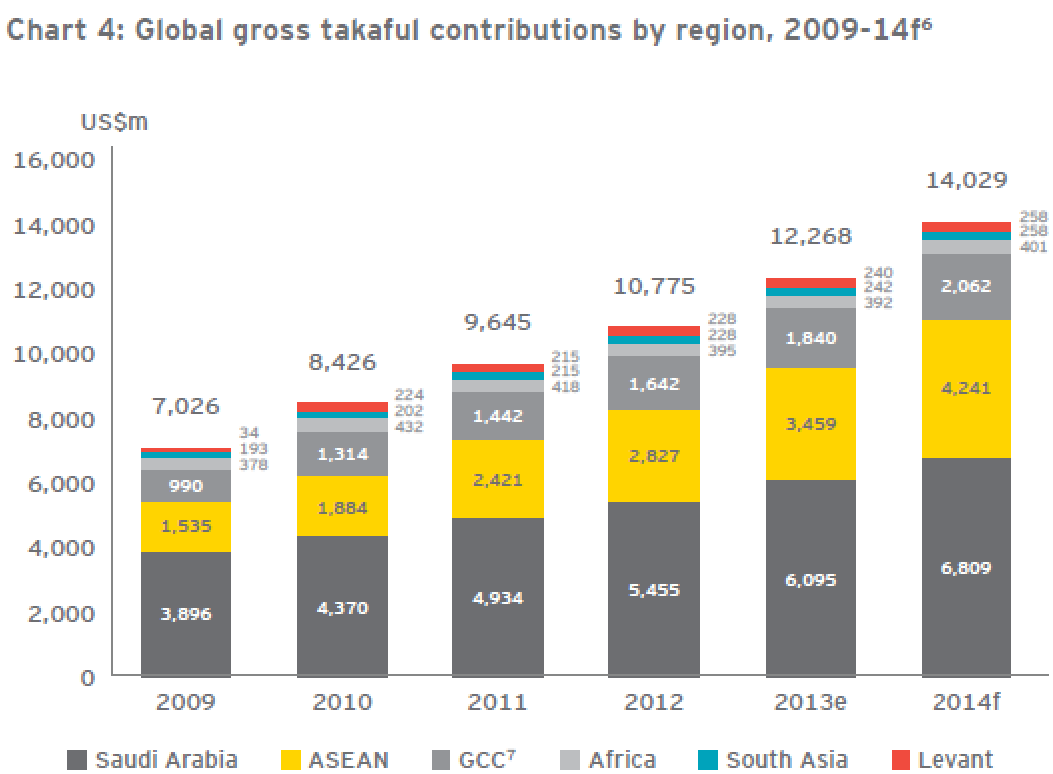



*Figure 1.8 Global gross takaful contributions by region, 2009-14*

**Source**: *EY, 2014.*

## 1.5. Role of Islamic Institutions In The Development of Islamic finance

The advancement and progress that have been achieved thus far have opened new frontiers for the Islamic financial services industry. The broad strategies that have been adopted as outlined in the Financial Sector Master Plan and the actions and initiatives taken leading to the rapid development and growth of the domestic Islamic banking industry have all contributed to the achievement we have realized today.

Indeed, the recent two years have seen the Islamic financial landscape being significantly redefined-the establishment of Islamic subsidiaries, the issue of new licenses to foreign players, and the initiatives of our domestic institutions to venture abroad. These developments have increased the potential for international integration of our Islamic financial system. More recently for the deeping of the domestic capital market.

In the area of Sharjah bank Negara Malaysia has introduced the Sharjah governance framework in April this year as one of the initiatives to strengthen the role and involvement of the Shariah scholars in the development of Islamic finance. Today, a larger pool of Shariah scholar has been created to better serve the needs of the industry and the plan is to further develop them to emerge as prominent Scholar who can serve both domestic and international Islamic financial communities. Recently bank Negara Malaysia also organized a closed door Shariah Scholars Dialogue attended by fifty prominent local and foreign scholars. This dialogue will now be held annually to serve as a platform for cooperation among the shariah scholars to promote greater understanding on emerging developments across the world in the area of Islamic finance. This is to promote a greater understanding on the approaches taken by different jurisdictions in their Shariah interpretation. To support the Shariah scholars, activities especially in the areas of research and capacity building, Bank Negara Malaysia has also allocated a RM200 million endowment fund to meet the financing requirements of the Shariah Scholars Dialogue research activities and the provision of scholarships. It is hoped that this will contribute towards greater understanding in the process of harmonizing the International Implementation of Shariah in Islamic finance. (Iqbal, 1997)

These initiatives have contributed to the success in the creation of a robust Islamic financial environment. It is further supported by the requisite financial infrastructure that includes the financial markets and that is reinforced further by a comprehensive regulatory, prudential, legal and accounting framework. These elements have provided an enabling that increases the potential for Malaysia to evolve as an Islamic center. These measures however, need to be reinforced by the efforts by the Islamic financial institutions to take on a more active role in promoting Islamic finance.

Indeed, the rapid progress of Islamic banking over the last two decades would not have been possible without the pioneering efforts of the Islamic financial institutions in building up a successful and vibrant industry. In conjunction with the 30th meeting of the board of governors of the Islamic development bank, an initiative was taken to develop a ten-year master plan for the Islamic financial services industry. The master plan for the global development bank and the Islamic financial services board. The plan will provide the strategic direction envisioned of the future. Islamic financial institution thus need to adopt a positive approach in re-inventing themselves to meet the emerging issues, challenges and opportunities. (Kammer, et al., 2015)

In the domestic Islamic financial sector, despite the achievements that have been achieved thus far, the need remains for the Islamic financial institutions to strive to further enhance their capacity and capability so that they will be on par with global Islamic players in terms of efficiency, effectiveness and financial soundness. As we enter in to an increasingly challenging environment, the ability of the Islamic financial institutions to compete by creating innovative and differentiated products and by adopting strategic positioning to increase unique and tangible value to their customers will be the key to determining performance and relevance. It is imperative that players in the Islamic financial industry reposition themselves to create a unique and sustainable competitive position in responding to the changing environment.

Islamic financial institutions may now also take the opportunity under these new institutional arrangements to explore opportunities for building strategic partnerships to acquire new expertise and develop new value added activities. The move toward strategic partnerships would create potential for greater innovation and expansion of the market. Such strategic partnerships would also enable Islamic financial institutions to tap the best talents from a broad range of fields. (Ahmad, 1993)

With the experience that has been built up in Islamic banking and finance over the years, it is timely and desirable to extend our wings beyond our shores. New markets need to be identified to expand business operations, especially in the Asia-Pacific region, which offer considerable opportunities. There is a vast business potential to be tapped as several regional countries are progressively opening up their economies to greater foreign participation, Islamic financial institutions are strongly encouraged to continue their efforts by taking the lead to establish collaborative partnerships and develop new approaches for financing facilities in this region. To succeed, adequate resources would need to be allocated to build distinct capabilities in these areas and to put in place the proper risk management systems and sound corporate governance practices. (Ahmad, 1993)

## 1.6. Objectives

- To survey the data related to Islamic modes of banking and finance in Turkey.
- To provide an information source of Islamic Finance and Banking in Turkey for readers.
- To elaborate the products and services of participation banks in Turkey, Role of the Islamic finance in economic and social development.
- Analyzing and comparing the efficiency of participation banks and conventional banks.

## 1.7. Significance of Research

There has been significant growth in Islamic financial services in recent years and there is every reason to expect that this growth will continue at a rapid pace. Clearly, there is expanding demand for these products, and a closely associated desire on the part of banks, including non-Islamic banks, to provide Islamic financial services.

Although it is still modest in size relative to conventional retail banking, Islamic retail banking is rapidly becoming more visible. This is particularly true in the Middle East and Asia Pacific regions, where a number of Islamic banks and banking units have been opened in recent years. There are also Islamic banks and asset managers in key international financial centers of the United Kingdom and the United States and many other Western countries.

Because of the continuous growth of Islamic banking in all over the world specially in Asian Muslim countries Specially in Turkey I have decided to do a research and write a thesis about Islamic finance and its opportunities in Turkey for public awareness about Islamic Finance and Banking.

## 1.8. Scheme of Study:

This study consists of three chapters the first chapter is introduction and literature review of Islamic Finance and Banking; second chapter is explaining the Islamic finance in general and participation banking in details. third chapter is data analysis; DEA Data Envelopment Analysis is used to measure the efficiency of participation banks and conventional banks. The study ends with the conclusion and suggestions.

# CHAPTER TWO: DEVELOPMENT OF ISLAMIC FINANCE IN TURKEY

## 2. Development of Islamic Finance In The World

By the 2000s Islamic finance had stepped out of its niche market as demand for its services picked up pace worldwide. With an increasing awareness of what could now be called an Islamic financial system, the market experienced significant growth.

When the financial crisis hit in 2008, Islamic institutions proved to be more resilient than conventional ones, and even though growth slowed significantly in 2009, faith in Islamic financial institutions did not wane. Throughout the financial crisis Islamic banks were still able to increase shareholder wealth by improving equity positions and generating profitable returns. Total growth in equity was 43.3% between 2004 and 2011. (Thomson Reuters, 2014)

During this period, larger and more mature Islamic finance centres started to flex more muscle in the international arena. As Islamic finance more confidently stepped out the world's financial centres also started to harbour their own Islamic finance ambitions. London is chasing Kuala Lumpur and Dubai for the right to be called the world's Islamic finance hub and Hong Kong and Luxembourg are racing to follow the UK in tapping the sukuk market and attract sharia-compliant business. (Venardos, 2005)

Today, Islamic financial institutions operate in over 58 countries. Islamic banks are offering new and more sophisticated products for both retail and wholesale markets. A more complete suite of products and instruments has also been developed to help financial institutions manage liquidity and hedge risks. Islamic finance is by no means 'fully-developed' but is in a far stronger and more influential position now to work across borders to take the development of the industry forward.

**1950s:** Discussions surrounding Islamic economics and finance emerge and books on the subjects are published; experimental banks are set up.

**1960s:** The first modern Islamic savings bank is opened in Mit Ghamr, Egypt, and a sharia-compliant savings and investment institution, Tabung Haji, is established in Malaysia.

**1970s:** Developments in Islamic banking with Islamic banks opening in UAE, Kuwait, Bahrain, Egypt, Saudi Arabia and Sudan. Islamic finance begins to gain an international presence.

**1980s:** Start of Islamic finance in Turkey**,** More Islamic banks are established in countries such as Malaysia and Bangladesh; Iran and Sudan adopt interest free banking system; start of introduction of regulations for Islamic banks in Bahrain and Malaysia.

**1990s:** Increased regulation of Islamic banks as Bahrain develops the international Islamic accounting standards organization, AAOIFI; sukuk market begins to develop as the first sukuk are issued; Dow Jones Islamic Market Index is launched.

**Early 2000s:** Many industry infrastructure institutions are established including CIBAFI, IIFM, IFSB, LMCIIRA, and IICRA; Bahrain issues Financial Trust laws; Dubai announces steps to create the first sharia-compliant stock exchange; many conventional banks offer Islamic services.

**2008 - 2009:** The financial crisis hit, Islamic banks initially performed better than conventional banks but were hit when the crisis hit the real economy.

**2010 - 2016:** Islamic banks recover and are performing well; more sukuk are issued. More western countries Entered Islamic Finance Market.

Overall, Islamic finance is now present in 90 countries (characterized as mainstream relevance or a niche presence) with more than 600 financial institutions offering some type of Shariah compliant financial products, mainly in the Middle East and Asia. Several European countries such as the UK, Luxembourg, Germany and France have become increasingly active in Islamic finance. Meanwhile, selected countries in the African and

Commonwealth Independent States (CIS) region are either engaging with regulators or exploring the concept of Islamic finance. Post financial crisis, Islamic finance continues to be a popular choice globally – while the global banking segment was estimated by the International Monetary Fund (IMF) to have experienced losses in the tune of USD3tln to USD4tln as a direct consequence of this crisis, Islamic finance were significantly less affected..

*Table 2.1 Top Largest Islamic Finance Economies*

| **Rank** | **Country** | **Islamic finance assets ($Million)** | **Islamic Financial Institutions** | **Islamic Banking Assets** | **Education Institutions** |
|---|---|---|---|---|---|
| **Global** | | **1,657,998** | **995** | **1,214,274** | **477** |
| 1 | Malaysia | 423,285 | 76 | 170,280 | 44 |
| 2 | Saudi Arabia | 338,106 | 99 | 264,345 | 25 |
| 3 | Iran | 323,300 | 54 | 319,008 | 1 |
| 4 | United Arab Emirates | 140,289 | 73 | 113,102 | 39 |
| 5 | Kuwait | 92,403 | 92 | 82,911 | 9 |
| 6 | Qatar | 81,027 | 38 | 59,047 | 7 |
| 7 | Bahrain | 64,644 | 57 | 59,807 | 21 |
| 8 | Turkey | 51,161 | 8 | 44,730 | 2 |
| 9 | Indonesia | 35,629 | 78 | 19,169 | 17 |
| 10 | Bangladesh | 18,938 | 38 | 18,676 | 10 |
| 11 | Pakistan | 14,647 | 54 | 9,605 | 24 |
| 12 | Egypt | 12,086 | 26 | 11,499 | 7 |
| 13 | Sudan | 8,034 | 44 | 7904 | 6 |
| 14 | Jordan | 7,430 | 12 | 7,052 | 14 |
| 15 | Switzerland | 6,575 | 3 | - | 3 |

**Source:** *Thomson Reuters, 2014.*

## 2.1. Development Of Islamic Finance In USA:

The history of Islamic finance in the United States began with the grassroots efforts of American Finance House-LARIBA, which in 1987 began offering Sharia compliant home financing products. LARIBA is a finance lender in Pasadena, California that began using investment capital from individual American Muslims to provide home financing to other American Muslims. (Zyp, 2009)

As early as 1993 a major international bank worked with both a US mortgage bank and a key Islamic bank to structure an Islamic home finance program. In 1997 the United Bank of Kuwait (UBK), operating in the United States as a Federal branch under the National Bank Act, applied to the Office of the Comptroller of the Currency (OCC) for guidance on a Sharia compliant ijara (lease-to-purchase) home financing product it sought to offer to US customers. This program was named Al-Manzil. Abdulkader Steven Thomas, who made the request on UBK's behalf, said of its importance: "The pioneering regulatory interpretations obtained by the United Bank of Kuwait have begun to open both the door to scalable funding for Islamic finance in America, the development of securitization, including participation by the government sponsored entities." In 1999 the OCC issued guidance to UBK that approved murabaha (cost-plus-profit) home financing products. Al-Manzil began offering its home financing products in California. (Zyp, 2009)

Thomas explained that the program took a longer time than most to become established because there was a lot of "customer training" required educating customers about the features of the Islamic product, since it was newly developed and unfamiliar to consumers. However after this initial period UBK expanded the Al-Manzil program to eleven states, and financed small ticket commercial properties as well as single-family homes. However in 1999 UBK merged with Ahli United Bank and, because the U.S. operation was the bank's smallest, Ahli made a strategic decision to leave the U.S. market in 2000. At that point Al-Manzil had provided financing for sixty homes. The Al- Manzil program was also in place in the United Kingdom and its operation continues to today under the successor bank. (Zyp, 2009)

Since UBK left the market, no bank offering Islamic products has operated under the National Bank Charter or the supervision of the OCC. For this reason the Office has issued no further guidance on Islamic products. However the state regulators that supervise the state-chartered bank providers – Devon Bank and University Islamic Financial Corporation – have followed the guidance of the OCC's interpretive letters on ijara and murabaha products in granting approval for these financing facilities, since state-chartered banks must comply with national regulations in addition to any further regulations mandated under state law.

On the financing side, one of the most important developments for Islamic finance was Freddie Mac's 2001 decision to buy Islamic mortgages from LARIBA via its cash window. This represented the first type of securitization for Islamic mortgages, and provided a large-scale source of funding for providers. At this time Freddie Mac and Fannie Mae, which began purchasing ijara products in 2003, are effectively the sole investors in Islamic mortgage products in the United States. As government-backed entities, both invest in Islamic mortgages as part of their mandate to expand access to home ownership to underserved populations. Currently all of the providers of Islamic home financing sell their mortgage contracts to either Freddie Mac or Fannie Mae. These sales also represent the only form of securitization presently available for Islamic mortgages in the U.S. market.

The importance of the US to the global economy and financial markets suggests ample potential for Islamic finance to take root in the country. Financial markets in the US are the largest and most liquid in the world. Major financial services sub-sectors in the US include banking, asset management, insurance and venture capital. It has been estimated that US asset managers serve over 55% of the global pension’s market. As such, the growth of the US asset management industry is dependent not just on domestic factors, but is also related to global trends. (Zyp, 2009)

## 2.2. Islamic Finance In Europe:

European Markets are one of the fresh and speedy growing market for Islamic finance, Europe having almost 20 million Muslims becomes a significant market for Islamic finance. Europe is sharing almost 3% of the global financial market. The business relationship of Europe with Muslim countries and a high demand of Muslims in Europe for Islamic finance persuade many European countries to start Islamic finance and Islamic banking operations. Luxemburg as a center of Islamic finance hub in Europe while other countries like; UK, Germany, Italy, France, is those countries who operate Islamic finance. (European Central Bank, 2013)

## 2.3. France

The development of Islamic finance in France is attributed to strong support by the French authorities, who have built an appropriate and friendly environment for such finance in this country. In December 2007, Paris EUROPLACE, the organization that promotes the city's role as a financial centre, established the Islamic Finance Commission. Since then, the French financial markets regulator, the Autorité des marchés fi nanciers (AMF), has issued two positions allowing Shari'ah compliant investment funds and sukuk listings. As such, the Bourse de Paris (Paris stock exchange) has created a sukuk segment and four tax regulations (relating to murabahah, sukuk, ijarah and istisna') have been published that confirm a parity of tax treatment with conventional financial products.

There are presently six Shari'ah-compliant funds in France with total assets under management of USD 147.2 million, which are split relatively evenly between money market (47%) and equity (53%) assets. (2013)

## 2.4. Germany

Germany was the first Western country to tap the Islamic capital market when the federal state of Saxony-Anhalt issued the country's first Islamic bond (sukuk) in 2004. The paper attracted strong demand and was fully subscribed, with 60% of the issue going to investors in Bahrain and the UAE and the remaining 40% to investors in Europe, particularly those in France and Germany. The €100 million ijarah sukuk (Islamic sale-and-leaseback debt instrument) was fully redeemed in 2009.

The prospects for the further development of Islamic finance in Germany are rather solid. First, Germany is the largest economy in Europe and it features the largest Muslim population (4.1 million people, against 3.5 million in France and 2.9 million in the UK). Second, German exporters could use institutions offering Islamic financing solutions as alternative sources of funding and thereby further enhance their funding profiles. Third, Islamic trade finance products offer the potential to strengthen trade ties with countries such as Turkey; a country which is an active trading partner of Germany and that has a budding Islamic finance sector.

## 2.5. Italy

According to market estimates, Islamic retail banking deposits among Italy's diverse Muslim community could reach USD 5.8 billion and generate revenues of USD 218.6 million by 2015, with these figures rising to USD 33.4 billion and USD 1.2 billion respectively by 2050.

Meanwhile, efforts have also been made by a local bank to set up a working group on the introduction of a Shari'ah-compliant home finance product. In the wholesale banking area, a number of institutions are active in the Islamic capital market (mostly in terms of trade finance, murabahah and participation in syndication facilities) via foreign offices or wholly-owned foreign subsidiaries. Italian banks have also been active in the GCC region, more specifically in private-public partnerships. In addition, there are a number of bilateral trade ties between Italy and GCC-based institutions that have been successful in introducing Islamic insurance products for group employee benefit purposes.

## 2.6. Luxembourg

Luxembourg is one of the major financial markets in Europe; its popularity is based on competitive pricing, incentives and access to European clients. Since 2002, when Luxembourg became the first European country to list a sukuk, there has been a total of 16 sukuk listed on the exchange.

Luxembourg is being promoted rather strongly by its government to attract more Islamic funds as well as foreign investments from oil-rich countries and emerging wealthy nations. It became the first EU jurisdiction to adopt UCITS IV (The UCITS Directive 85/611/EEC (entered into force in 1988 as amended by UCITS III in 2002) has been the key driver contributing to the significant development and success of the European investment fund industry over the last two decades. However, with the rapid evolution of the investment fund market, it was necessary to further enhance the UCITS market and brand.) At the end of December 2010, and as a major domicile for both conventional and Islamic investment funds it had a first-mover advantage.

In December 1982, the country saw the establishment of a family-owned Islamic insurance operator. Luxembourg has a large traditional life assurance industry, albeit driven by international business. However, given the small domestic Muslim population in Luxembourg, any Islamic insurance operator's strategy was likely to be a cross-border one.

Luxembourg is the second largest investment fund centre in the world after the US. As regards Islamic funds with USD 1 billion Islamic AuM, they are largely equity funds domiciled in Luxembourg, managed and promoted by global investment companies. Today, Luxembourg emerges as the leading non-Muslim domicile for Shari'ah-compliant investments funds.

In terms of sukuk, the Luxembourg Law of 22 March 2004 on securitization (the Securitization Law) created a flexible and efficient regime for securitization vehicles. Since then, several Shari'ah compliant sukuk structures have been implemented in Luxembourg.

In 2009, the country's position in Islamic finance was considerably enhanced with the admission of the Central Bank of Luxembourg as the first EU Central Bank to become a member of the IFSB. Also, that year a major German bank launched a trading platform, al-Mi'yar, in Luxembourg to facilitate the issuance of Islamic securities.

Other European countries have been looking to adopt a similar approach to attract foreign funds. The favorable legal framework combined with the UCITS qualification allows Islamic funds domiciled in Luxembourg to be a successful instrument for Gulf investors wishing to tap the European market.

## 2.7. United Kingdom

The UK has one of the most advanced Islamic financial markets in the western world and is quickly becoming a key destination for foreign Shari'ah-compliant institutions. The country is home to the west's first fully fl edged Shari'ah-compliant retail bank and currently has fi ve true Islamic banks. London in particular is an important financial centre, with major international firms and the Middle East's biggest traditional banks offering Islamic products in this city. Islamic financing activities started in the UK in the 1980s when the London Metal Exchange provided Shari'ah-compliant overnight deposit facilities based on the murabahah principle.

In 2005, the Sanctuary Building Sukuk was launched; the first corporate sukuk in Europe and the first from the UK. Based on the same structure, the second corporate sukuk was issued by International Innovative Technologies (IIT) Ltd in 2010.

The UK is a major global provider of the specialist legal expertise required for Islamic finance, with around 25 major law firms providing legal services in this area. Specialist services are also available for advice on tax, listings, transactions, regulations, compliance, management, operations and information technology systems.

Islamic banking began in the UK in the 1990s when corporations from the GCC introduced Islamic mortgages (based on the murabahah principle) and offered mortgage financing (based on the ijarah principle) shortly thereafter. However, these instruments were perceived to be very expensive due to the double stamp duty applicable (i.e. first, when a bank purchases a house, and, second, when a buyer/client purchases this house from the bank concerned). The abolition of the double taxation regime in 2004 paved the way for increased demand for Islamic home financing.

Below chart shows the number of funds available in the above mentioned countries, the numbers in the chart are from 2012, with the fast growth of Islamic in finance in Europe this number might reach to its double in 2015.

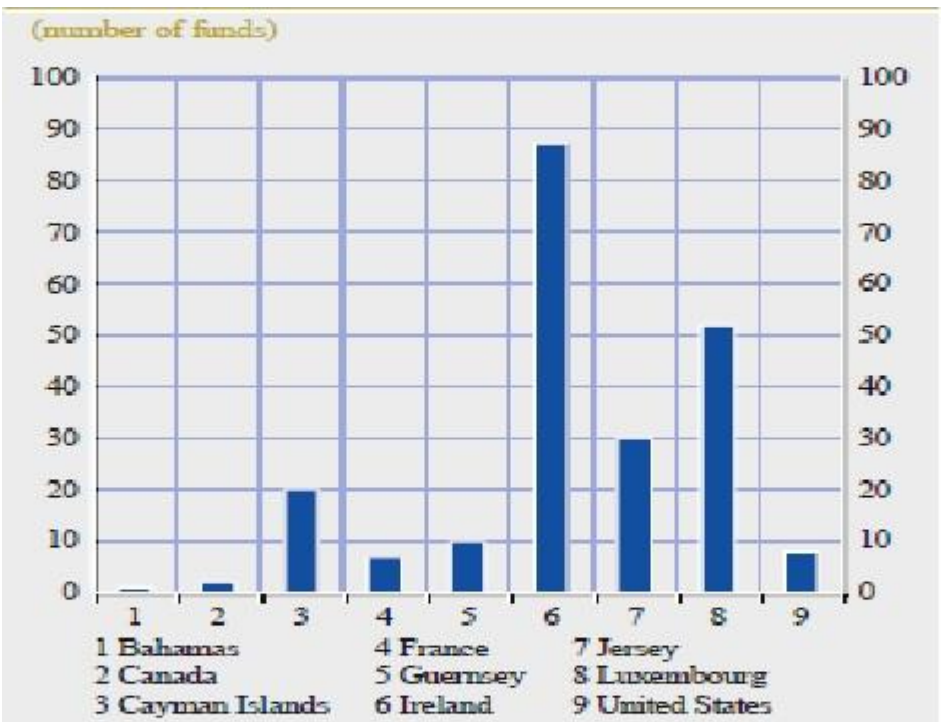



*Figure 2.1 Islamic Funds in Selected Counties*

***Source**: European Central Bank, 2013.*

## 2.8. Development Of Islamic Finance In Turkey

### 2.8.1. Background

Turkey economic history starts from 11th century when Turks started their migration to Anatolia. For around thousand years Turkey had two economical sessions, the first period was Classic Session (N'zam-I kadim) and Second Period was Modernization session (Nizam-I Cedid). The classic session was between 11$^{th}$ and 18$^{th)}$ Century almost Eight hundred years. The Modern Session ( Nizam-I Cedid) refers to the period starting from last decade of 18 century. They modernization period can be divided to three important sessions which are; Mahmud II. (1808 – 1893), Reforms (Tanzimat) (1839-1876), and AbdulHamid II. (1876-1909). (Tabakoglu, 2015)

It is import to mention the three important sources of Turkish economic system. They are, ownership of economic recourses of Anatolia territory, the customs, traditions and laws which are made by Turkish people when they are leaving in Central Asian countries and the Islamic Economics principles and practices from 8$^{th}$ Century. The practices of Islamic Economics system started in 6$^{th}$ Century in Madina by the Prophet Muhammad, then the Islamic economics implementation were followed by Umayyad and Abbasids. Following Umayyad and Abbasids the Islamic economics system was implemented in Turkey in Medieval Turks, Seljuk's and Ottomans Time.

Ottoman Empire was Turkey's strongest empire economically and socially from 1300 to 1919.In organizing the six centuries of ottoman history, the classical period 1300-1600 is taken as a well-defined, distinct period with an autocratic centralist government and a command economy, while in the following "Decline" period, underpinnings of this traditional polity entered a process of transformation. The seventeenth century became in fact a period of transition, witnessing through – going changes, the Köprülüs attempt to restore the traditional autocratıc centralist system totally failed during the disastrous war period from 1683 to 1699. The eighteenth century saw a radically changed ottoman empire with the rise of local powers under provincial notables and "dynasties," decentralized, so to speak, the central government followed "Liberal" policies not only in the administration of the empire but also in landholding the economy in general. Also, there occurred a radical change in the attitude of the ottomans toward Europe and its civilization. The ottomans, for the first time, now admitted the Europeans superiority and began to imitate and borrow western ways. This led to increasing ottoman dependence on western powers for survival; the nineteenth century witnessed gaining momentum in ottoman dependence on the West, both politically and economically, and in radical westernization reforms. (Tabakoglu, 2015)

Turcoman Nomads in ottomans were the important part of Economical society and fulfill certain functions without which the society could not survive. The ottoman state, recognize this fact, took measures to accommodate the nomads in its imperial system. Each clan was given a yurt consisting of summer and winter pasturelands the limits of which were determined and were entered in the imperial registers. In this yurt area, along with animal husbandry, Turcoman was also engaged, though marginally, in agriculture. They reclaimed land in forests or swamps to grow wheat, cotton and rice for their own needs or for the market. Most of the land, for example, in the river walleyes in western Anatolia and in lower Cilicia was Malaria-stricken swamps left uncultivated. Coming for their winter encampment Turcoman nomads reclaimed part of this land for such cash crops as cotton and rice. When the left for summer pastures they stationed watchmen and came back for the harvest.

### 2.8.2. The Financial Mind in Ottoman State

Although it seems contradictory with the goals of a power state, there is in the Islamic state an overriding concern for the well-being of the community which called for an economy of plenty. After all, in the pure Islamic tradition, the state is considered merely a means to promote the ideology of Islam. Deriving their judgments from Islam’s canonical sources with some perspective perhaps from max weber, modern Muslims scholars assert the economics activities are determined by the values. System of Islam, whose prime concern is the well-being of the Muslim community as whole, criticizing the western concept of *homo economicus*, they point out that the Islamic world-view is based on oneness of this world and the hereafter, since human life is conceived as one harmonious whole oriented toward one ultimate goal, "obtaining the acceptance of Allah." Giving charity to the poor and needy, committing resources for the welfare of future generations and seeking to improve communal life are the real "Economics" goals, "Production and profit are not," M. Al-Mubarak asserts, "Ends but Means. The moving force of current system is profit, but in an Islamic system it is human welfare." But one may, of course, dispute when and where the Islamic theories have been translated into a reality. In fact the conflict between the Islamic ideal and everyday practice has been an ever-present issue in Islamic societies. Completely ignoring the the elaborate non-Islamic taxation found in all of the Islamic states, the orthodox legalistic view also asserts that Islam's fiscal system is based on Islamic charity, "which aims at ensuring minimum means of livelihood to each and every individual" and productive use of economic resources for the material well-being of the community. The basic orientation "is the mutual sharing of the community's income between the affluent and have-notes." But at the same time private property is a religiously sanctioned precept in Islam.

There is, however, a theory propounded by classical Muslim legists which distinguishes necessities and refinements, so, in practice, they say, while luxury goods, mostly imported by merchants, are not subject to state price controls, necessities and local products in the common bazaar are subject to the close inspection of the bazaar inspector (Muhtesib) appointed by the state. the maximal price system (narb) and the constant inspection of prices and weights and measures in the bazaar as far as necessities are concerned are among the most important responsibilities of the head of the community, sultan or local kadi; in fact, ottoman sultans took this duty most seriously, one may argue that political concern too may be involved since popular uprisings for bread are quite familiar in Islamic cities, in any case, to prevent shortages in basic needs and to secure an economy of plenty was a central concern of the sultan. Archival evidence indicates that these principles guided ottoman bureaucrats in all of their decisions concerning economic activities.

In this context, the important place of charity in Islamic law is revealing. It is the expression of thanks for Gods bounties to his creatures. Thus, interpreted within the religious duty of alms giving, or sadaka, charity is highly meritorious behavior in Islam. Sultans frequently distributed alms, slaughtered thousands of sheep on certain occasions and distributed them to the poor, sometimes with their own hands. Soup kitchens (Imaret) were one of the most widespread institutions attached to the religious endowments in cities; incidentally, ottoman sultans had difficulty in curbing the influx of beggars into Istanbul during the fasting and charity month of Ramadan. Thousands of "prayer-saying" people (duaguyan) in the mosques throughout the empire, in particular in the fortresses on the frontier, formed a regular salaried group in the payrolls of the state. The belief that charity pleases God and brings God's blessings determined Muslims behavior in many basic acts of economic importance in Islamic states, and the ottoman were particularly zealous in the regard.

Institutions derived from charity played a significant part in redistributing wealth in society. Large groups of the destitute and unemployed in Ottoman cities and towns were maintained through such charity institutions. Thus, a significant part of the fortunes accumulated in the hands of the elite, although sometimes temporarily employed in *commenda* enterprises, ultimately were bestowed on charitable endowments. The economic significance of such institutions is not to be underestimated in Ottoman society.

Unlike market economies, Karl Polanyi points out, economic integration in the so-called "archaic" or traditional societies is regulated under institutional arrangements such as kinship, household, temple or state. in fact, the categories in use in market economies such as profit, wage and salary take on a rather liturgical meaning in Ottoman society. Since redistribution presupposes the presence of " an allocation center," the sultan assumes a fundamental role in that society. Obviously, a pious foundation (VAKF) in the Islamic state is a primordial institution for redistribution with a basic social and economic integrative function.

On the other hand, reciprocity in the form of exchange of gifts, in particular gifts or pişkeş presented to the sultan on special occasions, at the beginning of the New Year festival *(NEVRUZ)* or at religious festivals by dignitaries and foreign embassies, was carefully observed by the Ottomans, the economic consequences of this tradition are not to be underestimated. A group of palace artisans (*brief-I bassa*) was created to prepare imperial gifts in the palace, periodic distribution of woolen cloth to the janissaries gave rise to an extensive woolen industry in Salonica and Istanbul. Gifts, baksheesh and service fees expected by the dependents had a quasi-ritual significance, the neglect of which justified protest or rebellion, money distributed to all the members of the military divisions and employees on the occasion of the accession to the throne of new sultan had a tremendous impact on the imperial finances and taxpayers; uprisings of the military in Istanbul broke out when the administration was unable to pay.

Mention should be made of transactions intended purely for profit making, such as investments in *commenda partnerships* (Mudaraba), a practice approved by Islamic law and widely followed in the Ottoman Empire. Also, following the widespread practice of credit giving with interest concealed under religiously approved form, the use of letters of credit, the activities of money-changers and a primitive type of banking *(dolab),* Ottoman economy of the sixteenth century employed some practice basic to capitalist market economies partly because of the influence of the Italian merchant community at Galata and of Ottoman subjects of Italian origin. But all these commercials devices appear to have remained rather marginal or peripheral since the Ottoman socio-economic structure and mind did not undergo any fundamental change because of these, and no development parallel to what happened in the west occurred in the Ottoman Empire. Obviously, in Ottoman society, the states control and patrimonial relationships remained an essential mechanism for redistribution. The empires economy and finances depended fundamentally on state ownership of land and its control of agricultural production, the main source of wealth, peasant subsistence as well as the maintenance of a large body of the military class was based on a specific landholding system and taxation policy.

During the Ottoman Empire (1301-1922) global trade grew, but the development of Islamic finance products was limited though it is believed the first Sukuk was issued in 1775 by the Ottoman Empire when it borrowed money against future income on tobacco customs levies to fund its budget deficit.

Ottomans Empire took the first debt from Western banks in 1854 and from this date to the collapse of the Empire in 1922, the Ottoman government's wanted new debts from European banks and sometimes with very high interest rates. These new debts were used sometimes to pay (only) the interests.

The former bank established in Turkey was Osmanli Bankası (Bank of Ottoman) in 1856, It was founded by the British with a capital of $ 500,000. However, the British soon became dissatisfied at the restrictions placed on the bank by the Ottomans and most of its shares were sold to the French. The Ottoman Bank, as it is known today, came into being in 1863. This bank, together with the State Treasury, was responsible for the issue of Turkish currency until the founding of the Central Bank of Turkey in 1930. The second bank was Ziraat Bankası (Bank of Agriculture) founded in 1888 and that operated and created their branches in the important cities in Turkey at the end of the 19th century. Subsequently, at the beginning of the 20th century, other two banks, Emniyet Sandığı and I'itibari Milli Bankası, entered to work in the existing Interest based principles. (Boulam, 2015)

During the 1930s, two new development banks were set up to finance and control the expanding state industrial sector. Sümerbank founded in 1933 and two years later Etibank was opened.

In this scenarios, Noninterest based Banks were totally absent due to two essential factors:

**Political view:** after the collapse of Ottoman Empire, new strong secular republic, essentially, did not follow an Islamic way and did not think Islamic solutions for economic problems. In fact under Ataturk regime, in 1928 the GNA deleted the clause in the constitution that declared Islam as the official state religion. Islamic had been replaced with Ataturk's secular ideologies.

***Absence of knowledge:*** few experts argued about the need of an ethical bank, for instance, Namik Kemal spread the idea of "bank of muslim" but he did not give any other knowledge about it and what kind of bank he thought. Following the proclamation of the Turkish Republic, Banks were continuously subject to the Banks Act which was contained in Decree. (Boulam, 2015)

### 2.8.3. Modern Era of Islamic Finance in Turkey:

In Turkey, Islamic banking is called participation banking. Turkey today has very limited local participation banking activity — the country is home to four participation banks plus two very new State Islamic banks representing approximately 5.6% of total financial assets as of 2016. However, growth within the participation banking sector outpaced the conventional financial sector in 2012, with the former increasing its assets by 25% as opposed to the latter's 13%. This growth within the Islamic sector is projected to continue with the announcement of the new sukuk legislation on June 7, 2013 that has introduced new types of structures to boost Turkey's Islamic capital market. However there are other areas that still need further development including takaful, SME financing, funds management, microfinance, and zakat. (Thomson Reuters, 2014)

### 2.8.4. Turkey`s Islamic Finance Milestones:

**1983 -** Aug, "Special Finance houses" Decree was passed for the first time after creation of a new and Secular Turkey by Mustafa Kamal Ataturk.

**1984** - Nov, Al Baraka Turk was established. Al Baraka is Bahrain based bank which operates with almost 1000 banks in over 100 countries.

**1985** - Saudi-based Faisal Finans Kurumu was established.

**1989** - Kuveyt Turk was established

**1991 -** Anadolu Finans was established

**1995** - Ihlas Finans was established

**1996** - Bank Asya was established. Bank Asia was over taken by government for a short time in 2015.

**2000** - Ulker acquired Faisal Finans, changing its name to Family Finance house

**2001** - Feb, Turkish Lira moved from a crawling page to a free floating regime

**2001** - Turkey Financial Crisis

**2001** - Ihlas Finance filed to bankruptcy

**2002** - Justice and Development Party (AKP) came into power; AKP Government started pushing Islamic finance institutions to a better stage.

**2005 -** Family Finans and Anadolu Finans merged to form Turkiye Finans Katilim Bankasi

**2005** - Banking Law officially replaced the "Special Finance Houses" term with "Participation Banking"

**2007 -** Saudi National Commercial Bank (NCB) acquired 60% of Turkiye Finans Katilim Bankasi for $1 billion

**2008** - Global Financial Crisis

**2010 -** Framework for corporate Sukuk was et up

**2010 -** Aug, Kuveyt Turk issued Turkeys first Sukuk ($100 million)

**2011** - First participation index was launched by the Istanbul Stock Exchange

**2011** - The parliament passed legislation to promote "Islamic Finance"

**2012** - Sep, First dollar denominated sovereign sukuk issuance ($1, 5 billion)

**2012** - Oct, First Lira denominated sovereign sukuk issuance ($904 million)

**2013** - Amendment to the sukuk law was enacted on June 7, 2013

**2013** - Mar, Announcement by Deputy Prime Minister Ali Babacan to establish two new State-owned participation banks

**2013** - Mar, Bank Asya issues the First Turkish Lira Sukuk out of Turkey

**2014** - July, Newly adapted mutual fund regulation, "Participation umbrella fund" (Katılım şemsiye fonu) will include funds with no interest bearing securities.

**2014** - First Takaful (Islamic insurance) company started operation.

**2015** - First state bank, Ziraat Bankası announced Islamic banking.

**2016 -** Vakıf Bankası islamic banking window is added to Turkey participation banks

### 2.8.5. Special Finance House

The Turkish banking system has three main players: Commercial Banks (private and state-owned), Investment Banks, and Special Finance Houses. Special finance houses (SFH), the name given to financial institutions based on interest free principles, started to operate in Turkey in 1983 after a government decree allowing their operations. In 1984, Al-Baraka Turk and Faisal Finance House were established. Kuveyt-Turk Finance House was the third institution operating in this sector. These three SFHs were established with large foreign capital, and the first SFH with 100% domestic capital, Anadolu Finance House was established in 1991. In 2000, the Faisal Finance House has been purchased by a large Turkish company, Ulker, and has been renamed as Family Finance House. The general motivation for the foundation of such institutions is to attract the funds from people, who do not want to deal with interest-based financial institutions for religious reasons. Today, it is clearly observed that these institutions are attracting funds not only from those people but also from others, and their overall performance as compared to other financial institutions is conspicuous.

Under the 1983 government decree, the status of the SFHs was different from those of the conventional banks, and this caused some competitive disadvantages for them. With the entry of fully-domestic-owned special finance houses into the market, the complaints regarding the weaknesses in legal structure became more pronounced. As a result, in 1999, special finance houses became subject to the new Banking Act. After a revision in this act in 2001, the competitive position of the SFHs has been improved in terms of the legal infrastructure. In 2001, the Association of Special Finance Houses has been established, and the legal status of these institutions has been strengthened with the passage of the enabling legislation from the Parliament. (Alpay, 2007)

### 2.8.6. Operations of Special Finance Houses

The operations of special finance houses are based on interest-free system. Transactions based on interest in the conventional banks are usually performed by profit-loss sharing principle. One can group different operations of the SFHs into corporate services and retail services. We briefly summarize each category in turn. In general, according to Islamic terminology, mudarabah, murabahah and musharakah are the main forms of the operations; however, we will here mention the very own terminology used by the special finance houses operating in Turkey.

### 2.8.7. Corporate Services

1) **Leasing: Fixed assets**, which are subject to depreciation, can be leased to investors on the condition that the ownership of the leased belongs to the lesser according to Turkish financial leasing law. Minimum period for financial leasing is 48 months except for computers and some other specified consumer goods, which may be leased for the period of two years. At the end of the leasing period, the leased equipment is transferred to the lessee

at a price stipulated in the agreement. Leasing is more commonly used in the SFHs as compared to conventional banks.

2) **Financial Support for Production:** Businesses and manufacturers continuously need raw materials, semi-products, final products, machinery and other equipments to maintain production. Special finance houses provide support to its corporate customers, and purchase any goods in advance and resale it to the customers on Installment basis. After delivery of the requested goods, customer businesses become indebted to the SFHs according to a previously agreed price, profit rate and payment term.

3) **Profit and Loss Sharing Funds:** This is a special type of funding provided for customer businesses, which need to be financed to realize their short term projects. This kind of transactions starts with signing a contract between the SFHs and the customer businesses, and this contract is based critically on the feasibility of the project, and it mentions the agreed rates of profit and loss between the parties. At the end of the project, generated profit is distributed between the parties with the rate stipulated in the agreement, and the project is concluded. Other most commonly used operations are mainly related to the international trade. The SFHs provide services such as letters of guarantee and counterguarantees, avalization, foreign remittance (outgoing and incoming money transfers), letter of credits, export and import services.

### 2.8.8. Retail services

In this group, different types of consumer financing transactions are offered to individual customers. In essence, with this service, special finance houses purchase goods in advance and, after adding a certain profit margin, sell them to their customers on payment by Installment. These transactions are performed according to principles of interest-free banking and obviously, no cash credit is given. In general, the SFHs are financing final consumer goods such as residence, automobile, long-lasting consumption goods, computer, office equipment, house equipment, second-hand cars and commercial vehicles, etc., within the principles of interest-free banking and with favorable rates. Usually, customers are presented with a payment calendar of 36 months in every product except residence financing, which can go up to 60-month Installments. The payment currency can be chosen as Turkish Lira, US Dollars or Euro for the transaction periods up to 36 months. For longer term financing, only foreign currencies such as USD or Euro are used. In real estate financing, customers are usually required to make a % 25-advance payment, and the SFHs finance only 75 % of real estate's value. In real estate financing, initially the sellers transfer the residence to the SFHs, and after adding a certain profit, it is sold to customer. Special finance houses keep the residence under mortgage until the total debt is cleared by the customer. All expenses and taxes generated by this operation are borne by the customer.

### 2.8.9. Comparative Performance of Special Finance Houses Against Conventional Banks

As of the end of 2004, the total amount of deposits at the conventional banks is 191 billion new Turkish lira. Only 52 percent of all these deposits is transferred to the real sector as credits. In the same year, the total amount of deposits at the special finance houses is 6 billion new Turkish lira, and 82 percent of these deposits is given as credits to the real sector. Although the share of special finance houses in overall deposits is 3 percent, their share in overall credits transferred into the real sector is 5.7 percent. This kind of differences in the share of deposits and the share of credits between special finance houses and conventional banks is visible during almost entire existence of the SFHs in Turkey. This little piece of information clearly indicates that special finance houses are doing a better job with respect to what one expects from financial institutions in general; that is to say, they are performing better than banks in terms of financing the real sector of the economy, which is especially very critical for developing countries. (Alpay, 2007).

### 2.8.10. Participation Banks in Turkey

#### 2.8.10.1 Albaraka Türk

Albaraka Türk, the first finance institution and the pioneer in the field of interest-free banking, completed its establishment in 1984 and commenced operations in the beginning of 1985. Albaraka Türk continues its operations in compliance with the Law of Banking numbered 5411. Albaraka Türk was founded by Albaraka banking Group (ABG), one of the prominent groups of the Middle East, Islamic Development Bank (IDB) and a native industrial group of Turkey, which served the Turkish economy for more than half a century. As of 31.12.2013, in the partnership structure of Albaraka Türk, foreign partners are 66.10%, native partners are 10.48% and shares open to the public is 23.42%.

Albaraka Türk including one international Branch in Iraq is having total 202 branches across the country, it's the first bank in turkey offer Murabaha for the customers.

***2.8.10.1.1. Albaraka Türk Contribution to Economy***

Albaraka Türk maintain its strong contribution to the economy by placing 97% of collected funds as loans in 2014.

The values given below shows a huge increase in the assets in 2014, where funded credits did not increase as much as assets but still there is a fair increase in the funded credits as well. It seems that bank fund is more collected funds compare to shareholders equity the date shows increase in both values. There is a very big increase in number of branches and number of personal.

*Table 2.2 Al Baraka Key Financial Highlights*

Key Financial Highlights (TL thousand)

| | 2010 | 2011 | 2012 | 2013 | 2014 | Growth (%) |
|---|---|---|---|---|---|---|
| **Total Assets** | 8,406,301 | 10,460,885 | 12,327,654 | 17,216,553 | 23,046,424 | 33.9 |
| **Collected Funds** | 6,881,590 | 8,044,747 | 9,225,018 | 12,526,212 | 16,643,218 | 32.9 |
| **Funded Credits'** | 6,296,815 | 7,286,960 | 9,100,063 | 12,059,901 | 16,183,692 | 34.2 |
| **Shareholders' Equity** | 852,635 | 1,004,251 | 1,218,333 | 1,497,268 | 1,790,927 | 19.6 |
| **Net Profit** | 134,044 | 160,155 | 191,835 | 241,409 | 252,631 | 4.6 |
| **Number of Personnel** | 2,175 | 2,601 | 2,758 | 3,057 | 3,510 | 14.8 |
| **Number of Branches** | 109 | 123 | 137 | 167 | 202 | 21.0 |

**Source:** Al Baraka, 2015b

### *2.8.10.1.2. Social Contribution of Albaraka Türk to Community*

Non-reciprocated scholarships were provided for 16.057 students of which 92% for Under-graduate and 8% for graduate education since 1987.

Sponsored a documentary film entitled "Maşukun Nefesi" in order to regenerate the 600-year-old tradition of Mevlid, which is on the verge of being forgotten.

Sponsoring Şeb-i Arus Ceremonies held in Istanbul with the participation of thousands spectators.

Sponsorship of the summit on the subject of "Tomorrow's changing scenarios: Understanding the Challenges and improve Dialogues".

Sponsored the Islamic Finance News (IFN) forum Turkey.

Sponsored the 9$^{th}$ Turkish-Arabic Economy forum in Istanbul in May.

Albaraka Türk Contribute to Education in through the Bereket Foundation, A total of 2089 students received scholarships in 2014 of which 2001 were under-graduate and 88 doctorate students.

### 2.8.10.2. Asya Bank

ASYA KATILIM BANKASI A.Ş. commenced its activities on October 24th, 1996 with its head office in Altunizade, as the sixth private finance house of Turkey. The company's name, which had been previously "Asya Finans Kurumu Anonim Şirketi", was changed into "Asya Katılım Bankası Anonim Şirketi" on December 20th, 2005.

Asya Bank, initial capital of which is 2 million TL and current paid up capital is 900 million TL, has a multi-partnered structure based on domestic capital.

Main objective of Asya Bank, which accepts supporting production by complying with the requirements of interest-free banking as the foundation principle, is to spread interest-free finance system to larger masses by using the latest opportunities of technology in accordance with customer-oriented service mentality.

In this direction Asya Bank carries out its activities with 272 branches (including Erbil Branch and our travelling branch), 2 national and 1000 foreign correspondent banks besides the head office units as of November 2012.

Asya,Bank the first private finance house having ISO 9001 Quality Management System Certification, is in service with its organization and wide range of products meeting all needs and demands of its customers for retail, commercial and corporate banking.

Besides traditional distribution channels, namely branches, Bank Asya aims at offering uninterrupted, rapid and effective service via Online Banking, Alo Asya Telephone Banking, ATM and POS stations.

Asya Bank accepts the two basic approaches below as the requirement of gaining targeted market share and works to achieve them: (1) to develop products of interest-free banking and bringing out new alternative products and (2) o adapt the products used effectively in banking to interest-free banking system.

In 2013 10-year due subordinated loan amounting to 250 million USD in Sukuk format was provi ded for the first time in Turkey by Asya Bank.

Asya Bank continues to provide international services to its customers with a wide network of over 1,400 correspondent banks in 110 countries throughout the world. In May, Asya Bank launched the "Murabaha Syndicated" credit worth $380 million (consisting of two parts as €115.3 million and $230.5 million) with the participation of 28 banks to be used to finance foreign trade. The maturity date for the murabaha credit is 1 year.

*Table 2.3 Capital and Shareholder Structure*

| **Share Holder** | **Amount TL** | **Share (%)** |
|---|---|---|
| Ortadoğu Tekstil Tic. San. A.Ş. | 44.022.478 | 4,89 |
| Forum İnşaat Dekorasyon Turizm San. ve Tic. A.Ş. | 34.667.791 | 3,85 |
| Osman Can Pehlivan | 27.976.000 | 3,11 |
| Sürat Basım Yayın Reklamcılık ve Eğitim Araçları San. Tic. A.Ş. | 24.271.960 | 2,70 |
| BJ Tekstil Tic. ve San. A.Ş. | 20.350.000 | 2,26 |
| Others | 254.912.197 | 28,32 |
| Publicly Listed | 493.799.574 | 54,87 |
| **Total** | **900,000,000** | **100** |

**Source:** *Bank Asya, 2014.*

*Table 2.4 Financial Information of Bank Asya for Five-Years*

| **Selected Asset Items** | **2009** | **2010** | **2011** | **2012** | **2013** |
|---|---|---|---|---|---|
| Liquid Assets | 2,572,230 | 2,666,154 | 2,818,654 | 3,887,379 | 5,420,171 |
| Loans | 8,355,346 | 11,060,267 | 13,451,522 | 16,307,390 | 21,257,166 |
| Fixed Assets | 137,382 | 143,821 | 123,805 | 141,878 | 164,110 |
| Total Assets | 11,608,955 | 14,513,419 | 17,190,099 | 21,390,024 | 27,784,947 |

| **Selected Liability Items** | **2009** | **2010** | **2011** | **2012** | **2013** |
|---|---|---|---|---|---|
| Collected Funds | 9,136,578 | 11,166,582 | 12,397,043 | 15,741,858 | 18,511,563 |
| Credits Received | 191,461 | 622,237 | 1,457,830 | 1,815,403 | 3,808,063 |
| Subordinated Credit | - | - | - | - | 544,263 |
| Equity Capital | 1,707,894 | 1,941,667 | 2,137,426 | 2,349,273 | 2,510,946 |
| Paid-In Capital | 900,000 | 900,000 | 900,000 | 900,000 | 900,000 |
| Net Profit for the Operating Cycle | 301,281 | 259,962 | 216,090 | 190,392 | 180,604 |
| Sum of Liabilities | 11,608,955 | 14,513,419 | 17,190,099 | 21,390,024 | 27,784,947 |

| **Income Statement** | **2009** | **2010** | **2011** | **2012** | **2013** |
|---|---|---|---|---|---|
| Dividend Income | 1,305,652 | 1,206,930 | 1,278,154 | 1,672,257 | 1,816,158 |
| Dividend Expense | 705,805 | 613,392 | 646,930 | 791,932 | 838,902 |
| Non-dividend Income | 507,387 | 479,817 | 489,546 | 525,080 | 651,801 |
| Non-dividend Expense | 728,842 | 749,057 | 851,638 | 1,159,964 | 1,415,953 |
| Pre-tax Profit | 378,392 | 324,298 | 269,132 | 245,441 | 213,104 |
| Tax Provision | 77,111 | 64,336 | 53,042 | 55,049 | 32,500 |
| Net Profit for the Operating Cycle | 301,281 | 259,962 | 216,090 | 190,392 | 180,604 |

**Source**: Asya Bank, *2014.*

In the first sheet Liquid Asset, loans and fixed asset are located, there is an increase in each year, comparing 2009 to 2013 it is a very big difference this shows that the Islamic Banks are performing well and attracting more customers day by day. This high increase is there in the liabilities sheet as well, where the equity capital from 1,707,894 in 2009 increases to 2,510,946 in 2013 this show that there is a demand for more capital. The last part is the income statement income statement shows the reducing Net profit cycle from 2009 to 2013, the reason might the high rates of dividend paid to equity holders.

#### *2.8.10.2.1. Asya Bank Social Responsibilities*

Asya Bank actively takes part in different types of social responsibilities, the social responsibility projects are listed below:

**Culture Publication:** Asya Bank publishes works under the name of Bank Asya Cultural Publications regularly in order to own the historical and cultural values of belonged society, to maintain and to introduce the cultural richness. Till today Bank Asya signed many Publications in this field.

**Cinema:** Asya Bank which also maintains its support for culture-art and becomes sponsor of 2 pieces of full-length cinema film within 2009 also aims at maintaining its support in this field in the following years.

"Uzak İhtimal (Wrong Rosary)" Film Sponsorship

"Eşrefpaşalılar" Film Sponsorship

Crystal Clapper Short Film Competition Sponsorship

#### *2.8.10.2.2. Sponsorship of International Turkish Olympics*

**Environment and Nature Support Projects:** Asya Bank has also works about protection of environment and especially raising awareness of the young people about the environment, by acting with the reality of “all creatures deserve a clean and livable environment", as well as cultural, artistic, training projects realized within the scope of institutional social responsibility principle.

**Sport Support Project:** Asya Bank Support Many Turkish Football leagues and their award program and as well as Sponsored Junior Athletes in Turkey.

#### 2.8.10.3. Kuveyt Türk Bank

Kuveyt Türk was funded in March 31, 1989 under the business name Kuveyt Türk Evkaf Finans Kurumu A.Ş. It has operated under the status of a private financial institution, and like other private financial institutions, became subject to Banking Law in 1999. In 2006, the business title of the Bank was changed to Kuveyt Türk Katilim Bankasi A.Ş. (Kuveyt Türk), the name the Bank continues to use today.

As of year-end 2014, Kuveyt Türk shareholders equity stood at TL 3.2 billion. Of the Banks outstanding shares, 62.32% are owned by Kuwait Finance House, 18.74% by the Turkish General Directorate of Foundations, 9.01% by the Kuwait Public Institution for Social Security, 9.01% by Islamic Development Bank, and the remaining 0.92% by other real and legal persons. The Banks consolidated assets grew by 31.3% in 2014, to TL 34 billion.

Kuveyt Türk offer services and products via 306 branches throughout Turkey, as well as oversea branches in Bahrain and Mannheim. As of year-end 2014, the Bank had 5,082 employees. With a young, dynamic staff composed of mostly university graduates and experts in their respective fields, Kuveyt Türk has adopted modern management practices and a service-driven approach.

Throughout 2014, Kuveyt Türk rolled out products that encourage savings and launched new initiatives in the area of SME banking. Maintaining market leadership in gold banking and mortgage financing, the Bank expanded its investments in technology with a dedicated R&D center, a first in Turkish banking and financial service sector. In Interest-free investment instruments Kuveyt Türk launched Turkeys first Sukuk in a three-year, US$ 100 million in 2010, Kuveyt Türk undertook two more Sukuk issuances in 2014, which were well oversubscribed by leading investors.

By honing Kuwait Finance houses extensive correspondent network and deep-seated interest-free banking experience to a competitive edge, Kuveyt Türk function like a financial bridge for Turkish investors seeking access to the world, particularly to the Gulf Region. A major contributor to the burgeoning trade between Turkey and the Gulf Region through its Bahrain branch, the Bank is developing international project that will present new opportunities for investors.

The Islamic International Rating Agency (IIRA), which rates Islamic/ interest-free Banks, upgraded Kuveyt Türk short-term national rating from A+ to AA- and its long-term national rating from A- to A-1+.

Kuveyt Türk Competed the XTM project, which offers video chat and self-service transitions at the same time, the first of its kind in the world. This innovative service was offered to customers at 22 locations across Istanbul.

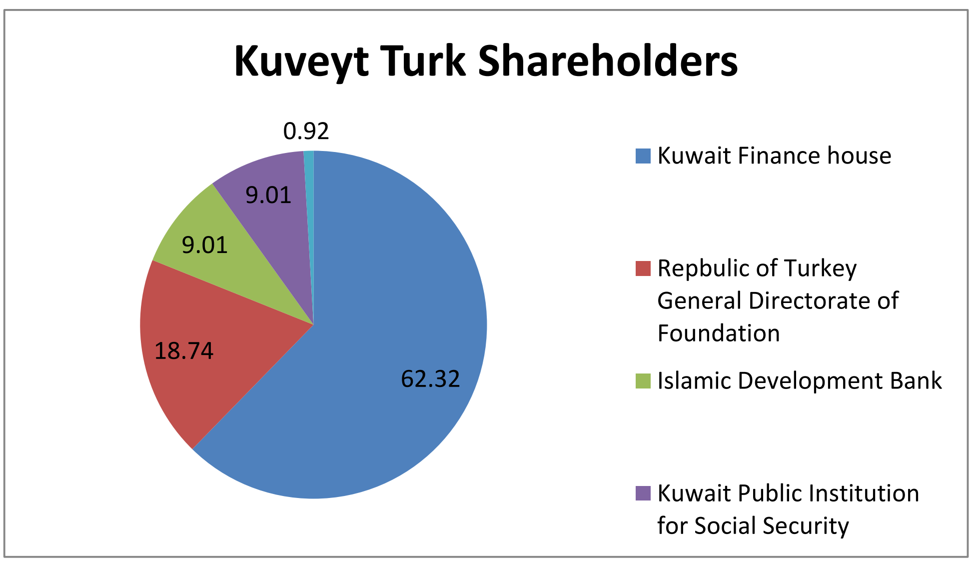



*Figure 2.2 Capital Structure*

**Source:** *Kuveyt Türk, 2015.*

*2.8.10.3.1. Contribution to the Society*

**R&D Center:** Kuveyt Türk R&D Center was established to meet the Banks own technological infrastructure requirements and to implement the innovation projects required by the financial sector as a whole.

**Van Earthquake Temporary Shelter Campaign:** in order to provide urgent disaster relief to the victims of the van earthquake in 2011, Kuveyt Türk pioneered the creation of a temporary shelter camp built out of shipping containers.

**Support for Victims of the Soma Mining Accident:** in order to provide support to the families of victims who lost their lives in the 2014 Soma mining accident in Turkey, Kuveyt Türk senior management decided to donate TL 1 million.

**Support for culture and arts and other:**

Restoration of Saliha Sultan (Azapkapı) Fountian; Restoration of Bursa Kozahan Fountain; Restoration of the Grand Imperial Mosque of Ortaköy.

Support For youth Projects, support for SMEs projects, and support for the Environment projects

*Table 2.5 Kuveyt Türk Five-Year Financial Summary*

| Summary Financial Highlights (TL thousand) | 2010 | 2011 | 2012 | 2013 | 2014 |
|---|---|---|---|---|---|
| Profit sharing income | 639,251 | 882,153 | 1,182,236 | 1,332,063 | 1,897,864 |
| Profit sharing expense | 318,096 | 437,367 | 610,562 | 548,888 | 815,583 |
| Net fee and commission income | 140,051 | 172,813 | 220,518 | 240,477 | 267,934 |
| Other income | 110,200 | 126,628 | 136,723 | 234,655 | 193,929 |
| Other expenses | 361,578 | 466,576 | 606,690 | 824,902 | 986,404 |
| Tax charge | 41,576 | 49,731 | 59,997 | 72,230 | 99,704 |
| Net profit for the period | 168,252 | 227,920 | 262,228 | 361,175 | 458,036 |
| Total assets | 9,594,265 | 14,540,661 | 18,596,049 | 25,602,525 | 33,750,746 |
| Total shareholders' equity | 1,275,766 | 1,471,716 | 1,728,337 | 2,418,506 | 3,236,703 |
| Capital adequacy ratio (%) | 17.05 | 16.28 | 14.16 | 14.43 | 15.21 |

* IFRS Consolidated Figures.

**Source**: *Kuveyt Türk, 2015.*

### 2.8.10.4. Türkiye Finans

As a joint venture between The National Commercial Bank (Saudi Arabia), the Boydak Group and the Ülker Group, Türkiye Finans is a leading institution that transforms its deeply rooted know-how and experience into “growth reflex” with its determination to leave a mark on the future of our country’s participation banking and with its vision.

Türkiye Finans was established in 2005 with the merger between “Anadolu Finans”, which was founded in 1991 with 100% domestic funds, and “Family Finans”, which operated in participation banking between 1985 and 2001 under the name of “Faisal Finans Kurumu”.

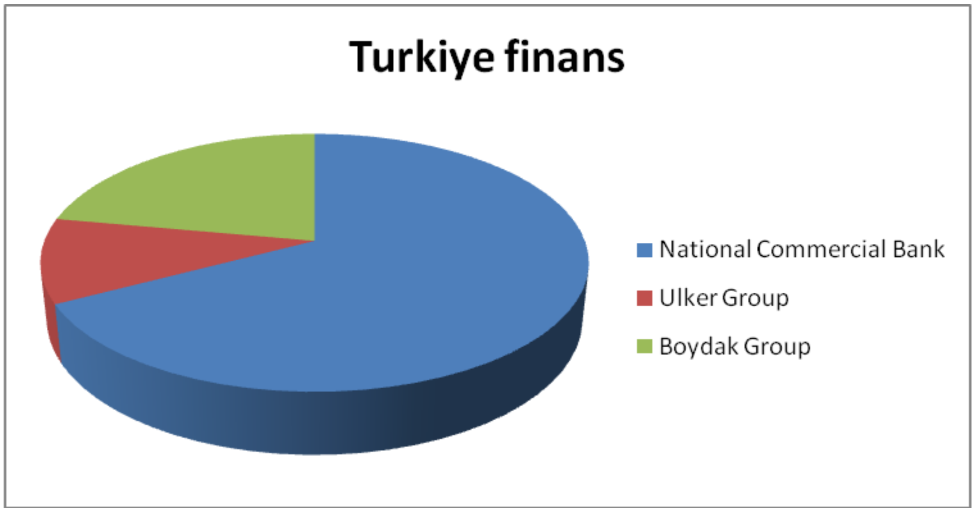
In 2005, the Boydak Group and the Ülker Group combined these two participation banks under a single roof. This union of strengths was undertaken in order to generate more value for Turkey and to bolster the competitive advantages of both entities.

The merger between Anadolu Finans and Family Finans was approved by the Banking Regulation and Supervision Agency (BRSA) on 28 December 2005. The name of the bank was changed to Türkiye Finans Katılım Bankası A.Ş. on 30 December 2005.

At the end of 2014, the total number of employees reached to 4478 employees in 280 branches across the country supported by alternative delivery channels. The Bank provide products and services to the commercial/corporate banking, enterprise banking and retail/personal banking segments.

In 2014 Turkiye finans`s frist Sustainability Report became the first and only report among Turkish deposit and participation banks to be rated A+ by the Global Reporting Initiative (GRI). In the same year Turkiye finans issued the first sukuk in Malaysian Ringgit, worth of MYR 800 million.

*Figure 2.1 Capital and Shareholder Structure*




**Source:** *Türkiye Finans , 2015.*

*Table 2.6 Turkiye Finans Financial Summary: Balance Sheet*

| (TL thousand) | 2014 | 2013 | Change (%) |
|---|---|---|---|
| **Assets** | **33,494,790** | **25,126,629** | **33.30** |
| Cash and Banks | 5,729,230 | 4,790,457 | 19.60 |
| Securities | 2,544,554 | 1,413,025 | 80.08 |
| Loans | 23,056.422 | 17,447,961 | 32.14 |
| Receivables from Leases | 1,235.541 | 841,649 | 46.80 |
| Fixed Assets (Net) | 466,741 | 248,838 | 87.57 |
| Other Assets | 462,302 | 384,699 | 20.17 |
| | | | |
| **Liabilities** | **33,494,790** | **25,126,629** | **33.30** |
| Funds Collected | 19,112,760 | 15,141,718 | 26.23 |
| -Special Current Accounts | 4,297,645 | 3,440,407 | 24.92 |
| -Participation Accounts | 14,815,115 | 11,701,311 | 26.61 |
| Loans Received | 8,569,415 | 5,166,009 | 65.88 |
| Shareholders' Equity | 3,153,847 | 2,522,381 | 25.03 |
| Paid-up Capital | 2,600,000 | 1,775,000 | 46.48 |
| Other Liabilities | 2,658,768 | 2,296,521 | 15.77 |
| | | | |
| Non-Cash Loans | 10,648,417 | 8,904,139 | 19.59 |

**33.3%**

Türkiye Finans' total assets increased by 33.3% when compared to 2013 to reach TL 33.5 billion.

Source: *Türkiye Finans , 2015.*

*Table 2.7 Turkiye Finans Financial Summary: Income Statement*

| Income and Expense Accounts | | | |
|---|---|---|---|
| Profit Share Income | 2,169.968 | 1,566,233 | 38.55 |
| Profit Share Expenses | -1,072,136 | -692,150 | 54.90 |
| Net Profit Share Income | 1,097,832 | 874,083 | 25.60 |
| Net Fee and Commission Income | 148,598 | 128,272 | 15.85 |
| Other Non-Profit Income | 196,858 | 179,911 | 9.42 |
| Non-Profit Share Expenses | -1,018,003 | -769,754 | 32.25 |
| Profit Before Tax | 425,285 | 412,512 | |
| Provision for Taxes | -91,057 | -83,235 | |
| Net Period Profit | 334,228 | 329,277 | |

Source: *Türkiye Finans , 2015*.

### *2.8.10.4.1. Social responsibility projects*

Turkiye finans take it as a social responsibility mission to protect and pass down the country’s cultural heritage and traditional values to the next generations, and derives pride in supporting the project that add values to our society. Below are some of the Sponsored Social Programs.

→ Kırpınar Oil Wrestling Sports Sponsorhip

→ Exhibition: “Dialogue in the Dark”

→ Anatolian Brand Competition

→ Down Café Project

→ International Mediterranean Games

#### 2.8.10.5. Ziraat Participation Bank

Ziraat Participation Bank, is Recently established by Ziraat Bankasi the Turkey state Bank with the full capital amount of 675.000.000,- TL was paid by the Turkish Treasury, was established with the consent of the Banking Regulation and Supervision Agency (BDDK), dated October 14th, 2015. The Bank has begun its operation by opening its first branch in 29 May 2015 Governance body of the bank in Istanbul.

Main operation field of the Bank is gathering funds by the accounts named as “Private Current Accounts” and “Participation Accounts to Profit and Loss” from domestic and abroad additional to its own capital and lending these funds to the economy, carrying up every kind of financing operations within the scope of legal legislation, promoting investment operations of real and corporate bodies that are making agricultural, industrial and commercial operations, participation in these operations, making up joint ventures and carrying out all these services and operations within the scope of participation banking fundamentals.

#### 2.8.10.6. Vakıf Participation Bank

Vakıf participation bank is another new bank which announced its present in Turkish market in 2016. Vakif participation bank started its operation with the totall amount of Capital 805.000.000 Tl under the Banking law of Republic Turkey. Vakif participation bank received its legal permission of Activity on 17.02.2016 from Banking Regulation and Supervision Agency.

The share holders of the banks are T.C Başbakanlık vakıflar Genel Müdürlüğü, Bayezid Han- ı sani (ıı.bayezid) vakfı, Mahmut Han-ı Evvel Bin Mustafa Han (ı.Mahmut) Vakfı, Mahmut Han-ı Sani Bin Abdulhamit Han-Evvel (ıı.Mahmut) Vakfı ve Murat Paşa Bin Abdusselam (Murat Paşa) Vakfı.

### 2.8.11 TKBB (Participation Banks Association of Turkey)

The participation Banks Association of Turkey (PBAT), headquartered in Istanbul and established in accordance with the Banking Act, is a professional public institution of legal personality.

The foundations of the PBAT, the umbrella organization of the participation banks operating in Turkey, where laid in 2001 by the Association of Special Finance institutions. The title of the Association was emended as Participation Banks Association of Turkey in 2005.

The aim of the PBAT is to defend the rights and interests of participation banks within the framework of a free market economy and the principle of full competition in accordance with banking regulations principles and rules, to work for the healthy growth of the banking system and development of the banking profession, increase competitiveness, ensure necessary decisions are taken for the creation of a competitive environment and prevent unfair competition, and implement and demand the implementation.

İn accordance with the legislation, participation banks become members of the participation Banks Association of Turkey within one month of being granted their permission to operate. As of the end of 2015, five participation banks were operating in Turkey, which are, Albaraka Turk, Kuveyt Turk, Asya Bank, Turkiye Finans and Ziraat Katilim, all of which were members of the PBAT.

### 2.8.12 Participation Banks Products And Services

Participation Banks Services are divided into two main categories; Retail Services and Commercial/Corporate Services. In this paper it’s not possible to explain all products but very important and useful products and services will explore as below.

**Retail Services:**

**Residence Financing**

With this Service Participation Bank helps their customer to buy/owned a house with long term installment payments.

**Features**

Customers who meet the necessary requirements for credit and income can enjoy this service.

You can pay your installments on a home within a 120 month term; you also have the option of paying bi-monthly, quarterly or with other flexible term.

There are no restrictions on the maturity of the building or home when financing.

Financing is available for up to 75 % of the appraised value of the home you are looking to purchase. (Appraisals will be made by an authorized company contracted by Albaraka.

**Profit Lost Accounts**

The most important distinction that sets participation accounts apart from others is that depositors are able to withdraw funds before maturity. Doing so does not change the maturity date of the interest-bearing account. At maturity, participation from profit sharing is added to the amount remaining in the account.

**Gold Accounts**

Gold account is a private current account which lets you purchase and sells gold by grams, as you purchase and sell FX. You can purchase and sell gold at daily quoted gold purchase and selling prices. Gold account is a private current account and you are not paid profit share for it. You can transfer gold from your gold account to other Bank gold accounts in branches.

**Education financing**

Participation Banks support Student Educational Needs in Undergraduate, graduate and postgraduate levels.

**Features**

Customers who meet the necessary credit and income requirements can take advantage of education financing from Albaraka

No fees or charges will be applied when installment payments are made through Albaraka without any fees or charges.

Late fees apply to payments made after payment due date.

Educational Financing is utilized when the repayment plan (tuition fee) is approved by the educational institution.

**Vehicle Financing**

Vehicle financing is another service of Participation Banks which helps the customer to buy the car they want.

**Features**

Installment period is up to 36 months; payment is bi-monthly or quarterly.

First Hand Vehicle is financed 80%, while second hand vehicles are financed between 40% - 70%.

**Consumer Financing**

This Service helps the customer to purchase Major appliances, like; computer, refrigerator, washing machine, dishwasher, furniture, television, and air condition.

**Features**

24 months Installment payment period, payment can be done monthly or quarterly.

Natural Gas Conversion Financing

This services Helps Customers to pay their gas payment by the bank and they repay the money to bank on installment payment for 24 months.

**Landing Finance**

In this Service Islamic Bank Help the Customer to buy/own land

**Features**

This financing is available for the purchase of zoned lands within municipal boundaries of our branches with up to 60 month payment plans available.

Transaction happens only in Turkish Lira

Financing is available only for zoned lands, Non-zoned lands are not included.

A maximum Term loan for landing is 60 months.

**Credit Cards**

Albaraka as other Islamic banks in Turkey provide Credit cards services without interest on timely payment, but if payment is due a fee will be added to the total amount.

**Lease Certificate**

A lease certificate is a security issued by an asset leasing company in order to finance the assets that are acquired or leased, and which entitles its holders to the revenues attained from such assets in proportion to their shares.

**Finansör**

Finansör is a special debit card which is limit, profit rate and number of installments are determined during your application and which enables purchase of goods and services from defined industries until expiry of the defined financing limit.

**Silver Accounts**

Silver Account is a type of drawing account enabling you to utilize your savings as silver and trade silver in grams whenever you want.

**Bank Cards**

With Bank Card Customer are able to use ATM machines 24/7, do shopping across the country, with Bank card customers are also able to withdraw different currencies; dollars, Euro etc from ATMs across the country.

**Commercial Cards**

Türkiye Finans Commercial Cards will secure payment and crediting transactions of dealers and retailers that purchase goods from your company.

**Bereket Card**

Bereket Cards Provides the advantage of free-of-charge transactions for payments and purchase of agricultural products such as wheat, cereals, and hazelnuts.

**Out of Branch Banking**

Out of Branch banking is those activities which customer can access to it anytime, anywhere they are, and those services are:

SWIFT
Internet Banking (Personal)
Internet Banking (Corporate)
Phone Banking
ATM Banking
EFT and Transfer
Safe Deposit Boxes

**Corporate Finance Support**

Corporate Finance Support is a Cash Credit Service is a service of participation banks, with cash credit customers can purchase the manufactured, semi-manufactured and raw materials they need for their small and medium investments and working capitals to ensure adequate cash flow, achieve income/expenditure balance and establish growth for their business. Corporate finance support is the purchasing of commodities, real estate and services by Albaraka on behalf of the customer; Albaraka directly compensates the seller and the customer repays the bank. Customer is debited at a predetermined term and rate of profit sharing and repays his or her debt in installments on predetermined dates.

**Financial Leasing**

Financial Leasing is a method of financing in which the ownership of investment properties such as machines, equipment, vehicles, computers, etc. remains with the financial leasing institution and the usage rights are given to the lessee in return for determined installments. Once the installments are paid off, the property is transferred to the lessee in return for the nominal price determined in the contract. Instead of buying the investment goods, the companies lease them, thereby allowing their circulating capital to meet their other needs. Consequently, leasing plays an important role in increasing efficiency and profitability.

**Profit Share Participation**

In the project, the borrower puts forth his labor and knowledge while the capital of the financed project belongs to the bank. Profit incurred in the project will be distributed according to rates previously agreed upon between the bank and the customer.

Credit Guarantee Fund (CGF) supports small and medium-sized enterprises (SMEs) that cannot find the necessary avalisation for financing by providing guarantees for them and enabling them to use bank credits for their investments and operations.

### Enterprise Finance

You may use Enterprise Finance in the purchase of inputs such as raw materials that your enterprise needs in production. In Enterprise Finance, you may use the limit defined for your company within the agreed term of maturity.

### Investment Services

With Participation banks, customers can turn their savings into investment. Secure a better future with lucrative investment solutions that are both aligned with economic conditions of the day and participation banking values.

Utilize savings in accordance with their preferences and needs, made possible by the expert staff of participation banks and its reliable infrastructure enabling to easily perform investment transactions online.

### Installment Commercial Finance

Installment Commercial Finance covers the financing of goods such as vehicles, workplace, and machinery, equipment that you acquire in order to develop the business of your enterprise or to make investments.

### Direct Collection System (DCS) / Direct Debiting System (DDS)

Being called as DCS or DDS, this system is the body of processes which enables companies operating on the basis of dealership system to securely manage their cash flow with the dealers affiliated to them by automatic file transfer system.

This system is based on the collection of invoice amounts from dealer accounts on invoice dates according to the invoice information electronically sent by parent company to the bank. In case of insufficient dealer account, the parent company is able to collect payments in time through goods finance within the scope of the DDS limits granted to the dealer.

**Cash loans**

Cash loans are available to meet the short-term or long-term financing requirements of your SME. Payments are agreed upon at the time of the contract and remain unchanged during the duration of your agreement.

**International transactions**

International Transactions are an important part of conducting business in today's market. For those firms that conduct such transactions, participation Banks offers many products and services to meet your needs. Among these are Letters of Guarantee, Exim Bank Letters of Guarantee, and Recommendatory Letters.

Through participation Banks, customers can obtain machinery, equipment, and various other goods both domestically and internationally via our leasing services.

**Other Services**

Cash Loans
Non-Cash Loans
International Business and Financing ( Import and Export)
Insurance Service
Letters of Guarantee
EximBank Guarantee letters
Letters of Credit
Acceptance Credit

## 2.9 Interest Free Capital Markets In Turkey: Islamic Bonds (Sukuk)

Accounting and Auditing Organization for Islamic Financial institutions (AAOIFI) describes Sukuk as follow: "Sukuk are certificates of equal value representing after closing subscription, the receipt of the value of the certificates and putting them to use as planned; thus, they represent common shares and rights in the underlines assets or their usufructs and services".

One of the Tradition debt instruments, sukuk has emerged as a result restructuring bonds so as to comply with the principles of interest free financing.

The most widely used structures of sukuk in the sukuk market are Murabaha, Musharaka, Ijara (Islamic Leasing), Wakala, Salam and hybrid.

Total Sukuk issuances worldwide in 2014 increased by 24.5% to stand at US$ 99.26 billion (US$ 79.9 billion in 2013). According to data published by S&P (Standard and Poor`s American Stock Market Index, Malaysia had a 67% share of the issuances carried out in 2014, followed by Saudi Arabia (10%shares) and the UAE (5%share).

Turkish sukuk accounted for 3% of the global new issuances in 2014, with a 4% share for Indonesia, 3% for Qatar and 2% for Bahrain, with other countries accounting for a 6% market share in total.

Sukuk, defined as lease certificates in Turkey, are securities that are issued by asset leasing companies for financing all kinds of assets and rights by various means and providing the owners the right to shares from the proceeds of these assets and rights.

With the new regulations in 2012, five types of internationally accepted sukuk have been identified in Turkey. Defined leasing Certificate (Sukuk) types are:

- sukuk based on ownership
- management agreements
- purchase and sale
- partnership
- the work contract

Asset leasing companies in Turkey have been provided with the opportunity to issue different types of sukuk simultaneously. Legislation to ensure the protection of the rights of investors in sukuk based on partnership and sukuk based on work contracts are given the opportunity to establish assets and the rights of pledge.

The first Sukuk implementation in Turkey was carried out by the Kuwait Turk participation Bank Inc. in 2012. Through this process, in which LMH (liquidity Management House) and Citibank acted as joint lead arrangers, Kuwait Turk introduced this financial instrument, which has a wide range of applications, especially in the Gulf region and Malaysia to Turkey.

Six participation banks operating in Turkey have demonstrated intense interest in the treasury's sukuk issuances. By the end of 2014, the sukuk issued by the under secretariat of the Treasury had a 5% share in the assets of participation banks.

Turkey becomes one of the top 10 sukuk issuers for the first time in 2013. As of the 3$^{rd}$ quarter of 2014, the issuances realized in Turkey amounted to US$ 2.98billion, while the total amount of sukuk traded in the market was close to US$ 8billion.

## 2.10 Islamic Insurance (Takaful)

Turkey, a new frontier market for takaful, is yet to see the entry of full-fledged takaful operators or even new takaful products by participation banks. Although Turkey remains a high-potential market for Islamic insurance in view of its large and young population, takaful`s supply-side constraints as well as limited legal infrastructure in the Islamic finance sector is hindering takaful market growth.

Turkeys insurance penetration rate is a low 1.4% (in 2012), and takaful activity is miniscule. There are two takaful companies in Turkey – Neoya and Asya Emeklilik – that together make up 0.39% of total insurance assets as of march 2013. Opportunities for takaful, hence, are aplenty, with a great need for market development. The sector would have to provide comprehensive training on takaful for industry-specific employees as well as raise public awareness of takaful. Insurers would need to introduce custom made products and explore alternative channels of distribution in order to increase the reach for takaful.

The market share of takaful in the GCC countries and Malaysia is 15% and 10% respectively, according to Ernst & young's world takaful Report 2012. The industry is likely to capture additional market share provided it matures and establishes stronger distribution capabilities.

## 2.11 Participation Banks Contribution To The Economy

Participation banking, the foundations of which were laid in Turkey in 1985, has demonstrated rapid growth in recent years. As of the end of 2014, Turkey's four participation banks had a share of around 6% in the Turkish banking sector. The total asset size of turkeys participation banking sector, consisting of Albaraka, Bank Asya, Kuveyt Turk and Turkiye finans, grew by 8% in 2014 exceed TL 104 billion. Two more participation banks were added to the Sector, Ziraat Katilim (2015) and Vakif Katilim (2016).

Participation banking is one of the pillars of the financial system of Turkey when the total size, market share reached at the end of 2014, strong penetration in different segments of the banking from SME to Corporate banking, the widespread network of branches and alternatives services in Turkey, the wide array of products and services, the growing employment levels and the continuous contribution to the sustainable growth of Turkeys economy of the 4 + 2 new participation banks operating in turkey are considered as a whole.

Turkish participation banks have rapidly consolidated their claim to the assets and competitiveness in the financial system, and have exhibited growth in excess of banking industry averages in recent years. On the other hand, participation banks successfully overcame the global financial crisis in 2008 and subsequent periods of volatility, and accelerated their growth after the crisis.

The market share of participation banks which was 4.0% of banking sector assets in 2009, increased to 6% at the end of 2015. During the 2009-2015 period, the compound annual growth rate of participation banking in total assets was 25-30%. An increasing rate of growth has also been observed in the volume of participation fund accounts since 2009.

The volume of participation funds collected shows that participation banks have increased both their transaction volume and their number of customer; with an average 20% rate of growth achieved in six years.

In the coming period, with the increase in number of banks and therefore the increase in the nationwide access to participation banks, the development in participation fund accounts is expected to gather pace.

According to an international study published by Ernst & Young, the market share of participation banking in 2023, which marks the 100$^{th}$ year of the Turkish Republic, is expected to reach 15%, with the size of total assets anticipated to approach US$ 180 billion.

Participation banks, in the last 15 years in Turkey have demonstrated a healthy performance. Participation banks have branched out in all geographic regions of Turkey, and succefully expanded to include a wide range of service coverage where GDP is generated and to offer the services to entire community.

*Table 2.8 Participation Banks in Turkey: Branches and Employees (2003-2015)*

**Participation Banks in Turkey: Branches and Employees (2003-2014)**

| Year | Number of Branches | Growth (%) | Number of Employees | Growth (%) |
|---|---|---|---|---|
| 2003 | 188 | 71 | 3,520 | 61 |
| 2004 | 255 | 36 | 4,789 | 36 |
| 2005 | 290 | 14 | 5,740 | 20 |
| 2006 | 355 | 22 | 7,114 | 24 |
| 2007 | 422 | 19 | 9,215 | 30 |
| 2008 | 530 | 26 | 11,022 | 20 |
| 2009 | 569 | 7 | 11,802 | 7 |
| 2010 | 607 | 7 | 12,677 | 7 |
| 2011 | 685 | 13 | 13,851 | 9 |
| 2012 | 828 | 21 | 15,356 | 11 |
| 2013 | 966 | 17 | 16,763 | 9 |
| 2014 | 990 | 2 | 16,270 | -3.1 |

Source: PBAT, BRSA

**Source**: *Participation Banks Association of Turkey, 2015*

By the end of 2014, four participation banks had a total of 990 branches plus four branches abroad, with opening of first state owned participation bank in 2015 and Vakıfbank participation bank in 2016 in Turkey. Participation banks have opened a total of 25 new branches during the year 2014. The total number of branches of participation banks has increased at a CAGR of 12.1% since 2009. The number of employees in the sector has increased steadily since 2009, growing at an annual average rate of 6.6%. A total of 16,270 people were employed in participation banks as of 2014, the 2.5% increase recorded in the total number of participation bank branches was 0.6 percentage points higher than the 1.9% rate of growth in the overall Turkish banking sector, indicating that the sector continued its rapid and healthy growth.

*Table 2.9 Participation Banks In Turkey: Total Assets and Postion in the Banking Sector*

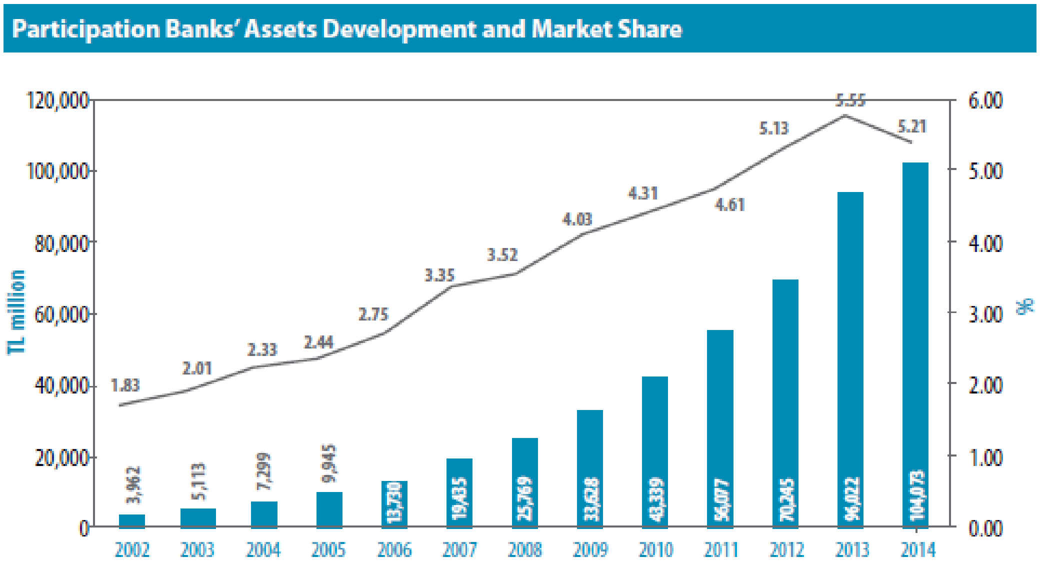
| Participation Banks in Turkey: Total Assets and Position in the Banking Sector (TL million, 2011-2014) | | | |
|---|---|---|---|
| | Total Assets | Change % | Share % |
| 2011 | 56,077 | 29.4 | 4.6 |
| 2012 | 70,245 | 25.3 | 5.1 |
| 2013 | 96,022 | 36.7 | 5.5 |
| 2014 | 104,073 | 8 | 5.2 |

**Source**: *Participation Banks Association of Turkey, 2015*

On the other hand, with the sustainable growth potential, Turkey's participation banking sector is expected to attract private domestic and foreign conventional banks in the medium and long term, in this case, it will trigger further expansion of the branch network and employment of participation banks.

The increase in the volume of funds that participation banks extended to the real sector also continued to grow. While the industry average was 4% the volume of funds extended by the three participation banks (excluding the bank transferred to the fund) to their customers increased by approximately 32%.

*Table 2.10 Source: Participation Banks' Assets Development and Market Share*




**Source**: *Participation Banks Association of Turkey, 2015*

The average of the rate of growth of the three participation banks, in both bunds collected and in funds extended, exceeded the over age rate of growth in deposits and loans of the Turkish banking sector in 2014. While the Turkish banking sector as a whole recorded an 11.3% rate of growth in deposits and an 18.8% increase in loan volumes in 2014, the volume of funds collected and extended by all three members of the participation banking sector grew at rates exceeding the banking sector average by 18.7% and 13.2% percentage points, respectively.

Participation banks sustained their growth trend at the top of the banking sector in terms of total assets as well. While the participation banking sector recorded as a whole an 8% rate of asset growth, the average rate of growth stood at 33%, when the contraction in the participation bank which had been transferred to the SDIF is excluded. This growth rate is 17 percentage points above the 15.1% rate calculated for the entire banking sector.

In parallel with the growth of participation banking in Turkey, New products have also been released to the market. Lease certificates, otherwise known as sukuk in the international arena, are one such product. The first sukuk issuance in Turkey was held by the Kuveyt Turk participation bank inc. in 2010. The issuance, with a 3 year maturity and nominal amount of US$ 100 million, received a high level of demand. In 2012, the first sukuk issuance was carried out by the treasury. In 2013, the issuance of sukuk based on the building contract (istisna), trading (Murabaha), partnership (Musharaka) and management agreement (ihara) were permitted.

## 2.12 Islamic Finance Awareness and Education

Islamic finance awareness and education is vital to the industry's development in any country. With the growth of the industry there is an increasing demand for proficient industry specific human capital. More mature Islamic finance countries such as Malaysia and Bahrain have developed education, training and awareness programs to ensure positive market development to drive the growing Islamic finance ecosystem. Bahrain alone has 51 courses in Islamic finance; this includes vocational training sessions, educational courses and university degrees. (Bank Negara Malaysia, 2015)

Islamic finance awareness and education in Turkey is largely undertaken by industry-specific organizations such as the Participation Banks Association of Turkey (TKBB), which organizes conferences and workshops. Recognizing the need to formally drive the development of Turkey's human capital in Islamic finance the Turkish central bank has been working with Kuala Lumpur-based INCEIF – the Global University for Islamic Finance Since mid-2012 to build Turkey's Islamic finance education infrastructure. Several Islamic finances related education and vocation initiatives have been introduced by a number of private institutions and local universities. For example, there are short courses offered by Fatih Sultan Mehmet Vakif University (FSMWU), which, since early 2012, has been working with the Islamic Banking and Finance Center-UK (IBFC-UK), a member organization of the UK Islamic Finance Secretariat (UKIFS). FSMWU was established in 2010 and supported by the 543-year old Fatih Sultan Mehmet Waqf. It is based in Istanbul. Other universities such as Istanbul Sabahattin Zaim University (ISZU), has a dedicated research and study center for Islamic economics and finance. ISZU was also established by a Waqf, namely the science Dissemination Foundation. (Liam, 2012)

# CHAPTER THREE: EFFICIENCY ANALYSIS IN ISLAMIC BANKS AND COMMERCIAL BANKS OF TURKEY

## 3. Introduction

In this chapter efficiency analysis has been conducted for Islamic banks and commercial banks in Turkey, to show which financial sector is more effective. Data from 29 banks' balance sheet is used, 3 of which are Islamic banks and 26 of which are commercial banks operating in Turkey from years 2010-2015, to analyze the efficiency of two sectors. Data Envelop Analysis (DEA) method is used for measuring efficiency. It has been found that for income per employee and income per branch scale, Islamic banks are more efficient in 2010, 2012,2013,2014 and 2015, and in 2011 commercial banks are more efficient with a small difference.

### 3.1. Methods: Data Envelopment Analysis

DEA is a method through which performance is measured. The main purpose of performance measurement is to increase efficiency. Performance measurement provides organizations with information regarding what additional improvements should be made to attain the best performance in efficiency. (Thanassoulis, 2003)

Data Envelopment Analysis (DEA) is an increasingly popular management tool. DEA is commonly used to evaluate the efficiency of a number of producers. A typical statistical approach is characterized as a central tendency approach and it evaluates producers relative to an average producer in contrast, DEA compares each producer with only the "best" producers. By the way, in the DEA literature, a producer is usually referred to as a decision-making unit or DMU. DEA is not always the right tool for a problem but is appropriate in certain cases.

In DEA, there are a number of producers. The production process for each producer is to take a set of inputs and produce a set of outputs. Each producer has varying level of inputs and gives a varying level of outputs. For instance, consider a set of banks. Each bank has a certain number of tellers, a certain square footage of space, and a certain number of managers (the inputs). There are a number of measures of the output of a bank, including number of checks cashed, number of loan applications processed, and so on (the output). DEA attempts to determine which of the banks are most efficient, and to point out specific inefficiencies of the other banks.

A fundamental Assumption behind this method is that if a given producer, A, is capable of producing Y(A) units of output with X(A) inputs, then other producers should also be able to do the same if they were to operate efficiently. Similarly, if producer B is capable of producing Y(B) units of output with X(B)inputs, the other producers should also be capable of the same production schedule. Producers A, B, and others can then be combined to form a composite producer with composite inputs and composite outputs. Since this composite producer does not necessarily exist, it is typically called a virtual producer.

The heart of the analysis lies in finding the “best” virtual producer for each real producer. If the virtual producer is better than the original producer by either making more output with the same input or making the same output with less input, then the original producer is inefficient. The subtleties of DEA are introducer in the various ways that producers A and B can be scaled up or down and combined.

Since DEA in its present form was first introduced in 1978, researchers in a number of fields have quickly recognized that it is an excellent and easily used methodology for modeling operational processes for performance evaluations. This has been accompanied by other developments. For instance, Zhu (2002) provides a number of DEA spreadsheet models that can be used in performance evaluation and benchmarking. DEAs empirical orientation and the absence of a need for the numerous *a priori* assumptions that accompany other approaches (such as standard forms of statistical regression analysis) have resulted in its use in a number of studies involving efficient frontier estimation in the governmental and nonprofit sector, in the regulated sector, and in the private sector. See, for instance, the use of DEA to guide removal of the Diet and other government agencies from Tokyo to locate a new capital in Japan, as described in Takamura and Tone (2003).

In their originating study Charnes, Cooper, and Rhodes (1978) described DEA as a 'mathematical Programming Model applied to observational data [that] provides a new way of obtaining empirical estimates of relations such as the production functions and/or efficient production possibility surfaces- that are cornerstones of modern economics'. (William W. Cooper, 1990)

## 3.2. How Does Data Envelopment Aanalysis Work

To illustrate how DEA works, let's take an example of three banks. Each bank has exactly 10 tellers (the only input), and we measure a bank based on two outputs: checks cashed and loan applications. The data for these banks is as follow:

- Bank A: 10 tellers, 1000checks, 20 loan applications
- Bank B: 10 tellers, 400 checks, 50 loan applications
- Bank C: 10 tellers, 200 checks, 150 loan applications

Now, the key to DEA is to determine whether we can create a virtual bank that is better than one or more of the real banks. Any such dominated bank will be an inefficient bank.

Consider trying to create a virtual bank that is better than Bank A. such a bank would use no more inputs than A (10 tellers), and produce at least as much output (1000 checks and 20 loans). Clearly, no combination of banks B and C can possibly do that. Bank A is therefore deemed to be efficient. Bank C is in the same situation.

However, consider bank B. If we take half of Bank A and combine it with half of Bank C, then we create a bank that processes 600 checks and 85 loan applications with just

10 tellers. This dominates B (we would much rather have the virtual bank we created than bank B). Bank B is therefore inefficient.

Another way to see this is that we can scale down the inputs to B (the tellers) and still have at least as much output. If we assume (and we do), that inputs are linearly scalable, then we estimate that we can get by with 6.3 teller. We do that by taking .34 times bank A plus .29 times bank B. The result uses 6.3 tellers and produces at least as much as bank B does. We say that bank B's efficiency rating is .63. Banks A and C have an efficiency rating of 1. (seiford, 1990)

## 3.3. Strenght and Limitations of DEA

It is suggested that DEA can be a powerful tool when used wisely. A few of the characteristics that make it powerful are:

- DEA can handle multiple inputs and multiple output models.
- It does not require an assumption of a functional form relating inputs to outputs.
- DMUs are directly compared against a peer or combination of peers.
- Inputs and outputs can have very different units. For example, X1 could be in units of lives saved and X2 could be in units of dollars without requiring an a priori tradeoff between the same characteristics that make DEA a powerful tool can also create problems. An analyst should keep these limitations in mind when choosing whether or not to use DEA.
- Since DEA is an extreme point technique, noise (even symmetrical noise with zero mean) such as measurement error can cause significant problems.
- DEA is good at estimating "relative" efficiency of a DMU but is converges very slowly to "absolute" efficiency. (William W. Cooper, 1990)

## 3.4. Data

There are 6 banks that operate according to Islamic principles while 52 commercial banks are operating in Turkey as of the moment of this study (2016). In this study, uninterrupted data from 3 participation banks and 26 commercial banks have been used to scale the efficiency analysis of the two sectors. Commercial banks include; Government owned banks, private banks and foreign banks operating in Turkey. Data was collected from the financial statements of the banks published in Turkish Banks Association (TBB) website. The study analyzes the efficiency for 6 years between 2010 and 2015. Financial institutions were not included not to harm homogeneity. Table 3.11. shows the banks included in the Sample.

*Table 3.1: List of Participation and commercial banks included in study.*

| *Participation Banks* | *Commercial Banks* | |
|---|---|---|
| *Albaraka Türk* | Deutsche Bank A.Ş. | Türkiye Vakıflar Bankası T.A.O. |
| *Türkiye Finans* | Burgan Bank A.Ş. | Habib Bank Limited |
| *Kuvyet Türk* | Bank Mellat | Société Générale (SA) |
| | ICBC Turkey Bank A.Ş. | Anadolubank A.Ş. |
| | Türkiye Halk Bankası A.Ş. | Şekerbank T.A.Ş. |
| | Denizbank A.Ş. | HSBC Bank A.Ş. |
| | Türkiye Garanti Bankası A.Ş. | Alternatifbank A.Ş. |
| | Yapı ve Kredi Bankası A.Ş. | Türk Ekonomi Bankası A.Ş. |
| | The Royal Bank of Scotland Plc. | ING Bank A.Ş. |
| | Türkiye Cumhuriyeti Ziraat Banka | Turkland Bank A.Ş. |
| | Finans Bank A.Ş. | Citibank A.Ş. |
| | Türkiye İş Bankası A.Ş. | Turkish Bank A.Ş. |
| | Akbank T.A.Ş. | |
| | Arap Türk Bankası A.Ş. | |

In the study, leverage ratio, nonperforming loans to total loans ratio and loan to deposit ratio are used as inputs, and income per employee, income per branch and return on equity are used as the output.

*Table 3.2. Input and output*

| Period | Inputs | Outputs | Method |
|---|---|---|---|
| **2010 – 2015** | • Leverage Ratio<br>• NPL to total loans Ratio<br>• Loan To deposit Ratio | • Income Per Employee<br>• Income Per Branch<br>• Return On Equity | DEA (Data Envelopment Analysis) |

Only uninterrupted data is selected for the study, banks with the interrupted data are excluded from the study. Asya Bank with no data in recent years is excluded from the study.

## 3.5. Finding

The application was addressed to find out which banking sector is more efficient using data envelopment analysis. The efficiency scale is between 0 and 100. The closer to 100 the more efficient; the more closer to 0 the more inefficient. As a result, the application obtains that participation banks are more efficient in income per employee, per branch and return on equity filed between 2010 – 2015. According to the sample commercial banking sector is efficient in only 2011 with 43.01 score, where Participation banks is 42.2.

The result also shows that there are 4 inefficient commercial banks. They are HSBC Bank, Société Générale (SA), Burgan Bank and Turkish Bank, were all three participation banks are efficient. Table 3.13 shows these results.

*Table 3.3. Efficiency scores of participation banks and commercial bank*

| Unit name | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|---|
| Albaraka Türk katılım Bankası | 100 | 90.06 | 100 | 100 | 100 | 100 |
| Türkiye Finans Katılım Bankası | 98.99 | 45.7 | 85.39 | 100 | 92 | 84.81 |
| Kuveyt Türk Katılım Bankası | 87.46 | 39.82 | 72.46 | 79.79 | 80.74 | 72.43 |
| ICBC Turkey Bank A.Ş. | 100 | 100 | 100 | 100 | 100 | 100 |
| Deutsche Bank A.Ş. | 100 | 100 | 100 | 100 | 100 | 100 |
| Türkiye Cumhuriyeti Ziraat Banka | 100 | 100 | 100 | 100 | 100 | 100 |
| Türk Ekonomi Bankası A.Ş. | 100 | 67.07 | 100 | 100 | 100 | 100 |
| Akbank T.A.Ş. | 100 | 65.27 | 100 | 100 | 100 | 100 |
| Arap Türk Bankası A.Ş. | 100 | 51.19 | 99.25 | 100 | 100 | 100 |
| Burgan Bank A.Ş. | 100 | 47.42 | 98.12 | 100 | 97.03 | 100 |
| Habib Bank Limited | 100 | 47.23 | 91.22 | 100 | 95.43 | 100 |
| Bank Mellat | 100 | 46.79 | 88.33 | 100 | 93.09 | 89.01 |
| Türkiye Halk Bankası A.Ş. | 90.74 | 43.63 | 83.33 | 100 | 91.94 | 81.43 |
| Türkiye İş Bankası A.Ş. | 90.69 | 43.11 | 81.48 | 93.13 | 85.96 | 78.76 |
| Türkiye Garanti Bankası A.Ş. | 89.95 | 42.05 | 80.21 | 92 | 83.69 | 76.74 |
| Denizbank A.Ş. | 89.48 | 40.55 | 74.79 | 87.57 | 82.04 | 74.34 |
| Yapı ve Kredi Bankası A.Ş. | 87.43 | 38.85 | 69.63 | 77.8 | 80.52 | 67.43 |
| Citibank A.Ş. | 81.36 | 37.79 | 59.29 | 73.35 | 72 | 64.57 |
| Anadolubank A.Ş. | 79.74 | 34.15 | 59.12 | 73.18 | 71.41 | 60.94 |
| ING Bank A.Ş. | 79.4 | 32.09 | 57.83 | 71.75 | 70.51 | 59.11 |
| Şekerbank T.A.Ş. | 71.96 | 30.76 | 54.33 | 68.79 | 66.79 | 55.68 |
| Finans Bank A.Ş. | 71.07 | 28.96 | 50.31 | 64.19 | 66.63 | 55.06 |
| Türkiye Vakıflar Bankası T.A.O. | 69.53 | 25.23 | 49.01 | 62.36 | 65.18 | 53.71 |
| HSBC Bank A.Ş. | 68.63 | 16.34 | 40.11 | 60.06 | 34.21 | 50.88 |
| Turkish Bank A.Ş. | 59.78 | 14.23 | 34.38 | 57.93 | 30.55 | 47.11 |
| Alternatifbank A.Ş. | 56.25 | 10.07 | 28.44 | 40.79 | 29.53 | 46.69 |
| Turkland Bank A.Ş. | 55.43 | 3.19 | 16.59 | 37.82 | 6.85 | 30.59 |
| Société Générale (SA) | 52.03 | 1.78 | 6.21 | 29.55 | 0.07 | 15.76 |
| The Royal Bank of Scotland Plc. | 44.82 | 1.53 | 4.44 | 0.08 | 0.07 | 0.14 |

Albaraka Türk, among other participation banks is more efficient in average. It also shows that participation banks were more efficient in 2010, 2014 and 2015 compared to other years.

In the study the average of every year of participation banks and commercial banks is taken, to be able to analyze better which sector was more efficient according to the output we chose for the study.

*Table 3.4. Average efficiency*

| | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|---|
| **Participation Banks** | 95.5 | 42.2 | 81.11 | 83.19 | 84 | 85.48 |
| **Commercial Banks** | 82.24 | 43.01 | 66.95 | 77.71 | 80 | 69.56 |

Thus, when we look at the average of each year efficiency scores the participation banks are more efficient than the commercial banks, in 2010. Participation banks efficiency score is 95.5, where commercial banks efficiency score is only 82.24. This shows that participation banks were very efficient in general in financial sector and it was efficient compared to commercial banks too. Commercial banks on the other hands are quite efficient in general, but less efficient compared to participation banks.

In 2011, a reduction in efficiency is identified for both participation banks and commercial banks. In this year commercial banks with 43.01 average efficiency score are more efficient than participation banks. In 2012, participation banks keep its high score of efficiency, where commercial banks kept their inefficiency. In 2013 both sectors had higher efficiency scores. The participation banks increased to 83.19 from 81 percent in 2013, and commercial banks efficiency score increased from 66.95 in 2012 to 77.71 in 2013. Participation banks were comparatively more efficient in this year too.

Participation banks kept its efficiency in 2014 and 2015 as well, where commercial banks reflected an inconstant trend. The efficiency score of commercial banks in 2014 was 80, whereas it decreased to 69 in 2015. Participation banks were more efficient compared to commercial banks in both years.

Participation banks, despite its new market and system, have been perfoming well recently globally. Turkey, compared to some other Muslim majority countries is new to Islamic financial system though Islamic finance has had sucessful outcomes in Turkish society as observed in this study. The study results show that participation banks in Turkey are more efficient compared to conventional banks in terms of income per employee, income per branch and return on equity.

## 3.6. Conclusion and Recommendation

Islamic finance has been growing very fast for the last 10 years. Today Islamic finance has crossed the Arabic countries' and Muslim countries' boundaries and become an important system for western counties to think about. Islamic financial system that we mention about started in 1960s. Today Islamic finance is operating in almost 80 countries with approximately 2 trillion Dollars of assets. After the good performance of Islamic financial institutions in 2008 crises, Islamic finance has become a debatable system worldwide. New banks and financial institutions started working in America and Europe, Conventional banks opened Islamic finance windows. On the other hand England and Hong Kong have been making preparations to become Islamic finance centers.

Islamic financial system is not only profit-earning organizations like conventional financial systems, but Islamic finance is a system based on Islamic laws, ethics, social responsibilities, and justice. Islamic finance services and products must be according to Islamic principles. Islamic financial system forbidden all those acts which harms human beings, such as interest, manipulation, dharar, gambling, over expenditures, and all those acts which harm human and society.

Islamic financial system is not limited system only to Muslims and Muslim majority countries but this system is applicable for all the humanity. Among the things that Islamic financial system function, we can list followings: Islamic financial system promote equal distribution of wealth approach. According to Islamic finance all humans are siblings and should have equal rights to wealth. By doing this, the distance between very poor and very rich person will decrease. Islamic financial system is responsible for society development through promoting small and medium enterprises. And Islamic financial institutions responsibility is to give hands to poor people through Zakat and Sadaqa systems.

Islamic financial system from 1960s has been developing new models and financial products, which are customer-friendly and according to Islamic principles. The famous models used for partnership is Musharikah, for entrepreneurship and business Islamic finance use Mudaraba. For leasing and rent Islamic finance used Ijara, for prepaid transactions Istisna, in Capital Market Islamic finance use Sukuk model for buying and selling Islamic bonds and Takaful for Islamic Insurance.

Islamic finance practices started late 80s in Turkey. After a new law in 1983 Islamic finance started operations under name of Private finance house. In 2005, with a new law the Islamic Institutions are renamed as participation bank. Today Islamic banking and finance in Turkey is called participation banking. Turkey is house for 6 participation banks; two of them started operation recently, Ziraat Katılım bank (2015), Vakif KatılımBank (2016). Participation banks' total assets reach to approximately 70,00 billion US dollars in Turkey, which is almost 6% of the total financial sector. It's predicted that this percentage will increase to 15% by 2023. Islamic finance growth rate in Turkey is two times better than conventional banking. The data from 2005-2012 shows that the growth of Islamic financial institutions were 32% where conventional banks growth were only 19%. This shows that Islamic Finance has a better future in Turkey.

In this thesis, we found that participation banks are more efficient than conventional banks for the period analysed. We came to this result after collecting 6 years' data from both; Islamic banks and conventional banks' financial statements. Data Envelopment

Analysis was used to analyze the efficiency of both sectors. We have had three outcomes from this study. First, participation banking sector is more efficient in income per employee This means per staff efficiency in participation banking sector is better than conventional banking sector. Second, participation banks branches show better performance than conventional banks. Participation banks are more efficient in earning profit from each branch compared to conventional banks. Third, participation banks are more efficient in return on equity compared to conventional banks. This means that participation banks make more return from their invested equity compared to conventional banks.

Fast development of Islamic finance in the world **is** effecting Turkeys Islamic finance growth as well. Turkey has had good achievements in participation banking sector in the last 10 years. The current government of Turkey is promoting Islamic finance in Turkey. However, there is still a lot to do in Islamic Capital Market part as well as the training and education about the Islamic finance. Government and participation banks association should support and encourage new departments and content in universities and every possible platform to accelerate the development of Islamic finance.

Turkey is late in Islamic capital markets. Countries like Malaysia, Saudi Arabia, UAE, and Bahrain are making a big income from Islamic Capital market. Turkey issued its first Sukuk, in 2012, followed by another in 2013. Islamic Insurance (Takaful) is not developed in Turkey yet. There are only two institutions which provide Islamic insurance (Takaful) services. The reason why especially takaful (Islamic insurance) is not developed in Turkey might be a topic for another research paper. Islamic finance and banking education and awareness is another research topic to find out how much Islamic finance is known in Turkey.

This efficiency analysis can be done from different points of views by using different inputs and outputs as well. Another action which would complete the picture and contribute to form a sound knowledge and literature about efficiency of Islamic banking in Turkey can be repeating this analysis for different time periods both earlier and later. Comparing the efficiency of the sector in Turkey and in other countries where there are spread and developed Islamic finance sector would provide another sound knowledge for the literature.

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