

Private banking potential for Turkish participation banks

AHMET BICER examines the situation of the private banking business in Turkey and focuses on the potential for Islamic banks (participation banks) in the country.

Private banking can be defined as a combination of traditional banking and investment-related advisory services, such as accounting/tax services and legal/property planning, offered to high net worth individuals (HNWIs) through specialized advisors. Today, in addition to the basic services such as growing existing wealth and providing tailored financial solutions, the range of products and services offered by private banks is moving towards planning for a favorable retirement and conveying wealth to the next generation.

Private banking, dealing with high quality financial and related services to HNWIs on a personal and tailored basis, has an exclusive place in the financial services sector. Although private bankers have spent three years coping with serious difficulties which emerged just after the global financial storm in 2008, it seems that there has been a remarkable increase in private banking asset size over the last decade.

Today, the total amount of investable assets at the disposal of HNWIs is estimated to be around US\$40 trillion with a population of approximately 10 million. Such substantial growth may explain why many global and local banks have targeted more HNWIs and focused on designing new strategies to grab a sufficient piece of this pie. To this end, having reasonable market segmentation and offering proper products with a high service quality to targeted individuals are critical issues for industry players.

In Turkey, a HNWI is described as a person having investable and liquid assets above TRL1 million (US\$613,000) whereas this threshold is accepted as US\$1 million globally. Thus, the base amount for HNWIs is accepted as TRL1 million in this article.

Private banking

In parallel to Turkey's impressive economic performance, the banking sector as a whole has demonstrated substantial growth in recent years. However, the private banking segment in

Turkey remains relatively small, although the number and wealth of HNWIs have increased significantly according to the Banking Regulation and Supervision Agency's (BRSA) latest report. The report states that 47% of the total domestic deposits has been composed of accounts exceeding TRL1 million, while the total amount of these accounts reached almost TRL286 billion (US\$180 billion) increasing by 27% on a year-on-year basis, as of March 2011.

For the same period, the number of HNWIs also rose by 17%, reaching 36,210. It is also estimated (based on IMF and World Bank Economic Outlook Reports) that Turkey will have a greater growth rate in volume and number than Central and Eastern Europe, and BRIC countries, in the future.

All the recent data and projections indicate that private banking in Turkey has great potential. In order to obtain a significant share from this segment, some major conventional players in the sector have started offering some sophisticated and personalized products and services in addition to traditional banking services.

Private banking and participation banks

Participation banks have been outperforming the banking sector averages in the Turkish market with considerable growth rates which are also linked to a widening customer base. However, the participation banks' private banking activities have been somewhat limited compared to other conventional banks.

There are some explicative and convincing excuses from the point of participation banks, which are briefly mentioned and analyzed below.

Firstly, Turkish participation banks have registered a remarkable growth in size and a thriving penetration in the country since 2003. In this expansion period, these banks have naturally prioritized increases in their balance sheet items

such as asset size, loan and deposit volumes in the most practical way, such as opening new combined branches instead of specialized ones like private banking branches, in order to reach economy of scale to compete with their conventional counterparts.

Secondly, entering new areas of business has a cost aspect and, in most cases, there are no guarantees that it will succeed. This reality means that Turkish participation banks have had relatively limited capacity to reach financial resources and to generate more profit from going forward to new areas of the sector in which initial costs are high for the short-term.

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Thirdly, the Turkish participation banking sector has a very short history compared with conventional banking. This has restrained participation banks from having various Shariah compliant investment products and ultimately developing depth in the interest-free financial sector.

On the other hand, I believe that Turkish participation banks have strong private banking potential despite these factors. Indeed, participation banks have had significant growth in recent years and it

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seems that this trend is likely to continue. Correspondingly, there are some positive factors that can stimulate them to initiate private banking business in the Turkish interest-free banking industry. These can be summarized as follows:

- 1) It seems that participation banks are ready for private banking with their advanced technological infrastructure, high quality human resources, innovative approaches and large branch network.
- 2) In order to have an attractive and interest-free banking sector, regulatory bodies of Turkey have become more supportive for new products, such as Sukuk, Ijarah certificates and exchange-traded funds (ETF's). Therefore, participation banks have a variety of investment instruments for their potential private banking costumers.
- 3) The Turkish government has plans to make Istanbul an international financial hub in the next few years. To this end, the related governmental bodies have shown an impressive performance so far in preparing prepare the legislative framework and convincing global and local players. Today, after the ruling party won the general election on the 12th June, it is expected that the government will maintain its strong momentum towards achieving this goal.

Private banking potential

I agree with the idea that designing a Shariah compliant private banking system that can wholly match the products and yields of conventional banking may have its challenges. However, the general trend is toward using interest-free banking products more often, and thus, it can be argued that there is a demand for Islamic private banking in Turkey. In order to understand this potential, the target market should be analyzed on two segments: local costumers and foreign costumers.

Regarding local customer potential, participation banks have some advantages now compared to the past. Today, many analysts claim that socio-economic changes and trends support the idea that the client base preferring Shariah compliant products is widening.

In addition to the banks' gradual

penetration in the country, participation banking has a brand familiarity in the minds of these newly emerged wealthy people. Therefore, it is inevitable that participation banks will be catering to a wealthier and more conservative group of individuals who are essential to initiate private banking services.

Furthermore, besides traditional private banking products and services, some new innovative services like inheritance and donation planning are expected to be attractive for these individuals who are already inclined to make donations and to join in various social responsibility organizations.

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Concerning foreign customer potential for Islamic private banking in Turkey, I may suggest that the main target market for participation banks planning to offer private banking products and services should be GCC HNWI's, due to their tremendous wealth: estimated at US\$1 trillion and expected to grow in the coming years; and their increasing preference for Islamic offerings over conventional products.

In recent years, there have been some remarkable developments in Turkey to attract GCC companies and individuals. Firstly, government bodies have been reflecting a high level of desire to draw foreign investors — especially GCC investors — to the country, and to ease the procedures for them by adapting related legislation and preparing required infrastructure.

Secondly, Turkey's national economy has been performing very well after the last global crisis by growing in almost all sectors. Turkish companies naturally

have been benefiting from this growth and correspondingly the number of companies which are suitable for foreign investment has been increasing.

Today, most global funds (venture capital funds, private equity funds, pension funds and such) are trying to catch investment opportunities especially in the energy, retail, food and property development/construction sectors.

Thirdly, the Turkish real estate sector, which significantly stepped forward in last decade, is offering attractive opportunities for GCC investors; who have an insatiable appetite for investment in property development projects, while European and US real estate markets are still suffering from the negative effects of the recent economic crisis.

Fourthly, the Turkish private tourism sector, realizing the necessity of suitable facilities for GCC individuals, has recently developed new projects for their special needs so as to attract them to Turkey for their vacations as well as for their investments.

Conclusion

I believe that the local private banking potential for participation banks is expanding in parallel with the growing wealthy and conservative population, increasing familiarity and innovative approach.

However, it seems that this expansion will be gradual and relatively slow depending on the rate of generation of new products and services.

On the other hand, foreign investors — whether corporates or individuals — are showing more potential from which satisfactory results can be achieved in a short period.

Particularly, GCC investors and HNWI's, who already have private banking services in their own countries, hold significant potential for Turkish participation banks, if they are able to provide high quality and satisfactory services. ☺

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