DEVELOPMENT OF ISLAMIC BANKING IN TURKEY

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Abstract

While the financial world is still dominated by conventional banks, based on western economic principles, the number of Islamic banks is on the rise. Islamic banks have originated from colonial India as a response of the Muslims to the British who attempted to westernize their society. Other similar financial operations based on Islamic Law (Shari'a) were established in Pakistan, Malaysia and Egypt to facilitate access of rural poor to interest-free loans. However, being unprofitable, these operations did not survive for very long. Islamic banks, unlike conventional banks, are not based on interest and conduct their business in accordance with a wide array of ethical and moral issues.

The modern phase of Islamic banking started in the 1970s when the Islamic Development Bank was founded in Saudi Arabia. Soon after, a number of commercial banks were established in the neighboring countries. From this core, over the last four decades, Islamic finance and banking has spread across the entire Muslim world and beyond to become a global phenomenon.

This study examines the development of Islamic banking in Turkey in the wider context of global expansion. Turkey is an interesting case study because, although its population is nearly 100% Muslim, it is a secular state built on the model of Western European countries. However, lately, the moderate Islamic party in power since 2002 has shown some signs of openness towards a parallel banking system based on Islamic principles.

Keywords: *Islamic banking, participation banks, Turkey*

JEL Classification : *D39, E49, F69, G21*

1. Introduction

The roots of Islamic banking model can be traced to colonial India [37], [24]. The small interest-free financial operations established there on Islamic principles were meant to be a response of the Muslims to the British who attempted to westernize their society. At the time, Islamic economics was not yet established to provide an alternative to conventional (western) economics so, in essence, the first banking operations based on the Shari'a principles have emerged to strengthen Islamic identity because, according to Timur Kuran [37], westernization was weakening the influence of Islam on personal and social life.

Other interest-free financial projects were later established in the rural areas of Pakistan, Malaysia and Egypt in the 1950s and 1960s [55]. They attempted to provide loans and financial services to the poor who had no access to conventional banks in order to create a more just and equitable society. In Pakistan, in the late 1950s rural landlords created an interest-free credit network system to loan money to the farmers in need. Similarly, in Egypt, the Mit Ghamr Bank was created to loan money to poor people in the countryside who did not have access to conventional banks. Though its charter did not refer to Islam, its investments and trading projects were operated according to Islamic principles. Both projects failed, however, after a few years due to insufficient profit [46]. Also in 1963, Malaysia created a Pilgrim Savings Corporation which could be classified as Islamic bank, because it was run according to the Shari'a principles. It aimed to help people performing Hajj (pilgrimage to Mecca) [55]. Parents deposited money in a savings account for their children so they could marry in Mecca which is a local tradition. The savings corporation then invested the money into palm tree plantations and real estate projects realizing great profits. The corporation later started an Islamic bank named Bank Islam Malaysia [1].

The next major event was the creation of the Islamic Development Bank, the first international Islamic bank founded in Jeddah (Saudi Arabia) in 1974 under the auspices of the Organization of the Islamic Conference (OIC).

Soon after, a number of commercial Islamic banks were established in the neighboring countries, such as Dubai Islamic Bank, Bahrain Islamic Bank and Kuwait Finance House [45], [10].

Over the last four decades Islamic finance and banking has been the fastest growing segment of international financial markets to become a global phenomenon [55]. Islamic banks hold over US$ 1.3 trillion in assets[i] [34] in more than 70 countries [55], are growing at over 15% annually [15] and account for over 50% of all savings in the Muslim world [58]. Some countries, such as Iran, Pakistan and Sudan chose to entirely Islamize their financial systems [45]. Most countries, however, developed their Islamic financial systems in parallel with their conventional banking systems [58] (table 1). In the Muslim world, Islamic banking makes up 12% of the total banking systems [48]. Of the total global Islamic banking assets, almost 43% are in Iran, more than 34% in the Gulf Cooperation Council (GCC) countries and 10% in Malaysia [34].

Table 1: **Banking sector structure in sample countries (2007)**

Country	# conventional banks	# Islamic banks	Islamic banking %
Bahrain	11	15	27.68
Bangladesh	28	5	13.22
Cayman Isl.	11	1	6.53
Egypt	23	2	4.22
Gambia	5	1	8.48
Indonesia	53	1	0.62
Jordan	7	2	6.20
Kuwait	5	6	41.33
Lebanon	27	2	0.33
Malaysia	29	12	7.26
Mauritania	5	1	12.40
Pakistan	23	10	6.72
Qatar	7	4	14.02
Saudi Arabia	9	2	5.92
Singapore	12	1	0.17
Sudan	13	9	33.84
Syria	8	1	1.05
Tunisia	14	1	1.51
Turkey	24	3	2.96
UAE	16	4	12.86
UK	88	2	0.01
Yemen	4	3	51.45
Total	422	88	9.87

The main factors that have contributed to the rapid development of the Islamic banking system in the Middle East are [39], [1], [45]:

1. Islamic revivalism during the 20th century but especially after the 1960s.
2. Defeat of Muslim armies during the six-day war with Israel. Many Muslims resented the fact that Western countries generally sided with Israel.
3. The defeat of the Arab countries in the war with Israel also created the premises for the first oil crisis. Meant to be a response for the oil-thirsty Western countries siding with Israel during the wars with its Arab neighbors, OPEC (Organization of Petroleum Exporting Countries), dominated by Muslim Gulf countries, decided to raise oil prices. Oil prices quadrupled increasing the flow of money to the oil-rich countries in the Gulf. Most of the money was still deposited in western banks but due to the fact that western countries sided with Israel during the war Arab governments started to look for ways to hold and invest some of the money locally.
4. The growing sukuk market: Between 2000 and 2012 the global sukuk market increased from US$340 million to US$130 billion [48]. Sukuk is now accepted as a financial instrument even by non-Muslim entities.
5. The geopolitical changes in the region following the terrorist act on September 11, 2001 in the USA. On the one hand, the "war on terror" unleashed by the USA in the Middle East, especially the invasion of Iraq, caused a lot of bitterness among the wealthy individuals from the region who used to keep their money in western banks. On the other hand, the tighter financial regulations in the USA meant to discover and discourage terrorist financing and money laundering has often led to arbitrary persecution of Islamic financial institutions and funds further alienating Middle Eastern investors eventually convincing them to transfer their monies to the Islamic banks in the Middle East [26], [45: 85-86].

Today the petroleum-rich countries at the Arabian (Persian) Gulf are the global leaders in terms of the number of Shari'a -compliant banks and their assets (tables 2 and 3). For instance, the region has four out of the five largest Islamic banks in the world and the highest concentration of Islamic deposits and capital in the area [20] (table 4). The region's Islamic finance composes 20 % of the total Islamic banking sector in the world [20].

Table 2. **Geographical distribution of Shariah compliant (Islamic finance) assets**

World regions	Shari'a compliant assets (US$ in billions) 2013	Shari'a compliant assets (US$ in billions) 2012	Asset growth from 2012 to 2013 (%)	CAGR 2007-2013	Percentage of total (2013)
Gulf Cooperation Council (GCC) states	496.9	404.9	22.73	18.50	39.2
Non-GCC MENA (Middle East North Africa)	489.8	487.4	0.48	17.35	38.6
MENA total	986.7	892.3	10.58	17.92	77.9
Asia	248.6	208.5	19.24	12.24	19.6
Australia/Europe/North America	21.7	54.7	-60.33	0.84	1.7
Sub-Saharan Africa	10.3	10.7	-3.42	16.57	0.8
Global total	1,267.4	1,166.3	8.6	16.02	100.0

Source: The Banker, Special Report, November 2013

Table 3: **The 25 leading countries in 2009 by Shariah-compliant assets**

Rank in 2009	Country	Shariah-compliant assets (millions USD)	Rank in 2009	Country	Shariah-compliant assets (millions USD)
1.	Iran	293,165.8	14.	Jordan	4,621.6
2.	Saudi Arabia	127,896.1	15.	Syria	3,838.8
3.	Malaysia	86,488.2	16.	Iraq	3,815
4.	UAE	84,036.5	17.	Indonesia	3,388.2
5.	Kuwait	67,630.5	18.	Brunei	3,201.4
6.	Bahrain	46,159.4	19.	Yemen	1,318.3
7.	Qatar	27,515.4	20.	Switzerland	1,040.6
8.	United Kingdom	19,410.5	21.	Mauritius	943.5
9.	Turkey	17,827.5	22.	Algeria	837.5
10.	Bangladesh	7,453.3	23.	Tunisia	632.3
11.	Sudan	7,151.1	24.	Singapore	618
12.	Egypt	6,299.1	25.	Thailand	495.5
13.	Pakistan	5,126.1			

Source: www.statista.com/statistics/265978/shariah-compliant-assets-leading-countries-in-2009/

Another major region for Islamic banks is South-East Asia with Malaysia being the leader of the region [20]. Here Islamic banks made up 20% of the banking sector in 2012. Moreover Malaysia is the leader country in the Sukuk exportation. In 2012 the country exported 100 billion dollars sukuk. Of the 21 Islamic banks in the country, four are international and 17 domestic [38].

Encouraged by the rapid success of the Islamic financial model in the Middle East, a number of conventional banking multinationals also started opening "Islamic windows" to win the businesses of the more conservative Muslims. In 1996, Citibank opened its first "Islamic window" in Bahrain followed by HSBC which established an Islamic banking division, HSBC Amanah, in 1998 [45].

Table 4: **Top Islamic banks by total assets**

Rank	Bank	Country	Total assets in billion USD
1.	Al Rajhi Banking and Investment Corp.	Saudi Arabia	45.5
2.	Bank Mellat	Iran	42.5
3.	Bank Saderat	Iran	41.1
4.	Kuwait Finance House	Kuwait	39.4
5.	Bank Tejarat	Iran	34.5
6.	Bank Sepah	Iran	25.0
7.	Dubai Islamic Bank	UAE	23.0
8.	Bank Maskan	Iran	19.3
9.	Agricultural Bank of Iran	Iran	17.8
10.	Abu Dhabi Islamic Bank	UAE	17.5
11.	Al Baraka Banking Group	Bahrain	13.2
12.	Islamic Development Bank	Saudi Arabia	11.5
13.	Qatar Islamic Bank	Qatar	10.8
14.	Maybank Islamic Berhad	Malaysia	9.7
15.	Asya Katılım Bankası	Turkey	7.9
16.	Bank Islam Malaysia Berhad	Malaysia	7.8
17.	Emirates Islamic Bank	UAE	6.9
18.	Masraf al Rayam	Qatar	6.6

Source: based on Salem and Badreldin, 2013

Islamic banking is a growing presence also in non-Muslim countries [13], [42]. Owing to a constant flow of migrants from developing countries, the demographic structure of many Western European and North-American countries has been greatly modified over the last five or six decades. In many western European countries one-tenth of the population is Muslim and the concept of Islamic banking is appealing to them. This explains why the number of Islamic financial institutions is on the rise in the region (see table 5). London has already become a key player in the global Islamic financial market [12]. However, most Islamic institutions in the western world are based mainly in the United Kingdom (22) and the United States (15). The reason may be that development of Islamic Finance has initiated the regulatory in the United States and United Kingdom, thereby showing the ongoing co-constitution of Islamic and interest-based financial markets [43].

Table 5: **Islamic financial institutions in Western countries and offshore centers (2010).**

Country	Number of Institutions	Country	Number of Institutions
United Kingdom	22	Canada	1
United States	15	Cayman Islands	1
Australia	4	Germany	1
France	3	Ireland	1
South Africa	3	Luxembourg	1
Switzerland	3	Russia	1

While many studies have examined the development of Islamic banks in the GCC countries, in Southeast Asia (especially in Malaysia) and even in the western world, Turkey has been almost completely ignored in the global literature on Islamic banking. This study was initiated to fill in this gap. The article will proceed as follows: After a short discussion of the concepts guiding Islamic banking and its characteristic features, we will examine how Islamic banks can make money without using interest or breaking other Shari'a principles. Here the study will also highlight the main differences between Islamic and conventional banking. This will be followed by an account on the development of Islamic banking in Turkey in historical perspective. The study will conclude with an examination of future development directions.

2. Islamic Banking: Conceptual and Basic Features

While throughout much of the literature the concept of Islamic banking has been used as synonymous to "interest-free" banking, it is argued that the principles of Islamic Banking and Finance (IBF) refer to more than just "interest-free" operations, involving wider ethical and moral issues [35].

Besides banning riba (generally translated as "interest", or "usury"), Islamic banks stay away from transactions that involve excessive risks, such as speculative investments (gharar), or outright gambling (maysir) or from transactions that involve products that are religiously forbidden by Islam (haram) [35], [25]. Gharar does not mean elimination of all risks as entrepreneurial risks are considered an inherent part of all economic transactions, only the excessive, unnecessary risks [28]. For example, under gharar, are not accepted transactions of products that do not exist yet or any contracts that are not specific in terms of costs and duration (Sanhuri, 1967 cited in [12]). Also excluded from transactions are those products for which the parties lack proper knowledge or which cannot be controlled by the parties [54].[ii] The main idea behind this prohibition is that one party should not take advantage of the other party's ignorance [45].

Islamic jurisprudence is based on the following sources, in order [32], [29], [1]: the Qur'an (the Muslim book of revelation from God to Prophet Muhammad), the Hadith (a collection of reports quoting Prophet Muhammad on different issues), Sunnah (the teachings, deeds and sayings of Prophet Muhammad as reports about his companions), Ijma (consensus or agreement of the religious authorities or the entire community on religious issues), Qiyas (the process of deductive analogy in which rulings of the Qur'an or of the Sunnah could be used to provide a response to new problems that may arise) and Ijtihad (a decision making process in Islamic jurisprudence through personal effort; by relying on Qur'an and the Hadith, the Shari'a scholar will use analogical reasoning to find solution to a legal problem). The last sources require interpretation by Shari'a scholars, hence the crucial role these "gatekeepers" play to the legitimacy of Islamic banks [49], [45], [10], [11]. All Islamic banks are supervised by a Shari'a Board made up of one or more scholars [25]. These Shari'a scholars make sure that transactions made by the bank are compliant with Islamic principles and assist with the creation of new financial products [10], [1]. Based on their interpretation of the Qur'anic texts they issue a fatwa (opinion) which then becomes part of Islamic jurisprudence [42: 314].

3. How do Islamic banks make money?

There are a number of ways for Islamic banks to make money (see table 6) which can be basically reduced to the following categories:

1. Profit-loss sharing (PLS): banks are entering into joint-ventures with investors (bank deposits) and entrepreneurs (loans). As partners, they share both profits and losses of the ventures (mudarabah, musharakah, and wakala contracts).
2. Mark-up fees and service fees: the bank buys a commodity for the customer and is allowed to charge a pre-determined fee (either as a lump sum or as a percentage) for the effort (murabaha).
3. Leasing: the bank buys a resource the customer needs and then it rents it to the customer (ijara, musharakah).

Although the PLS contracts are considered the most Shari'a compliant financial transactions, mudarabah and musharakah represent only 5% (or even less in countries like Egypt) of all financing by Islamic banks, most of the rest being made-up by murabaha [42: 315). The main reason for this situation may be the uncertainty banks face when trying to calculate their returns in the case of the PLS contracts since these depend on the profitability of the venture financed [42: 315], [35]. The murabaha contracts are criticized by many for their resemblance to interest-based transactions [35], leading Yousef [57] to call this "the murabaha syndrome".

4. The main differences between Islamic banking and conventional (mainstream) banking – Is there an alternative banking system?

Besides the religious perspective, Islamic banking is also considered important for "the achievement of socio-economic development, social justice and welfare among Muslim communities by mobilizing savings that are kept out of interest-based financial institutions" [40: 75].

Islamic banking practices are often seen as more ethical than the practices of conventional banks [50]. By prohibiting riba (interpreted here mainly as usury), explicitly stated by the Holy Qur'an (verses 2: 239), the intention was to create a society based on fairness and justice (Siddiqi, 2004; cited in [28]). In Islam one cannot lend money to make money [18: 33] meaning that the supplier of capital cannot make money by predetermined fixed rates. This is considered as interest and is the main principle of conventional banking [4]. Since "money does not create a surplus value by itself", the lender makes money commensurate with his or her effort [44: 586]. Money is then not considered a commodity in Islamic banking transactions but rather as bearer of risk [42: 314]. For this reason, in Islamic banking money is not used as investment but rather as a tool of trade [39]. Similarly, by prohibiting maysir and gharar the intention is to avoid situations in which one can get rich and others lose everything based strictly on luck or on one party's lack of knowledge [45]. Islamic banks are also not allowed to invest in alcohol, prohibited drugs, prostitution and anything else that is considered haram and unethical by Islam. In addition, Islamic banks cannot make investments in companies which violate human rights or in companies that could damage the natural environment [53] because, according to Islam, people and the environment are sacred, and should not be exploited.

Table 6: **Types of contracts used by Islamic banks**

Name	Type	Description
Mudaraba	Risk and profit sharing	A contract between a capital owner (bank) and an entrepreneur (investment manager). The former contributes with capital to the venture and the latter with management and/or labor (and sometimes money). Both profits and losses are shared in pre-determined proportions.
Wakala	Risk and profit sharing	A contract between a bank depositor (capital owner) and a bank (investor). A bank's customer deposits money into a savings account and the bank uses the money to invest in a venture. The bank treats the customer as a shareholder who is entitled to a share of the bank's profits
Musharaka	Risk and profit sharing Leasing Business financing	A joint venture contract between two or more parties (which could include a bank or financial institution). All parties are supposed to contribute capital to the partnership and one or more parties will contribute with labor and management. Profits will be distributed proportionately based on all contributions (capital, labor, management, etc.). Losses, however, will be shared in proportion only to the capital contribution. A variety of these contracts is the "diminishing partnerships" when banks agree with business partners to gradually sell them their shares in the venture at an agreed-upon price and according to an agreed transfer calendar. Can also be used for mortgages
Murabaha	Trade contract	This contract allows a bank to purchase a commodity for a client. The bank then sells the commodity to the client at a marked-up price (representing its profit). The client can then pay the bank in installments as agreed with the bank.
Istisn'a	Trade contract	Under this contract a bank buys a piece of property and develops either on its own or through a subcontractor and then sells it to a client at a (pre-determined) mark-up price
Ijara	Leasing	Under this contract the bank buys the asset (building, equipment, etc.) and rents it to the customer at a pre-agreed rate. At the end of the contract period the asset returns to the bank or could be permanently transferred to the customer.
Sakk (pl. sukuk)	Bonds	This is the Islamic version of bonds in conventional finance. Under this contract, a bank (or a government, corporation, etc.) can issue sukuk to investors at an agreed value and promise to buy them back at a specific date in the future at a higher (agreed) price.
Qard hassan (good loan)	Loan	This contract is loan that is returned at the end of the agreed period in the same amount. The investor (bank, fund) is not benefiting from the loan neither directly nor indirectly.

Sources: [8], [36], [28], [33], [32], [31], [40], [45], [39], [1]

Furthermore, in the Islamic banking model, money that is collected from clients is used in the real economy as loans financing business ventures and profits (or losses) are then shared between the entrepreneur, the bank and bank depositors [1]. For this reason, in Islamic finance there is always a close relationship between financial flow and productivity[iii]. This characteristic reduces the risks that may be derived from speculative financial activities that characterize the conventional banking activities [2], [7]. Islamic banks are, therefore, generally less affected by global financial crises [2], [12], 24]. For this reason, Islamic banks are attractive not only to Muslims for which complying with the Shari'a law is important but also to those who regard them safer than the conventional counterparts [23].

However, this does not mean that Islamic banks are risk- free. In fact, Islamic banks are taking more risk in transactions compared to conventional banks because, while in conventional banking, all risks are borne by the entrepreneur, in Islamic banking the financiers share the risk [29], [51].

The goal of Islamic economics, besides the success of the individual is to promote the welfare of the society[iv] [39]. At the very least, the Islamic economy must allow everyone access to basics such as food, clothing and shelter [21]. Islamic banks are also required to collect the zakat, a compulsory religious payment or tax on the wealth of the rich payable to the poor. This model seeks to establish a more equitable standard of living in the community [1].

Islamic banks must also act altruistically when debtors, due to justifiable causes are unable to pay. In such situations, banks are advised to find solutions that will not hurt the debtor (for example, postpone payments until the debtor gets back on his feet), or, in the most desperate situations even forgive the loan [39].

5. Islamic Banks in Turkey

Turkey has a shorter banking history than most western countries. In the Ottoman Empire, due to the Shari'a law, lending money was relegated to Christians and Jews [22]. Then, while the banking sector was flourishing in the western countries in the second half of the 19th century, the Ottoman Empire, having missed the industrial revolution, had very few banks, and most of these were licensed to foreigners [22]. The country did not have a national central bank and only few regulations existed to control the Empire's banking system. This situation did not change very much until the proclamation of the Republic in the early 1920s. Due to shortage of private capital, the new Republican government was forced to use state money to help with the creation of new domestic banks. Moreover, sectoral banks were established to support the development of certain economic sectors that were prioritized by the government [22][v].

After World War II many smaller banks disappeared and, when in the 1950s the government decided to return to a centralized planned economy seeking an import substitution strategy for economic development most foreign banks also decided to leave Turkey [22]. This situation continued until the early 1980s, when, following a military coup, the new government decided to abandon import-substitution and adopt an export-led growth strategy which implied financial liberalization, privatization of state-owned companies, deregulation of economic sectors dominated by state monopolies, promotion of free trade and attraction of foreign direct investment. As result, after 1980, the number of foreign banks in Turkey started to increase. While in 1980, of the 42 banks, only four were foreign, by 2008, there were 18 foreign banks (of a total of 46 banks) with over 2000 branches across the country [56].

Also, in 1983, in order to attract more capital from the Middle East, the government created the legal framework for Islamic banks to operate in Turkey [5], [30]. These were named Special Finance Houses (in Turkish: Özel Finans Kurumları) with no direct mentioning of their Islamic character [52], [24], [30], [41] (for a summary of the events that influenced the growth of Islamic banks in Turkey see table 7).

However, these Special Finance Houses were highly regulated by a secular bureaucracy and did not enjoy the same status as the "conventional" banks so they were not covered by Turkey's Central Bank insurance scheme and were not allowed to invest in government securities causing them some competitive disadvantages in relationship with conventional banks [24], [30: 134]. This situation was later improved with successive banking acts in 1999 and 2001. In 2001 the Association of Special Finance Houses was created to provide a better regulatory framework for the special finance houses [5]. Figure 1 shows that the Turkish Participation banking system has grown considerably since 2000 although assets share is not very large compared to conventional banks. Except for year 2001, when economic crisis hit the Turkish economy, the participation banks have been developing continuously over the last decade.

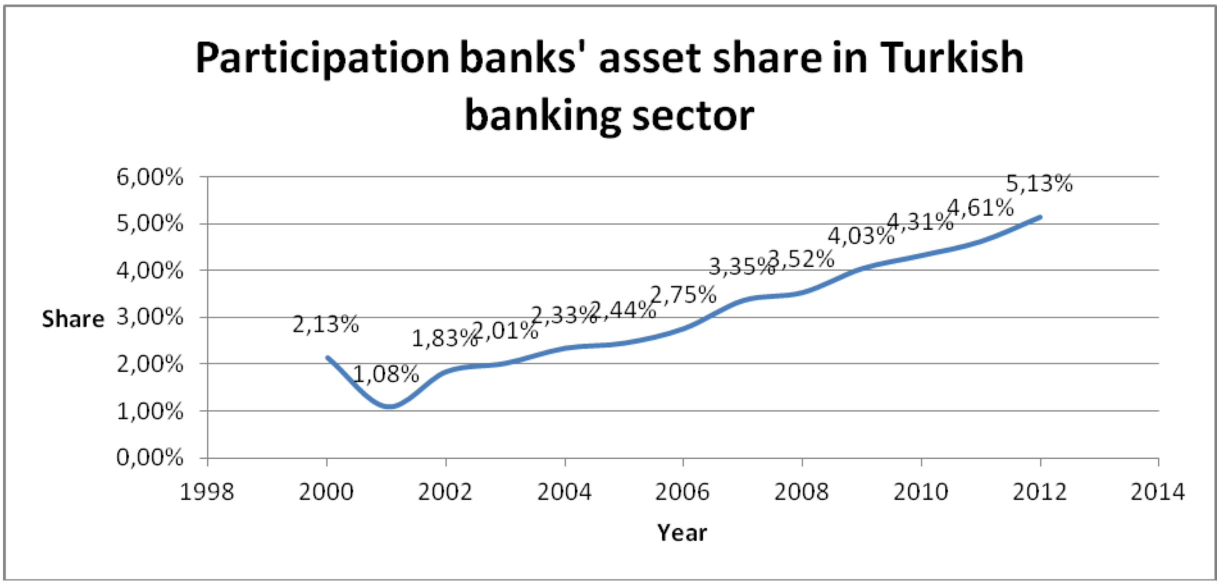

Figure 1: **Assets Growth (% share) of Participation Banks in Turkey between 2000 and 2012**.
Source: Participation Banks Association of Turkey (TKBB).

Table 7: **Main events that impacted the evolution of Islamic banking in Turkey.**

Date	Event
1983	Legal framework that allowed the operation of Islamic banks established. These were named "Special Finance Houses"
1985	Al Baraka (Bahrain) opened its first subsidiary in Turkey
1985	Faisal Finans (Saudi Arabia) opened its first subsidiary in Turkey
1989	Kuveyt Turk (Kuwait) started operations in Turkey.
1991	Anadolu Finans (domestic capital) started operations.
1995	Ihlas Finans (domestic capital) started operations.
1996	Asya Bank (domestic capital) started operations
1999	Finance houses become subject to the Banking law no 4389 which regulates the banking system in Turkey
2000	Turkish holding Ülker bought Faisal Finans and changed its name into Family Finans House.
2001	Ihlas Finance House went bankrupt
2001	Creation of the Association of Special Finance Houses
2004	The state extended its 50,000 lira guarantee on deposits to Special Finance Houses
2005	Special Finance Houses re-named "participation banks" and the Association of Special Finance Houses re-named Participation Banks' Association
2005	Türkiye Finans Participation Bank was established by merging of Family Finans and Anadolu Finans
2008	National Commercial Bank (NCB) from Saudi Arabia acquired 60% of Türkiye Finans shares for US$ 1billion
2010	Framework for corporate sukuk was set up
2010 (August)	Kuveyt Turk issued Turkey's first sukuk, US$ 100 million
2011	first participation index was launched by the Istanbul Stock exchange
2012 (September)	first dollar denominated sovereign sukuk issuance, US$ 1.5 billion
2012 (October)	lira denominated sovereign sukuk issuance US$ 904 million
2013 (March)	Bank Asya issues the first lira denominated sukuk out of Turkey.
2014 (July)	Newly adopted mutual fund regulation, "participation umbrella fund" (katılım şemsiye fonu) will include funds with no interest bearing securities.

In 2005, banking law no. 5411 replaced "special finance house" with "participation bank" ("katılım bankacılığı") while the Union of Special Finance Houses became the "Participation Banks' Association of Turkey" (TKBB) [47]. Also, the state has extended its 50,000 lira guarantee on deposits to participation banks [5]. This encouraged people to invest their money in the participation banks.[vi] Also, the legislation has been harmonized so that today both Islamic and conventional banks operate according to the same law [30: 134]. All these changes created a more favorable regulatory framework for participation banks in Turkey with the effect being that Islamic finance started to develop more rapidly in the country [16] (table 8).

Today there are four participation banks which operate according to Shari'a principles: Albaraka Turk, Kuveyt Turk, Turkiye Finans and Bank Asya (table 9). Al Baraka Turk, the first Islamic bank to start operations in Turkey in 1984is owned by Al Baraka Banking Group (ABG), the Islamic Development Bank (IDB) (together holding 66.16% of the shares), a Turkish industrial group (11.06%) and the public (22.78%) [3]. Kuveyt Turk is majority owned by Kuwait Finance House (62%). Other shareholders are the General Directorate for Foundations (18%), the Islamic Development Bank (9%) and other, small entities (2%). Turkiye Finans, resulted from the merging of Family Finans with Anadolu Finans in 2005, was acquired by National Commercial Bank from Saudi Arabia. Asya Katilim Bankasi A.Ş. (Bank Asya) which started its operations in 1996 is based mainly on private domestic capital[vii] [9], [14]. Bank Asya (91% of the loans) and Albaraka Turk (81%) work mainly with the population while Kuveyt Turk (74.5% of the loans) and Turkiye Finans (88.5%) have specialized in working with companies [23: 515-516].

Table 8: **Growth of assets and share participation banks between 2005 and 2012.**

Year	Total Assets Participation Banks (Thou TRY)	Growth from previous year (%)	Total Assets Banking Sector (Thou TRY)	Growth from previous year (%)	Share Participation Banks (%)
2005	9.945.431	36,36%	406.915.000	22,5%	2,44%
2006	13.729.720	38,05%	498.587.000	16,5%	2,75%
2007	19.435.082	41,55%	580.607.000	26,0%	3,35%
2008	25.769.427	32,59%	731.640.000	14,0%	3,52%
2009	33.628.038	30,50%	833.968.000	20,7%	4,03%
2010	43.339.000	28,88%	1.006.672.000	21,0%	4,31%
2011	56.076.929	29,39%	1.217.711.000	12,6%	4,61%
2012	70.279.000	25,33%	1.370.614.000	13.38%	5,13%

Source: Participation Banks Association Turkey (TKBB) (2012*)*

Table 9: **The number of participation bank branches in Istanbul, Ankara and Izmir**

Provinces	Albaraka Turk	Kuveyt Turk	Türkiye Finans	Bank Asya	Total Branches	Percent of total
Istanbul	58	91	88	98	335	40.5
Ankara	14	19	19	20	72	8.7
Izmir	4	12	8	13	37	4.5
Total (Turkey)	136	213	220	258	827	100.0

Source: based on data collected from Participation Banks Association of Turkey (TKBB) http://www.tkbb.org.tr).

However, although participation banks have grown continuously over the last few years (table 8; figure 2), most branches of the four banks are in Turkey's three main cities (table 9). Istanbul, Ankara and Izmir have together 827 branches of the four participation banks (or 53.7%). Istanbul alone concentrates 40.5% of all branches in Turkey while many provinces have no participation bank present (figures 3-6).

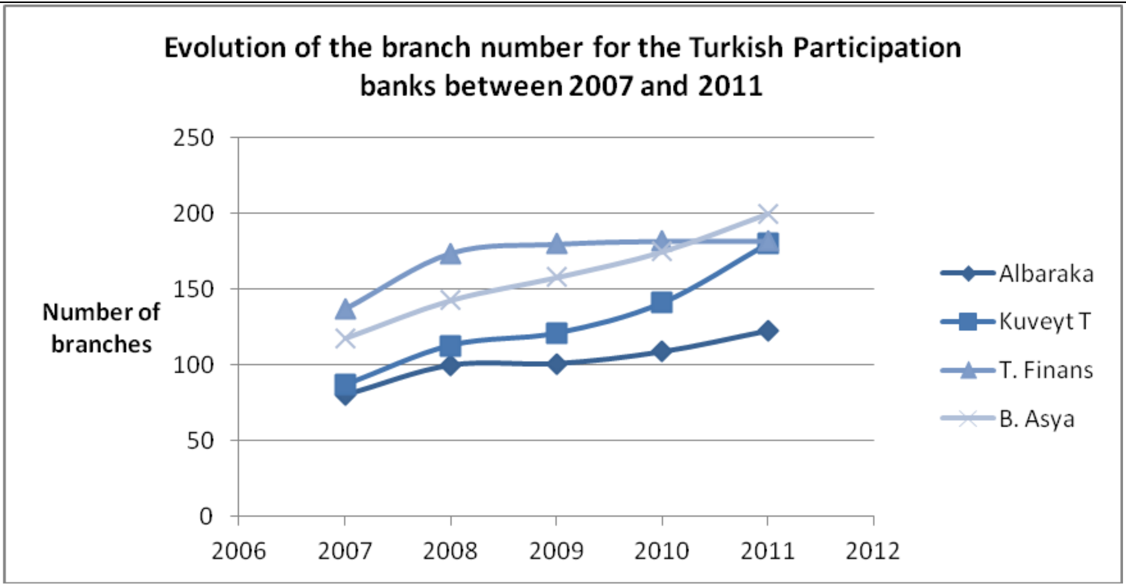

Figure 2: Evolution of branch numbers for the Turkish Participation banks (based on data from Sayim, 2012)

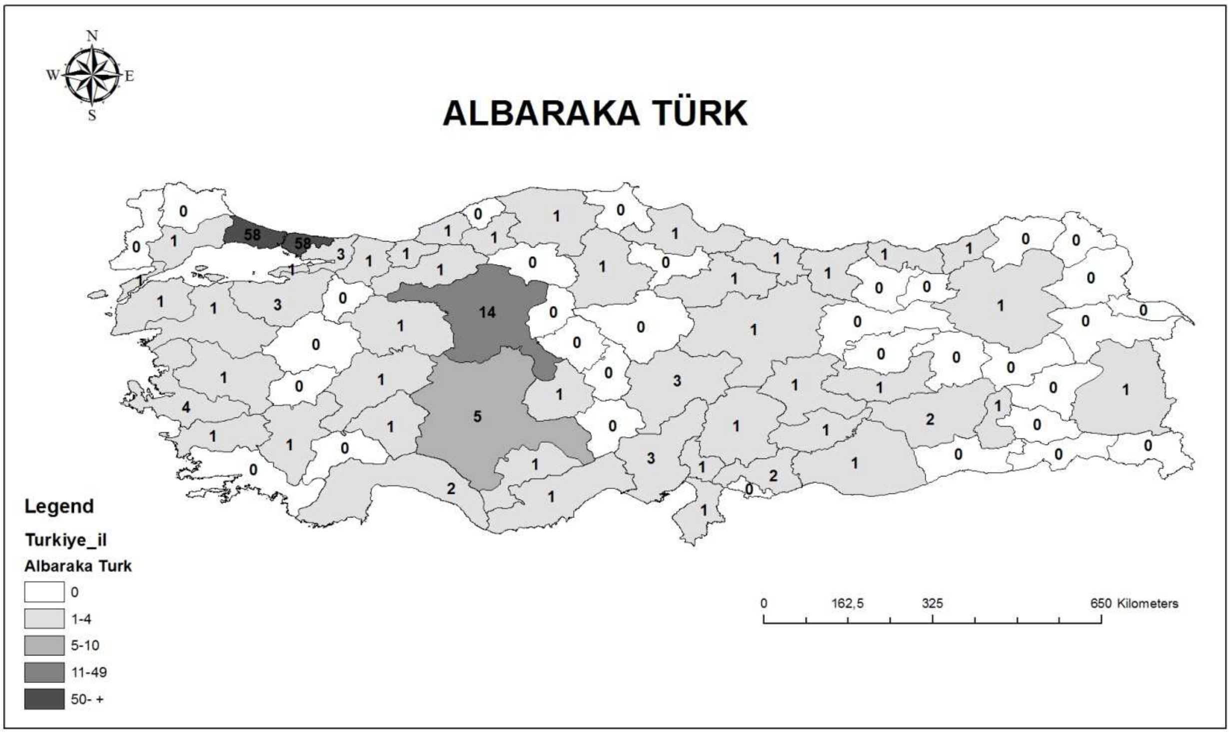

Figure 3: Geographical distribution of Albaraka Türk Bank branches across Turkey.

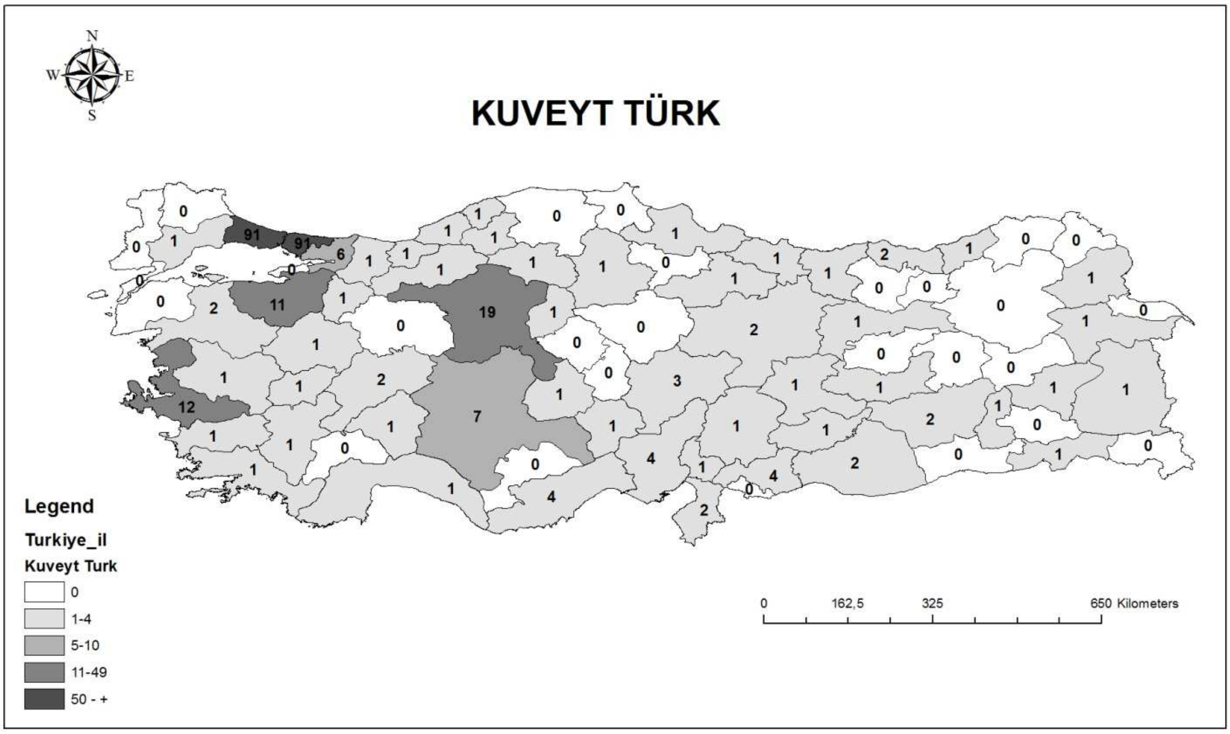

Figure 4: Geographical distribution of Kuveyt Türk Bank branches across Turkey.

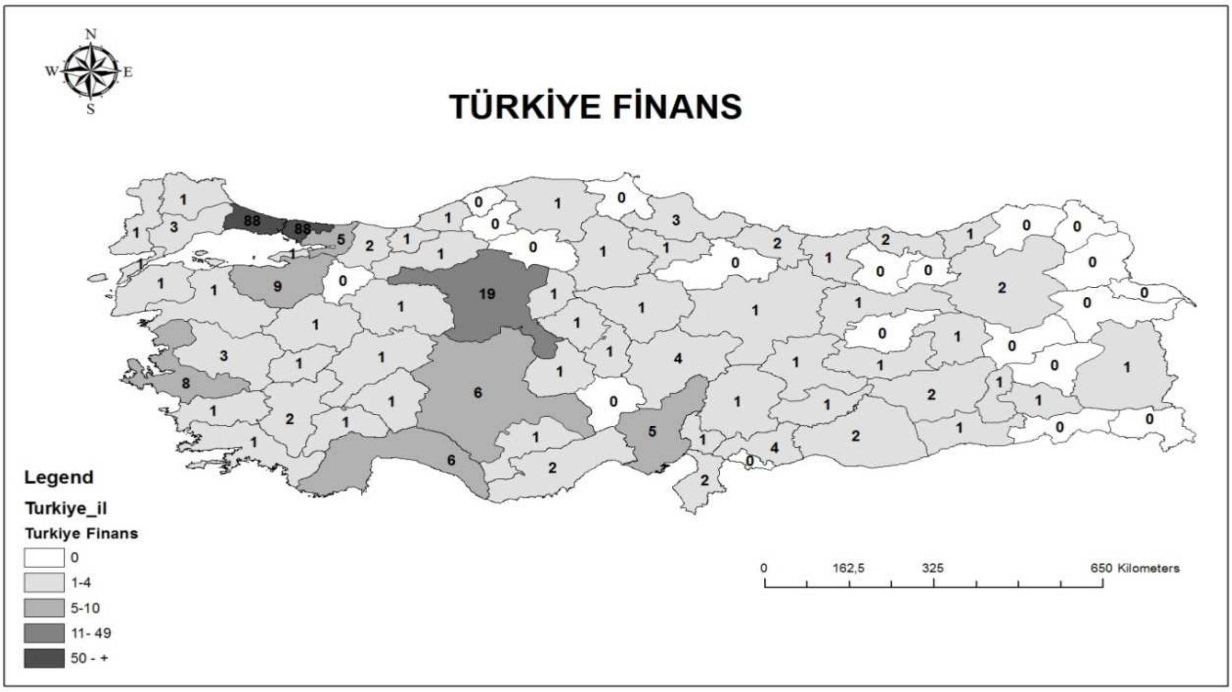

Figure 5: Geographical distribution of Türkiye Finans Bank branches across Turkey.

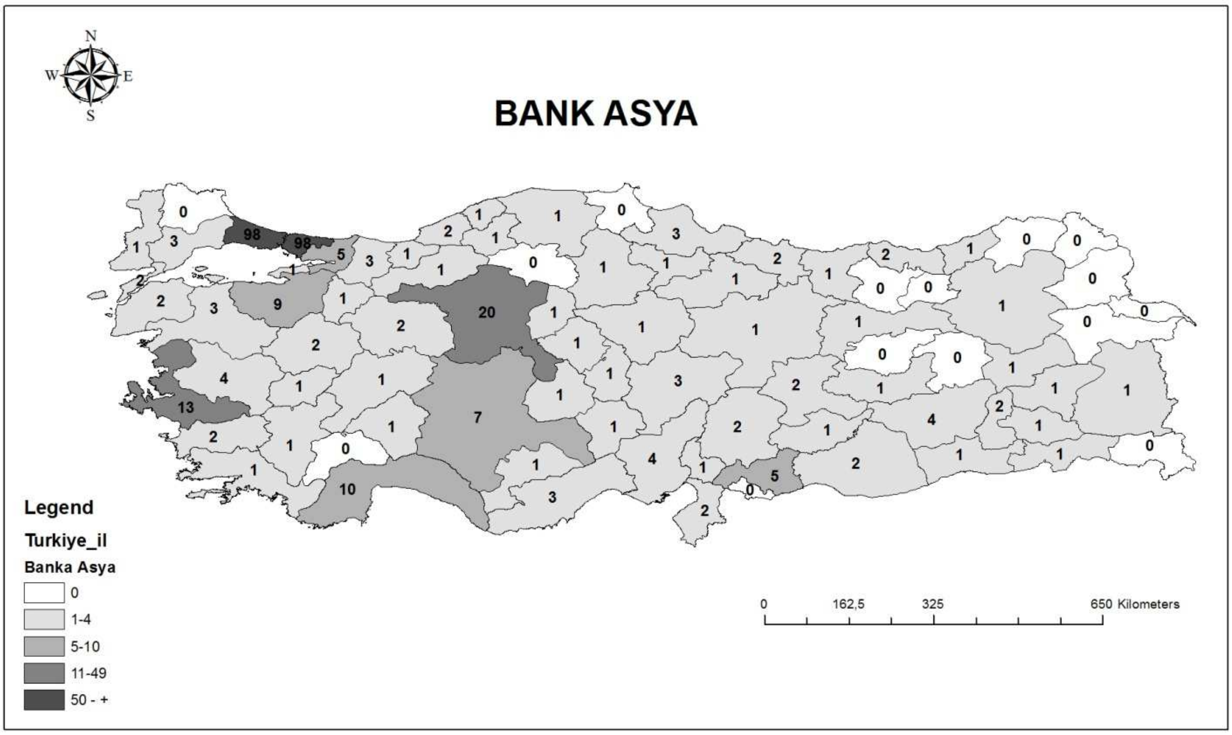

Figure 6: Geographical distribution of Bank Asya branches across Turkey.

6. Conclusion

From a small number of operations in the 1970s, Islamic banking has expanded continuously over the last 40 years. Islamic banks have become a very popular alternative in the Gulf countries and in Southeast Asia. Islamic finance is on the rise even in some non-Muslim countries. In Turkey, the first Islamic banks, known as "participation banks" started to operate much later than in other Middle Eastern countries yet they have since grown at much faster rates than Islamic banks elsewhere and also much faster than conventional banks in Turkey.

However, many contend that it would be difficult for the participation banks to maintain this high growth rate unless more companies from the Gulf countries or Southeast Asia decide to invest in the Turkish Islamic banking sector [24].

There are plans to increase the number of participation banks either via the private sector or through Islamic windows opened in state-owned banks, with Ziraat Bank, Halk Bank and, perhaps, Vakif Bank being the most likely candidates. If these plans are realized, participation banks would become accessible to virtually everyone in Turkey as these three banks have together thousands of branches in all provinces of Turkey.

[i].Although the fastest growing segment in the international financial system, it represents only 1% of the total global banking assets [34].

[ii]. For a more detailed discussion of gharar see [12].

[iii]. This may be true for PLS transactions; however, since murabaha contracts are dominant financial transaction we question the validity of this statement.

[iv]. However, in reality, because banks need to be profitable in order to stay in business, very few PLS loans are given to projects in economic sectors that promote the welfare of the society (agriculture, clean water, infrastructure, etc.) which are known to be less profitable. Most loans will, logically, go to industries with higher return rates [39: 29].

[v]. As such, the Industrial Bank of Turkey was formed to support the industrialization of the country and the Ziraat Bank (established in the 19th century) was restructured to serve the needs of the farmers. Later, Sumerbank was established to

finance the development of the textile sector, Eti Bank for natural resources, Deniz Bank to support the development of sea transport, Municipal Bank to finance regional development and Halk Bankası to serve medium-sized enterprises [22].

[vi]. However, this move is contested by some for not being compliant with the Shari'a principles [23].

[vii]. In 2014 the bank was in negotiations with Qatar Islamic Bank for a possible sale brokered by Goldman Sachs. However, the government opposed the sale saying that it would prefer a Turkish state-owned bank to acquire the participation bank. Soon after, Turkish regulators revoked Bank Asya's permission to issue new loans and put the bank on a watch list. This move has significantly affected the bank's activities and shrunk its assets and share value. Then, in February, the state took over the majority shares at Bank Asya and is now looking for a buyer. The bank's shareholders are accusing the government of political motivations and are ready to challenge the take-over in court. Bank Asya has been associated with the movement inspired by the leading Muslim scholar Fethullah Gülen. Members (or sympathizers) of this movement, President Erdoğan alleges, conspired against the government in a corruption scandal that implicated a number of ministers and even one of the President's sons. According to the media, President Erdoğan promised to retaliate [19].

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