

## Chapter 32

# Market Structure of the Banking Sector and the Turkish Banking Sector

**Nizamülmülk Güneş**

*Savings Deposit Insurance Fund, Turkey*

### **Abstract**

*The main function of banking is to contribute to economic growth by providing sectors outside of the finance section with financing that they need and fulfilling an intermediary role between lenders and borrowers. This intermediary function increases the importance of the banking sector compared to other sectors of the economy. Market structures are very significant in terms of firms' market entry and exit and stay on the market. Markets are subject to four different distinction as perfect competition, monopoly, oligopoly, and monopolistic competition markets. The objective in the market is to ensure efficiency in production and sales by pulling down the costs of production through competition. The factors determining the market structure are the numbers of firms in the sector, the degree of restriction on the entry and exit of firms in the industry, the number of those requesting products and homogeneity degree of product produced. The banking sector, unlike other sectors, has unique characteristics. Competition policies which are valid in other sectors are not appropriate for the banking industry. Market openness for instability and market failures change the structure of competition. Asymmetric information, product replacement costs and externalities create barriers to entry which, allows banks to be in a dominant position in their markets. This study examines the main indicators showing concentration, effectiveness, depth, and intermediation functions of Turkish banking sector and investigates in which market structure the sector operates. In this regard, it has made policy recommendations over the results obtained.*

### **INTRODUCTION**

With the financial liberalization policies which started in the developed countries and have expanded to include developing countries (DC) since 1980s, controls and restrictions on the domestic financial market first and then on capital movements were removed. When the removal of all obstacles to capital

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movements was combined with the developments emerged in communication technology, financial flows that could easily move from one country to another in the international financial markets have increased rapidly and reached large levels. During this process, international capital movements have gradually moved away from their traditional functions and reached to a different position. In addition to its rapidly growing volume, capital movements which have acquired a relatively short-term and speculative nature and shifted from official channels to private markets have mostly affected the economies of the DC with its mentioned characteristic.

The greatest opportunity provided by globalization is to increase the world's life standards as a result of the fact that more and more countries which can use their capital flows more efficiently have increased their commercial earnings. The biggest danger is that globalization may be the new source of financial instability and may intensify financial distortions when it occurs.

The main purpose of economic systems is to ensure that welfare reaches to the maximum level. For this reason, it is necessary to ensure the optimum resource composition in production and optimum distribution of goods and services in consumption. Production should be carried out at the lowest cost by using the resources efficiently, and the end users should be provided with the lowest price goods and services. Thus, efficiency in both production and consumption shall be ensured. In the economic theory, the balance of firms arises depending on the structural features of the market where they operate. Depending on the number of buyers and sellers, the level of competition, market share and concentration point determine the market structure.

As the market structure is linked to competitiveness and social welfare, it draws attention in the economics literature and industrial economics literature. In the literature, differences in the effectiveness levels of firms and regulatory or corporate entry barriers come to the fore as the two potential determinants of the market structure. The determinants of the market structure in the banking industry are important for two reasons. First of all, the market structure affects not only the competitiveness of the banking system, but also the ability of firms to achieve funding, and thus their investments. The second reason is to evaluate the possible effects of these regulations on the market structure as the banking system is regulated intensely (Gonzalez, 2009, p. 736).

The banking sector plays a key role in the financial sector with the effect of acting as an intermediary that channels the resources it collects to the investments. With the effect of financial liberalization in 1980s, Turkish banking sector has reached a level that cannot be ignored in terms of both its financial and institutional structure.

## **LITERATURE REVIEW**

Some of the outstanding studies in the literature review on the subject are briefly mentioned below.

Mishkin (2009) studied how globalization contributes to financial development and economic growth by strengthening the institutional structure in an economy. He has determined that in a country implementing a financial liberalization policy, productive investment projects can be supported by lower-cost loans; and with the increase in free foreign trade, the performance and quality of the real sector can be increased. He stated that financial development shall accelerate in a market where the real sector is getting stronger, and institutions shall have to implement reforms by keeping up with this development movement.

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