Demirbank: The History of a Small Commercial Turkish Bank

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The purpose of this paper is to explain the case history of a commercial Turkish bank, Demirbank (Iron Bank), a history spanning the second half of the twentieth century. Demirbank's history and development present a number of characteristics that shed light on Turkish economic and business life from a micro perspective.

Private banking has had a short past in Turkey. It began at the end of the nineteenth century, when some local businessmen came together to set up local banks in order to meet their short term credit needs. This process continued through the first quarter of the twentieth century. From 1926 to 1929, the number of these banks increased rapidly [Silier, 1974, p.523]. Still, prior to World War II, the scope of private banking in Turkey was determined by the local needs of businessmen.

After World War II, with the liberalization of Turkish economic and political life in addition to the injection of foreign aid, commercial activities expanded and exports increased, which resulted in a rising demand for short-term credit [Hershlag, 1968, pp.143-78]. In the 1940's, most of the banks were state-owned and commercial credit was limited. This lack of private credit institutions brought merchants and agricultural exporters together to set up banks in order to finance their activities. As a result, from 1944 to 1960, the number of private commercial banks increased, however, these took the form of national, not local banks [Akgüç, 1992, p.40].

The Founding and Formation Period

Demirbank was established at the peak of Turkey's economic expansion in the early 1950s by a group of iron and steel merchants of Persembe Pazari. Persembe Pazari was a district in downtown Istanbul where most of the iron and steel merchants' shops were located. These small-scale businessmen were having problems obtaining short-term credit from the state banks, a situation which inspired Nuri Cingillioglu, one of these merchants, to conceive of such a bank. This idea spread among the merchants of the district. Legal procedures for founding Demirbank were complete in 1953, with a start-up capital of 2 million TL or about $ 714 000 and 79 shareholders. Most of the shareholders

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were iron and steel merchants, and typically for that period, 33 out of 79 shareholders were from minority groups of Istanbul [Demirbank Articles of Association].

Demirbank's mission was to support and finance small merchants and retailers with a credit policy based on cautious and constructive business principles. Throughout the 1950s, the bank's activities were aimed at forming new management, organizing the bank's headquarters, and opening new branches nation-wide, 23 within four years of its founding in 1953 [Istanbul Chamber of Commerce Archives]. This network of branches concentrated on cities where iron and steel merchants were most numerous. At that time, savings account interest rates were low, consequently, banks chose to offer special advantages for enticing account holders. For example, a lottery system was effectively and extensively used for attracting new customers during the 1950s [Kuyucak, 1950, p.60]. Accordingly, Demirbank launched its branches with lottery drawings through which it distributed cash prizes, gold, apartments, household items and other valuables. In a short time, Demirbank managed to increase its saving accounts and achieve sound commercial standing in the banking sector.

The bottom limits for founding a bank had lost value by the 1950s due to inflation, thus tempting new entries to the banking sector. Because of a lack of control mechanisms on the banking system, some banks financed speculative and profiteering activities causing instabilities in the economy [Ayverdi, 1959, p.7]. As a result, in the second half of the decade the government started to set controls on the banks, and finally in 1958 a new banking law was issued which was remained in effect until 1980. Demirbank conformed to the government's regulations, did not engage in speculation activities, and pursued a policy of cautious credit, trustworthy administration and seeking out clients of proven good character [Author's interview with Nuri Cingillioglu, 1998].

The Stability and Conservative Period

Economic instabilities and dissatisfaction with the military and civil bureaucracy led to the military coup of 1960 [Turan, 1983, pp.21-27]. With the new administration, economic policy shifted to the planned import oriented industrialization strategy. During the next two decades, the government favored long term credit organizations and set extensive controls over the banking system [Artun, 1980, pp.49-50]. For economic reasons, in the early 1960s, fifteen banks had disappeared [Akgüç, 1992, p.52]. In order to ensure stability in the banking sector, government permitted very few entries to the banking system. Thus keeping the number of banks stable between 38 and 42, until 1980 [Atiyas, 1990, p.134].

In order to ensure the security of the banking system, the government supported big banks and forced the small banks to unite with big ones. Since Demirbank was a small bank, the government put pressure on it to unite with big banks. The bank's founder Nuri Cingillioglu was commited to its independence and thus resisted this demand [Çelebi's interview with Mustafa

Bakkaloglu, 1998]. Demirbank withstood the test of time by adhering to its principles: not taking risks, cautious credit policies and conforming to banking laws. The bank's founder told me that as of the 1960s he sold his family business in order to give his full attention to developing the bank. During his tenure as managing director, whoever applied for credit was investigated to determine his/her commercial background, and character. However, these conservative policies also created some problems. While the amount of saving deposits increased, the bank's limited commercial placements did lead to some financial losses in the early 1970s [Demirbank Annual Reports].

In the second half of the 1960s, the main competitive strategy of the banking sector switched from the lottery system mentioned above, to extending branch networks. Most of the large banks chose this second strategy. Demirbank had 23 branches by then, and management wanted to open more new branches in order to expand its services and profits but was unable to do so because of a lack of capital [Demirbank 1967 Annual Report]. Disappointed by small returns since the bank's founding, the small share holders did not participate in the capital increase opportunities and sold their shares to Nuri Cingillioglu. In 1976, capital was increased to 20 million Lira, ($ 850.000), while the number of share holders decreased from 79 to 32, thus the founder controlled 81 percent of the capital in 1976. According to the 1958 Banking Law there was no limits on the amount of shares which could be held by a single share holder [Ministry of Commerce Archives].

Import-oriented industrialization strategy ensured lucrative opportunities for private enterprise. The 1958 Banking Law removed the credit ceiling on lending to companies in which banks were themselves equity holders. As a result the scarcity of capital funds and high cost of obtaining credits during 1970s created conditions favoring the ownership of private banks by industrial conglomerates [Ocakcioglu and Karacan, 1977, p.5]. According to its annual reports that toward the end of the 1960s, Demirbank shifted its focus from banking operations to industry. During this period its placements to commercial activities declined, while industrial investments rose. Demirbank started to take on new roles in business by acquiring equity shares in such sectors as cement, fertilizers, cotton thread, and foodstuffs. Those investments supported the bank during the difficult years of the early 1970s, during which Demirbank came close to being shut down. In the mid of 1970s, inflation accelerated into hyper-inflation. Under these conditions, demand for commercial credit increased, and Demirbank's commercial placements were expanded. As a result, profits began to rise significantly.

The 1970s also saw changes in labor-management relations. The period from 1961 to 1980 was one of expanded individual and civil liberties and the growth of voluntary organizations. In the early years of the 1970s, two unions were created within Demirbank. One of them took the form of an independent union. The other was established by the personnel in cooperation with the managing director. Of these unions, the second one was granted the opportunity to sign the first collective bargaining agreement, by which it improved working conditions in many ways, including working hours, salaries, vacations, fringe benefits, some social and medical rights [Demirbank Archives]. However, with the military intervention of 1980, all unions were banned for a certain period [Kepenek and Yenturk, 1994, pp.395-8]. In the aftermath of the coup, unions in the banking sector were unable to resume their previous position and disappeared altogether.

By 1980, the financial system was highly repressed and concentrated. The commercial banking system was composed of 12 state banks, 24 private banks and 4 foreign banks. 58 percent of total deposits were concentrated in the four largest banks, three of which were privately owned and one which was state owned. Each of the 11 smallest private banks held less than one percent of the total banking assets [Atiyas, 1990, p.134]. At that time, Demirbank was one of the smallest commercial banks of Turkey with 23 branches and about 200 employees.

The Restructuring and Growth Period

In 1980, a structural adjustment program was announced by the government in order to decrease trade deficits and inflation, and to bring about liberal, export oriented policies. One of the significant elements of the program was deregulation of the financial system. Accordingly, interest and foreign exchange rates were freed, new entries to the banking system were permitted, and foreign banks were encouraged to come to Turkey. That created a relatively competitive and volatile market. After removing legal restrictions on deposit and loan interest rates in 1980, fierce competition arose among the banks and brokerage houses [Akyüz, 1990, p.99]. Demirbank was committed to " gentlemen's agreement, " style of doing business with the banking sector and kept its distance from this new competition activity [Hürriyet, 1980]. It refused to set deposit interest rates beyond its capacity to pay. Demirbank's main shareholder, Nuri Cingillioglu, kept the bank away from the risky banking activities mentioned above [Çelebi's interview with Muammer Ay, 1998].

Because of financial turbulence connected to the liberalization policies of the early 1980s, which led to some bankruptcies in the banking sector, the government decided to re-impose minimal start-up capital requirements in order to reduce new entries to the banking system [Abaç, 1986, p.218]. Existing banks were also subject to these requirements, and it took Demirbank four years to meet them [Dünya Gazetesi, 1982-1988] .

Financial reforms of the 1980s including the deregulation of foreign exchange and the opening of capital markets for stocks and bonds, and of inter bank money markets broadened the spectrum of the banks' activities [Akçaoglu, 1998, pp.73-8]. Especially, changing lines in business activities along with intensive public sector borrowings created profitable and safe investment opportunities for banks. As a result, public securities became an important area of placements for the banks.

In the mid 1980s, with the dramatic increase in exports, most small banks shifted their focus to wholesale banking operations and foreign trade finance. For Demirbank, this transformation process started in 1984, and was completed in 1992. Because continuity and stability were important to the Board of Directors, its members insisted on a gradual transformation [Demirbank 1988 Annual Report]. However, differences between the conservative management and new professional managers slowed the process of transformation. For example, the Board of Directors resisted borrowing foreign currency from Euro markets, which put a damper on the dynamic, risk taking approach of the professional managers.Then, in 1988, the founder and principal shareholder's son, Halit Cingillioglu, took over the management with a commitment to resolve this internal conflict. Under his supervision a new dynamic approach was adopted, which delicately balanced two opposing principles of the main shareholder on the one hand, and the dynamism of the reconstruction program, on the other.

The first measure taken to improve the Bank's position in trade finance was the upgrading of the staff by acquiring highly-skilled, experienced personnel and by instituting education programs for the existing staff. Some 200 new employees joined the bank, while some of the employees of the prior era chose to leave in 1988 [Author's interview with Halit Cingillioglu, 1998]. The result was a younger, stronger and more qualified staff base which benefited from a higher wage policy in the late 80s. Secondly, the bank re-organized its branch network, relocating some offices from residential to commercial areas and closing others, thus reducing the number of branches from 23 to 14. Finally, in 1980, a computer system was set up for the bank's headquarters, but until 1985, Demirbank made little use of computers in its regular transactions, and management and personnel continued to rely on manual accounting [Marwick, 1984, p.6]. In the late 1980s, Demirbank took the latecomers' advantage to replace its computer system with new technology.

Until Halit Cingillioglu took over in 1988, professional managers held positions in the bank, but all important policy decisions were made by his father Nuri Cingillioglu as Managing Director. The Board of Director's decision-making activity was limited to legal issues and other technicalities. With his son, managerial responsibilities became more widely distributed throughout the management structure [The Board of Directors' Minutes].

The customer portfolio of the Bank also changed over time. Before 1987, Demirbank's customers consisted of small and medium size domestic retail companies. At that point, it began serving large companies doing business in foreign trade.

The bank's cautious credit policy was sustained in line with the traditional importance it gave to the probity of its clients, thus ensuring the bank's larger goal of high quality assets. Since 1990, Demirbank's prudent credit policies has continued to succeed in raising asset quality and minimizing non-performing loans.

After liberalization of international capital movements in 1989, banks started to concentrate on financial sector activities by selling their industrial affiliations [Aksoy, 1998, pp.391-437]. While investment banking became an important area of activities Demirbank's management retained finance as its main business line. For example, Demirbank diversified into various activities such as factoring, insurance, and leasing. In 1992, Demirbank began to invest outside Turkey. Demir-Halk Bank Nedherland was set up in Rotterdam. Demirbank's foreign affiliates expanded to Romania and to Kyrgyzstan in 1997 and to Kazakhstan in 1998.

In 1990, fifteen percent of the Bank's shares were offered to the public on the Istanbul Stock Exchange. Starting in 1994, Demirbank's shares have been quoted at Munich and Frankfurt Stock Exchange and at New York Stock Exchange.

In early 1994, the Turkish economy experienced the most severe crisis since World War II. Growing external trade deficits and huge capital outflows from Turkey led to a sharp devaluation of the Turkish Lira [Köse and Yeldan, 1998, p.68]. Most of the Turkish banks had borrowed foreign currency from Euro markets and placed these funds in domestic credit markets. Because of the devaluation of the Turkish Lira, large deficits in foreign exchange short positions caused serious problems to the banks. Demirbank, like all private banks in Turkey, had a painful experience with the sharp devaluation of the Lira. Yet it maintained high asset quality and liquidity by reducing half of its assets and cutting down on personnel expenses and survived the crisis [Author's interview with Selahattin Serbest, 1998].

Two lessons learned from the 1994 crises have had an important influence on Demirbank's course of development. First, Turkish banks in general realized the importance of domestic funds, and that borrowing from abroad entails high risks. In 1996, Demirbank's management decided to establish a new business unit devoted to retail banking [Demirbank 1997 Annual Report]. With a clear appreciation of the immense growth potential for retail banking in Turkey, Demirbank expanded its network of branches from 15 to 111 in five years, added on and off-site ATMs, and introduced a system offering complete banking services over the phone. Along with new staff and technology upgrades, these changes were complete by 1998.

Another lesson learned from the 1994 crises was a realization of the importance of short and long-term planning. For the first time in its history, Demirbank created a roadmap for its future with the " Demirbank Change Project " of 1995. This plan is "a process of transformation that aims to place Demirbank among the world's largest banks. The ultimate objective of the Project is to achieve full customer satisfaction in all dimensions of service " [Demirbank 1996 Annual Report]. The new structure has been in effect since 1997. The future design of the bank is based on four pillars: investment banking, corporate banking, retail banking, and international investments.

Conclusion

Demirbank was established as one of Turkey's smallest commercial bank and has become one of the larger private banks of Turkey, with assets ranked sixth in 1997.The bank has become a genuine financial institution, in the sense that unlike many of Turkey's banks today it managed to gain independence from its industrial affiliations and does not hold any significant stakes in non-financial institutions. On the other hand, it bears the peculiar characteristic, rare among Turkish banks, of enjoying continuity of ownership since its inception. One could add that surviving in the Turkish banking system and economy for 45 years is no small achievement, and Demirbank managed to fulfill this task with the cautious and dignified business mind of Nuri Cingillioglu together with the dynamic approaches of its newer stable, professional management.

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