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Comparison of Participation Banks and Traditional Banks with Regards to the Industry Data and Services Provided

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Abstract

Traditional banking services have been provided by public and private banks for many years both in global markets and in our country. Thanks to these services, the savings of savers are collected and transferred to the economy by financing various private and public projects. However, the lack of desire of savers with interest sensitivity to direct their savings to banks leads to the situation that a large resource cannot be brought to the economy. Participation banks undertake this task by collecting the savings of savers with interest sensitivity within the framework of Islamic rules and transfer resources to the economy. In this study, a comparison between traditional banks and participation banks was made in regards of the services offered, their operating methods and industry data. In this context, industry data for the period of 2019-2023 for both banking types were used. The results obtained show that the fund collection and resource allocation methods of both banking types are different from each other, but there are similarities in various issues such as legal regulation and the guarantee of savings by the SDIF. As a result of the comparison of industry data, it is seen that although there is a significant increase in the participation banking industry data, it is not yet comparable to the traditional banking one. However, it is considered that the participation banking industry is more aggressive in terms of branching and the number of branches getting closer the number of deposit banks and other data such as asset size and profitability will increase significantly in the coming years as the instruments offered are diversified.

Keywords: SDIF, CAR, Participation Banking, Traditional Banking

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Introduction

When examining the banking system of our country, it is evident that regulatory and accounting infrastructure reforms, along with technological innovations that facilitate and accelerate banking transactions, have significantly advanced the sector. Due to the differences between participation banking and traditional banking, diverse perspectives have emerged within certain segments of society (Özulucan & Deran, 2014).

Participation banks have played a crucial role in transforming the prevailing lack of trust in this sector into a more positive perception (Canbaz, 2022). From the perspective of traditional banking, the share of revenue generated from banking services is considerably higher compared to participation banks. The Banking Law, in line with the financial structure of the country, has provided legal and financial support for participation banks to establish their own regulatory framework and compete with traditional banks (Tabaş, 2022).

Conceptual Framework

Participation Banking

The concept of participation banking is globally recognized as Islamic banking. Banks authorized to collect funds of a participatory nature are defined as participation banks. In Turkey, participation banking services were first introduced in 1985 under the designation of "Special Finance Institutions." Following amendments to the Banking Law in 2005, these institutions continued their operations under the name "Participation Banks" (Türkmen & Üçay, 2023).

Organizations that collect funds without providing a predetermined profit guarantee are generally referred to as "Financial Institutions" or "Islamic Financial Institutions" (Tunç & Odası, 2010). One of the most distinguishing features of this banking system is the use of profit-sharing instead of interest (Hazıroğlu, 2016). The objective of this system is to integrate the savings of depositors who seek to avoid interest-based earnings into the economy, thereby stimulating economic activity. Participation banks aim to channel the savings of individuals who, due to religious beliefs, refrain from engaging with interest-based banking, thereby contributing to the economy (Özulucan & Deran, 2014).

Participation banks hold the status of banks, are generally regarded as institutions of trust within society, operate their banking transactions based on interest-free banking principles, and function as intermediary institutions. Since these banks adhere to the principle of avoiding interest in their transactions, they invest the collected savings in economic ventures. Due to the inherent risks involved, these funds should be allocated to commercial enterprises to enhance efficiency. The prohibition of interest distinguishes participation banks from conventional banks. Given the capital-linked nature of banking transactions, participation banking operates on a profit-and-loss sharing model. In this process, the distribution of profits and losses is determined in advance, yet the exact amount is not guaranteed (Omar, Abdel-Haq, Al-Omar & Abdel-Haq, 1996).

Participation banks aim to channel economic resources that, for various reasons, remain unutilized into the economy through interest-free banking principles (Rodoplu, 1997). Since Turkey has a predominantly Muslim population, certain segments of society refrain from engaging in interest-based transactions due to religious beliefs. Additionally, past interventions by the Savings Deposit Insurance Fund in the resources of some traditional banks have eroded public trust in conventional banking, leading to a shift toward participation banks. Participation banks have implemented an interest-free banking system that aligns with Islamic principles by eliminating interest-based transactions and instead adopting a profit-sharing model based on shared principles (Özulucan & Deran, 2014).

Traditional Banking

Traditional banking practices have evolved across different historical periods in the Ottoman Empire, Turkey, and globally. In the Ottoman Empire, no banking activities were recorded until the 19th century, and financial needs were primarily met by money changers. These money changers played a significant role in laying the foundations of modern banking (Şimşek, 2019).

The first bank established in the Ottoman Empire was the "Istanbul Bank," which operated with foreign capital. The first bank with domestic capital was "Ziraat Bank," founded in Istanbul in 1863 (Kodra, 2018).

In Turkey, the development of traditional banking can be divided into two periods: pre-Republic Ottoman banking and the banking sector of the Republican era.

Globally, the foundations of traditional banking can be traced back to the Middle Ages when monetary transactions first emerged. The classical interest-based banking model has multiple definitions depending on different perspectives. From an economic standpoint, it is associated with savings, waiting periods, and time value. Additionally, it is considered to be linked to employment analysis. Many scholars view the classical interest concept within the framework of the "distribution theory." In economic terms, income is classified into wages, rent, interest, and profit (Conard, 2023). According to Adam Smith, lending money between two parties involves applying interest, allowing the lender to generate profit from the money provided (Kazgan, 1969).

In this banking system, interest rates are determined by banks and applied accordingly, which is one of the key factors distinguishing traditional banking from participation banking. In participation banking, interest is replaced by a profit-sharing model. The primary objective of traditional banking is to collect and allocate funds, with interest serving as the fundamental mechanism for these transactions. This indicates that traditional banking inherently operates within a monetary trade system.

Literature Review

In this study, national and international literature has been examined. As a result of our review, the perspectives of existing customers of participation banks and deposit banks regarding these banking systems have been analyzed in different ways. The literature review conducted in this field reveals that similar findings have been observed across multiple studies.

Studies in Turkey Comparing Participation Banks and Deposit Banks

Işıl and Özkan (2015) analyzed the variables affecting liquidity risk in four banks operating in Turkey during the period 2006–2014 using Seemingly Unrelated Regression analysis with quarterly data.

Their findings indicate that an increase in past credit expansion in participation banks has led to a rise in liquidity risk. As participation banks expand in Turkey, they are more exposed to liquidity risk.

Doğan (2013) conducted a study measuring the financial adequacy of participation banks and deposit banks between 2005 and 2011. The study analyzed the return ratios, liquidity statements, risk analyses, debt repayment statements, and capital adequacy of four participation banks and four deposit banks using a t-test. The results showed no significant difference in return ratios between the banks; however, deposit banks exhibited higher liquidity, debt repayment capacity, and capital adequacy ratios.

Sakınç and Poyraz (2018) examined the reasons why individuals prefer to keep their savings in participation banks. Their study surveyed 100 customers of a participation bank using a questionnaire, and the data were analyzed through frequency analysis. The findings indicate that customers are aware of why they choose participation banks, with a primary reason being their adherence to Islamic principles. Customers also perceive the services they receive as reliable and believe that the range of products and services offered is broader compared to other banks. Another significant factor influencing customer preference is the lower transaction costs in participation banks compared to conventional banks.

Tekin (2019) conducted a study involving 195 students at Çankırı Karatekin University to measure their perceptions of participation banks. The research employed a survey method and applied Exploratory Factor Analysis, t-tests, ANOVA, and Tukey tests. The findings revealed that students do not prefer these banks due to the use of Arabic terminology in their communication, which they find difficult to understand. Among the participants, 30% preferred participation banking, while 15% believed these banks processed transactions faster. Additionally, 22% considered participation banks more reliable than conventional banks, and 19.5% evaluated their service quality positively. It was also found that students majoring in Banking and Finance had more knowledge about participation banking than students from other academic disciplines.

Balkanlı and Yardımcıoğlu (2020) examined employees working in participation banks to assess their awareness of the principles of Islamic economics. The study employed Internal Consistency Analysis and Exploratory Factor Analysis. The findings suggest that employees in participation banks act in accordance with Islamic financial principles and recognize the necessity of sensitivity regarding interest-free banking. However, despite these findings, some participants still indicated that they did not prefer participation banks in certain aspects.

Pilatin (2022) investigated participation bank customers across Turkey's geographical regions to determine the reasons for their banking preferences through an online survey. The study utilized ANOVA, Reliability Analysis, Exploratory Factor Analysis, t-tests, and Post Hoc tests. The results indicated that the primary reason for choosing participation banks was their interest-free banking operations, followed by lower or non-existent transaction costs. Another key finding of the study was that residents of the Eastern Anatolia region preferred participation banking services more than those in other regions.

Foreign Studies Comparing Participation Banks and Deposit Banks

The following foreign studies have been examined in the comparison of participation banks and conventional banks:

Meero (2015) conducted a study comparing eight participation banks and eight conventional banks operating in Gulf countries between 2005 and 2014 based on various financial indicators. The study evaluated the return on equity, return on assets, and total liabilities-to-equity ratio using a t-test. The findings indicated that the banks were similar in terms of capital structure. Additionally, it was observed that return on assets had a negative impact in terms of financial leverage, whereas the equity-to-assets ratio had a positive effect across all banks.

Milhem and Istaiteyeh (2015) analyzed 13 conventional banks and 13 participation banks in Jordan between 2009 and 2013. Using a t-test, they compared the banks' profitability levels, liquidity positions, risk ratios, solvency, and efficiency through 13 financial ratios. The study concluded that, compared to conventional banks, participation banks exhibited lower profitability, higher liquidity, and lower risk and efficiency. However, the difference in profitability was not found to be statistically significant.

Aman, Sharif, and Arif (2015) examined the performance of five participation banks and 15 conventional banks operating in Pakistan between 2008 and 2013 using t-tests and simple regression analysis. The study found that participation banks exhibited lower performance than conventional banks in terms of business models and operational efficiency. However, participation banks outperformed conventional banks in terms of asset quality and stock price financing.

Bitar, Hassan, Pukthuanthong, and Walker (2016) investigated the impact of different capital structures on the profitability of participation and conventional banks. The study analyzed the annual financial statements of approximately 656 banks, including 116 participation banks from 33 countries, covering the period between 1999 and 2013 through regression analysis. The findings suggested that stronger capital structures had a positive effect on profitability, and this effect was more pronounced in participation banks compared to conventional banks.

Uddin, Ahsan, and Haque (2017) compared five participation banks and five conventional banks operating in Bangladesh between 2010 and 2014, focusing on capital adequacy, asset and management quality, earnings levels, and liquidity positions using a t-test. The results indicated no significant differences between the two banking models, except in terms of management quality.

Comparison of Participation Banking and Conventional Banking

Comparison in Terms of Provided Services

When analyzing the similarities and differences between participation banks and conventional banks, the findings indicate that there are no extreme differences in fundamental operations and business activities. Instead, the various banking transactions are executed differently depending on the type of banking model. Therefore, this study aims to highlight both the distinguishing aspects and the common grounds of these banking models.

Participation banks implement the profit-and-loss-sharing model while offering banking services similar to conventional banks. Consequently, they operate under an interest-free banking system. Institutions that conduct banking activities without any interest-based transactions serve as alternatives to conventional banks, essentially carrying out similar financial operations but under different principles, thereby contributing to the financial sector (Takan, 2020).

Although the comparison between participation banking and conventional banking initially brings their differences to mind, outlining their similarities first will provide a better understanding of their distinctions. From a broad perspective, despite the variations in execution methods, both banking models ultimately perform the same fundamental functions.

In terms of financial statements, both banking models are subject to the provisions of the Banking Law No. 5411, which was enacted on November 1, 2005. According to Article 37 of this law, "banks must apply a uniform accounting system in accordance with the procedures and principles determined by the Board, taking into account international standards and considering the opinions of the founding associations and the Turkish Accounting Standards Board. They must record all transactions in accordance with their true nature and prepare financial reports that are clear, reliable, comparable, and suitable for auditing, analysis, and interpretation, ensuring that they meet informational needs accurately and in a timely manner."

Participation banking and conventional banking can be compared across various dimensions. To better illustrate these differences, the distinctions between the two systems will be presented in the following table (Özulucan & Deran, 2014).

Table 1: Comparison of Participation Banking and Traditional Banking

Feature	Participation Banks	Traditional Banks
General Purposes	In terms of economy, it aims to maximize equity capital through the implementation of transactions that are in line with religious rules. It aims to correct new financial situations that are in line with Sharia rules in order to improve deposits. In terms of society, it aims to purify interest transactions in the banking sector and achieve social development.	The difference between the interest rate received from loans and the interest rate given to deposits is the bank's profit. The bank tries to balance risk and profitability and aims to maximize its equity through the profit it earns.
Working Order	Participation Banks and their customers share in profits and losses. There is no interest in banking transactions. It is not considered as an intermediary with a commercial return on money. There are fund collection and use practices in these banks.	In traditional banks, transactions are made according to interest. Therefore, money is seen as a commercial tool in traditional banks.
Use of Money	Money is not a tool in buying and selling transactions in participation banks. Therefore, bank customers make transactions with profit and loss sharing in line with the opportunities offered to them by the bank.	In traditional banks, buying and selling activities are carried out based on the value of money. For this reason, money provides profit as a commercial tool.
Functions of Money	In this system, money is not treated as a commercial commodity in purchase and sale transactions. Therefore, when participation banks collect funds, they conduct transactions based on profit-and-loss (P/L) partnerships with customers. Similarly, when providing funds, they	In this system, money is used as a commercial product, bought and sold in exchange for a specific amount. Therefore, the function of money operates differently within this system compared to participation banks. In

	utilize mechanisms such as forward sales, leasing, and P/L partnerships. Participation banks engage in trade involving tangible goods alongside offering various banking services.	addition to banking services, banks also engage in the trade of money.
Fundraising Procedures	Customers who wish to use funds are provided with resources through special current accounts and participation accounts. In this type of bank, partnerships are formed based on profit and loss accounts. Participation banks do not use the LIBOR system; however, they can meet their funding needs from abroad.	In traditional banks, funds are raised through interest. Therefore, there is no partnership relationship between the customer and the bank. When the customer uses funds from the bank, they become the debtor, and the bank becomes the creditor. In traditional banking practices, the LIBOR system may be used when needed.
Fund Usage Transactions	In participation banks, the provision of funds is not in the form of cash loans. Instead, the profitability ratio that the project will generate is of primary importance. Participation banks typically offer long-term maturities.	In traditional banks, investment in commodities other than money or gold is not possible. The bank provides loans to customers with interest. When customers apply for a loan, the value of the collateral they offer is of significant importance. Short-term loan repayments can be found at traditional banks.
Risks Assumed by Customers	In participation banks, customers accept to share the profits and losses from the very beginning, thereby assuming the risk from the outset. As a result, the banking system is based on trust. What matters most is the fundamental nature of the projects financed by the bank.	The structure of traditional banks is based on interest, and therefore, they have accepted returns based on interest rates.
Cost of Fund to Clients	In participation banking, since there is no interest, the amount to be repaid at the end of the term is predetermined.	In traditional banks, however, due to fluctuations in index rates, there may be variations in loan repayments.
Legal Audit	Participation banks are subject to regular audits.	Conventional banks are also subject to regular audits.
Return status to the customer	In participation accounts, the profit generated from the accumulated funds is generally distributed 80% to the account holders. Of course, if there is a loss, the system is structured in such a way that the fund holders will bear the loss in proportion to their contributions.	The profit of the account holder is predetermined proportionally according to the system.
Financial Instruments Used	Participation banks use the funds they collect through methods such as murabaha, musharaka, sukuk, takaful, and tawarruq.	Traditional banks, on the other hand, engage in transactions through interest, which is the process of making money from money by providing cash loans. The instruments they use include short-term

		instruments such as repurchase agreements (repos), interbank markets, and treasury bonds, in which banks also invest.
Assurance of Funds Collected	The funds collected by participation banks are under the guarantee of the Savings Deposit Insurance Fund (SDIF).	Traditional banks, like participation banks, are also under the guarantee of the Savings Deposit Insurance Fund (SDIF).
Risk Assumed	In participation banks, the utilization of collected funds in the real economy is fundamental, and since there is an investment partnership between the participation banks and the fund holders, risk is always present.	In traditional banks, interest is charged at predetermined rates. Therefore, there is no risk in the traditional banking system.
The status of distributed profits in relation to the Income Tax Law (GVK)	The profit shares distributed by participation banks are considered as securities income according to Article 75/12 of the Income Tax Law No. 193 and are subject to income tax.	Similarly, deposit interest is also considered as securities income according to Article 193 of the Income Tax Law and is subject to income tax.
Return Distribution	There is no legal limitation in participation banks.	There are limitations on deposit interest rates.
Professional Association to Which They Belong	It is mandatory to be a member of the Banks Association of Turkey.	It is mandatory to be a member of the Participation Banks Association of Turkey.

Comparison in Terms of Sectoral Data

As of 2024, there are 33 deposit banks and 9 participation banks in the banking system in Turkey. In this section, Participation and Deposit Banks will be compared based on criteria such as "branch number, total assets, total deposits, total loans, capital adequacy ratio, profit/loss, and non-performing loans."

Table 2: Participation Banks Statistics for the Years 2019-2023

Years	Number of Branches (Domestic)	Total Assets (Billion TRY)	Total Deposits (Billion TRY)	Total Loans (Billion TRY)	CAR	Profit/Loss (Billion TL)	Non-Performing Loans (Billion TL)
2019	1176	284.459	215.456	136.202	18	2.438	7.763
2020	1251	437.146	321.405	222.349	18	3.717	8.713
2021	1307	717.338	556.418	335.912	19	5.468	11.225
2022	1375	1.187.615	891.066	578.679	21	29.699	9.114
2023	1455	2.040.850	1.516.367	905.721	21	53.250	9.855

Source: Banking Regulation and Supervision Agency (BDDK)

Table 3: Deposit Banks Statistics for the Years 2019-2023

Years	Number of Branches (Domestic)	Total Assets (Billion TRY)	Total Deposits (Billion TRY)	Total Loans (Billion TRY)	CAR	Profit/Loss (Billion TL)	Non-Performing Loans (Billion TL)
2019	10063	3.904.022	2.351.289	2.307.033	18	40.986	140.631
2020	9802	5.281.462	3.133.673	3.089.297	18	48.688	140.843
2021	9651	7.882.809	4.746.356	4.149.398	18	77.608	144.622
2022	9515	12.340.649	7.970.075	6.513.823	19	380.040	149.852
2023	9347	20.166.457	12.703.999	9.670.580	18	450.573	160.827

Source: Banking Regulation and Supervision Agency (BDDK)

When the above tables are examined, it can be observed that the number of branches of deposit banks, which was 10,063 in 2019, decreased to 9,347 by 2023, indicating a decline in the number of branches. In contrast, the number of branches of participation banks, which was 1,176 in 2019, increased to 1,455 in 2023, showing a growth in the number of branches over the years. Looking at the total assets, deposit banks had a total of 3.904 trillion TL in assets in 2019, which increased to 20.166 trillion TL by 2023, marking an approximate 5-fold increase in total assets. On the other hand, participation banks had a total of 284.455 billion TL in assets in 2019, which grew to 2.040 trillion TL by 2023, representing an approximate 7-fold increase in total assets over the years.

When total deposits are compared, it can be observed that deposit banks, which had a total of 2.351 trillion TL in deposits in 2019, reached 13.334 trillion TL in total deposits by 2023, reflecting an approximate 5.5-fold increase in total deposits.

In participation banks, the total deposits, which were 215.456 billion TL in 2019, increased to 1.516 trillion TL by 2023, reflecting an approximately 7-fold increase over the years. On the other hand, when examining total loans, deposit banks, which had total loans of 2.307 trillion TL in 2019, reached 9.956 trillion TL in total loans by 2023, showing an approximate 4-fold increase. In participation banks, total loans, which were 136.202 billion TL in 2019, grew to 905.721 billion TL by 2023, indicating an approximate 6.5-fold increase over the years.

In 2019, the capital adequacy ratio of deposit banks was 18. Despite an increase to 19 in 2022, it was observed to return to 18 by 2023. In participation banks, the capital adequacy ratio, which was 18 in 2019, rose to 21 by 2023, indicating a continuous improvement in capital adequacy over the years. On the other hand, deposit banks, which had a total profit of 40.986 trillion TL in 2019, reached a total profit of 526.353 trillion TL by 2023, showing an approximately 13-fold increase. In participation banks, the total profit, which was 2.438 billion TL in 2019, increased to 53.250 billion TL by 2023, reflecting an approximate 22-fold growth over the years.

Lastly, when looking at non-performing loans, it was observed that deposit banks, which had non-performing loans of 140.631 billion TL in 2019, reached 176.063 billion TL in 2023, showing an increase of approximately 15%. In participation banks, non-performing loans, which were 7.763 billion TL in 2019, increased to 10.202 billion TL by 2023, reflecting an approximately 31% growth over the years.

Conclusion

The Turkish banking sector, with the lessons learned from past crises, now ranks among the strongest banking sectors in the world. For a long time, the banking sector primarily operated with deposit banks, and this was seen as a significant gap in terms of attracting the savings of individuals with sensitivity to interest rates. Participation banks, which focus on managing savings according to Islamic principles for those who are sensitive to interest, have effectively established their presence in global markets and have eventually started operating in our country as well. This has filled a significant gap in the banking sector in our country.

As of 2024, there are 9 participation banks, including 2 digital ones, and 33 deposit banks in our country. By offering various instruments, these banks contribute the savings of individuals back into the economy, providing financing for both private sector and government projects. In our study, we first compared the banking services offered by participation banks and traditional banks. The results indicate that while the general goal in both types of banking is to generate profit, participation banking aims to achieve this profit in accordance with Islamic principles and practices.

In terms of operational structure, traditional banks carry out transactions based on interest, while participation banks operate through profit-and-loss sharing methods. Regarding the use of money, in participation banks, money is not used as a tool for buying and selling, whereas in traditional banking, money serves as the primary tool for such transactions. When it comes to fund collection, participation banks establish partnership relationships with their customers through the Special Current Account and Participation Account, while traditional banks do not engage in such partnership relations, instead offering interest in exchange for the funds they collect from customers. In terms of fund distribution methods, participation banks do not provide funds in cash, while traditional banks mostly distribute credit in cash. Regarding the risks undertaken by customers, in participation banking, profit-and-loss sharing means that customers face the possibility of not making a profit or incurring a loss, while in traditional banking, the interest a customer will receive is predetermined, so under normal circumstances, there is no risk of loss. In terms of legal supervision, both types of banks are regularly audited by the relevant government authorities.

When considering the financial instruments used, participation banks provide funds they collect through methods such as murabaha, musharaka, sukuk, takaful, and tawarruq. On the other hand, traditional banks operate through interest-based transactions, which involve earning money from money by providing cash loans. The instruments they typically use include short-term instruments such as repos, interbank market transactions, and treasury bills. Regarding the security of the collected funds, in both types of banking, the funds are insured by the Savings Deposit Insurance Fund up to a certain limit. Lastly, in terms of the banking unions they belong to, participation banks are required to be members of the Participation Banks Association of Turkey (TKBB), while traditional banks must be members of the Banks Association of Turkey (TBB).

On the other hand, when comparing sectoral data, it is observed that while the number of branches of deposit banks has decreased from 2019 to 2023, the number of branches in participation banks has increased. Similarly, when looking at the total assets, it is observed that the total assets of deposit banks have increased approximately fivefold by 2023. In participation banks, however, there has been an increase of about sevenfold. When comparing total deposits, it is observed that deposit banks' total deposits have increased approximately 5.5 times by 2023. In participation banks, the total deposits have increased by about seven times.

When examining total loans, it is observed that the total loans of deposit banks have increased approximately fourfold by 2023, while in participation banks, there has been an increase of about 6.5 times. Looking at the capital adequacy ratios, it is observed that the ratio of deposit banks is 18, whereas in participation banks, this ratio is higher, at 21. When evaluating total profit, deposit banks have experienced an increase of approximately 13 times in their profits, while participation banks have seen an increase of about 22 times. Finally, regarding non-performing loans, it is observed that the non-performing loans of deposit banks have increased by approximately 15% by 2023. In participation banks, non-performing loans have increased by about 31%.

In conclusion, both deposit and participation banking continue to grow in Turkey. However, while the country has not yet gained a sufficient share of the global participation banking sector's size, it is observed that the participation banking sector is more aggressive in terms of branch expansion. As the number of branches approaches that of deposit banks, it is expected that other metrics such as active size and profitability will significantly increase in the coming years.

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