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SCIENTIFIC REVIEW

Process of Internationalization in Islamic Banking: The Case of Serbia

Aida Hanić[1*]

[1] Institute of Economic Sciences, Belgrade, Serbia

ABSTRACT
Islamic banks are financial institutions operating in accordance with religious Islamic law (Sharia). Although it is familiar as non interest banking, because the interest is forbidden, Islamic banking represents a complete set of moral and ethical activities that must be taken into account when making investment decisions and financing business activities. Share of Islamic banking in Islamic finance is around 80% with the value of approximately $ 1.57 trillion by the end of 2015 (IFSI Stability Report 2016). Islamic banking in Western Balkan is present only in Bosnia and Herzegovina (B&H) that has one Islamic bank, Bosna Bank International (BBI) established in 2000. Serbia, as a country that has attracted many Arab investors, doesn't have any Islamic bank operating in the country. The aim of this research is to explore is there a public interest in Islamic banking, especially among the commercial banks in Serbia and are there possibilities for development of Islamic banking in this country. To explore these two main questions, author conducted a research by using a questionnaire among the chairmen and members of the administrative Board of 12 commercial banks in Serbia. The result of the research show that commercial banks in Serbia are not interested in this type of a banking activity. On the other hand they are also not sufficiently familiar with the concept of Islamic banking. The research showed that process of internationalization of Islamic banking is not present in Serbia.

Key words: *Islamic banking, internationalization, ethical identity, development, Serbia*

JEL Classification: G21

INTRODUCTION

Islamic banking is a financial activity done in accordance with Islamic religious law (Sharia), and it is based on principles that are different compared to conventional banking. First, money is seen only as a medium of exchange because Sharia forbids payment or receipt of interest *(Riba*), gambling (*Maysir*) or excessive uncertainty (*Gharar*). Secondly, it promotes risk sharing where every economic activity must have a connection with the real economy and the parties are bound by agreement that includes the Profit and Loss Sharing Paradigm. Human effort and activities that are included in some investment project are valued equally as the funds that are going to use to finance that same investment project. In that case, individual has the right and responsibility to the society *("Therefore, as for the orphan protect him, as for the beggar, oppress him not, and as for thy Lord's favor, declare it"; Quran: 9:11)* and must be oriented towards the creation of a moral and sustainable society which form the basis of Islamic ideology. According to Iqbal & Mirakhor (2007), ideology is important because if the ideology is strong enough, the

[*] E-mail: aida.hanic@ien.bg.ac.rs

divergence between the choices individuals make and those expected of them are less. In other words it means that asymmetry and moral hazard are minimized since a large part of uncertainty is eliminated with rule compliance.

Islamic financial system began to develop when the process of decolonization started and the first Islamic bank, Mit Ghamr Savings**,** was founded in 1963 in Egypt and followed the model of German Savings Bank. Ever since, Islamic financial institutions (IFI's) started to grow at 10-12% annually. Beside Islamic insurance (Takaful), Islamic bonds (Sukuk) and other Sharia financial instruments, Islamic banking with a percentage of 80% is dominant in Islamic financial industry. Current size of the Islamic Finance market range is estimated from \$1.66 trillion to \$2.1 Trillion with expectations of market size to be \$3.4 trillion by end of 2018.[1] According to magazine "The Banker", in 2015 there were 360 registered Islamic financial institutions and 111 conventional institutions with Sharia windows. Dubai Center for Islamic Banking and Finance reports that, currently, on the global level, there are around 150 Islamic commercial banks that are fully-fledged[2].

Iman & Kpodar (2015) notes that countries where Islamic banking is present has positive impact on growth and experience faster economic growth than others. But despite the growth and economic stability, especially during the crisis, Islamic finance assets are still concentrated in the majority Muslim countries. Nevertheless, there are some exceptions like Indonesia, the world's most populous Muslim country, where according to World Islamic Banking Competitiveness Report (2016), Islamic banking has only 3.8% of market share. In others GCC[3] countries, Islamic banking has different market share: Saudi Arabia (31.7%), Malaysia (16.7%), UAE (14.6%), Kuwait (10.50%), Qatar (7.7%), Turkey (5.8%), Bahrain (1.7%), Pakistan (1.2%). This still represents a relatively small share of the economy.

Islamic banking in Europe is present since 1978 when Islamic Banking System International Holding was established in Luxembourg. In 2002, the Luxembourg Stock Exchange was the first to list a Sukuk. Today, London is considered to be Europe's capital of Islamic banking. The first Islamic financial institution in the country was founded in 1981, Al-Baraka International Company, and in August 2004 the Islamic Bank of Britain was established as the first Islamic Retail bank.

For the purposes of this paper, analysis will be focused on Serbia. In near B&H, there is only one Islamic bank, Bosna Bank International (BBI), based in Sarajevo and established on October 19, 2000 as the first bank in Eastern Europe to operate on the principles of Islamic banking. The share capital of BBI amounted around EUR 23 million, which at that time, was the largest paid in capital compared to other banks in the country. The bank founders are Islamic Development Bank (the major shareholder of BBI with 45.5% share capital), Dubai Islamic Bank (shareholder of BBI with 27.27% of the share capital) and Abu Dhabi Islamic Bank (shareholder of BBI with 27.3% share capital). In Serbia there are no Islamic banks but only one bank from UAE, "Mirabank" that is focused primarily on corporate financing.

This paper aims to provide an answer to the research, which is, whether Islamic banks have a perspective of development and further expansion in countries such as Serbia.

This paper is organized as follows. Section *Literature review* gives a brief overview of the process of internationalization, especially in banking industry. Section *Theoretical framework* examines Islamic banking and Islamic Financial Country Index. In the third section, *Methodology*, the process of data collection, regarding the presence of Islamic banking is Serbia, is explained.

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[1] https://www.islamicfinance.com/2015/05/size-islamic-finance-industry/(Accessed on February 2017).
[2] Fully fledged Islamic bank is a bank whose business is totally based and performs with Islamic principles while Islamic window is just a service provided by conventional banks but based on Islamic principles.
[3] The Cooperation Council for the Arab States of the Gulf known as the Gulf Cooperation Council (GCC) is consisted of Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates.

Results from questionnaire where given in the section *Results and Discussion*. The *Conclusion* presents the outcome of the paper.

LITERATURE REVIEW

Internationalization, in commerce, can be defined as a growing tendency of a company to take its business from local to international market. As a process, internationalization is unpredictable but from business perspective it can bring several advantages such as to increase the companies turnover, to be used to recover from the losses as the domestic sales is shedding, to help the company to be more competitive (Burdus & Alpopi) and from marketing perspective, it requires from companies to adopt it products and services to different cultures and languages. Paliu–Popa (2008) notes that process of internationalization is done in several stages and it is consisted of internationalization of trading goods, the internationalization of production and the internationalization of the firm.

In study *"Banking Across Borders"* done by Slager (2004), there are seven major incentives why to internationalize: 1. Follow your client, 2. Increase earnings, 3. Exploit financial and economic developments of the home country, 4. Regulation, 5. Market concentration, 6. Herding, 7. Efficiency, profitability. In the case of Islamic banking, rapid growth increased the demand for Islamic banking products contributing to its development. Islamic banking in the society can bring changes because it promises to foster greater financial inclusion, it is based on asset-backed financing and risk-sharing what is a good support for SME and it poses less systemic risk than conventional banking (Kammer, Norat, Piñón, Prasad, & Towe, 2015). Islamic banking is based on ethical norms, derived from the Islam, and according to Garas & Manama (2007) it enhances their Corporate Social Responsibility (CSR), what can bring them a favorable image from the stakeholders and enhanced their performance in their early stage.

Historically, during the first three decades of its development, Islamic banking was focused on two core markets: Bahrain in the Middle East and Malaysia in South-East Asia (Imam & Kpodar, 2010). Today Islamic banking is being identified as a multi-dimensional market. In practice more international banks are turning to Islamic banking in form of Islamic windows or as a fully-fledged bank which resulted in the expansion into new markets (Malik, 2010). In some countries, Islamic banking became systemically important and, in many others, it is too big to be ignored (IMF, 2010). Muslims make 24% of world population and in Europe there are around 20 million of Muslims as potential customers where Deloitte stands (2014) that saving rates of European Muslims are higher than those of other European populations. EU governments are welcoming Islamic banks and trying to make better conditions for their business. For example, Luxembourg is recognized as a leading hub for Islamic funds with 111 Islamic funds doing business in this country while in Ireland their number is 53 (Deolitte, 2014).

As a way of moving Islamic banking to new markets, some Islamic banks are rebranding their name and moving the word *"Islam"* from the banks name. In January 2014, *Dubai-based Noor Islamic Bank* changed its name to *Noor Bank*. On the other hand in Turkey, Islamic banks are named as *„Participation banks"* although they are operating in accordance with Sharia rules. Islamic banks are not planning to leave Sharia rules but just to be more close to other customers that are not Muslims especially in Non- Muslim countries.

As said before, Islamic banking is present in the region, with only one Islamic bank but the fact is that public is still not sufficiently enough familiar with the core of their business. Goksu & Becic (2012) conducted a survey whose main objective was to show customers' attitudes, beliefs and perceptions about the services offered by Islamic bank in B&H. Survey had three parts: demographics, general experiences and perceptions about Islamic banking in B&H. Results of the research on 186 clients showed that around 60% of respondents didn't gave the correct answer regarding understanding the principles of Islamic banking. In Serbia the awareness of the Islamic banking is even lower not just among the customers but also among the participants of the financial sector, especially conventional banks.

THEORETICAL FRAMEWORK

Islamic banking, as a financial activity, has its own principles and every transaction includes the following:

1. There must be a mutual trust and transparency between the partners in every part of a transaction,
2. The use of Profit and Loss Sharing paradigm,
3. Ownership – you can sell the commodity or the subject of the contract only if you own it.

Because of the prohibition of interest, Islamic banks have developed many products as an alternative to the conventional banking, with the aim to satisfy their clients financial needs but on a more ethical and moral way. There are two main types of product:

a) profit and loss sharing instruments (PLS)
b) mark-up (cost plus) contracts.

The further division would be the following:

a) sales based (Murabaha, Istisn'a, Ijarah, Tawarruq),
b) equity based (Musharakah, Mudarabah),
c) fee based (Wakalah, Kafalah, Rahn),
d) Islamic deposits (Wadai'ah, Qarḍ, Tawarruq),
e) Investment Accounts (Mudarabah, Musharakah) and
f) Investment Accounts (Wakalah).

Although the Islamic banking is still a relatively new way of doing business, according to Thomson Reuters' Islamic Finance Development Indicator (IFDI 2016), by 2021 Islamic banking assets will reach US$2.8 trillion as shown in chart below.

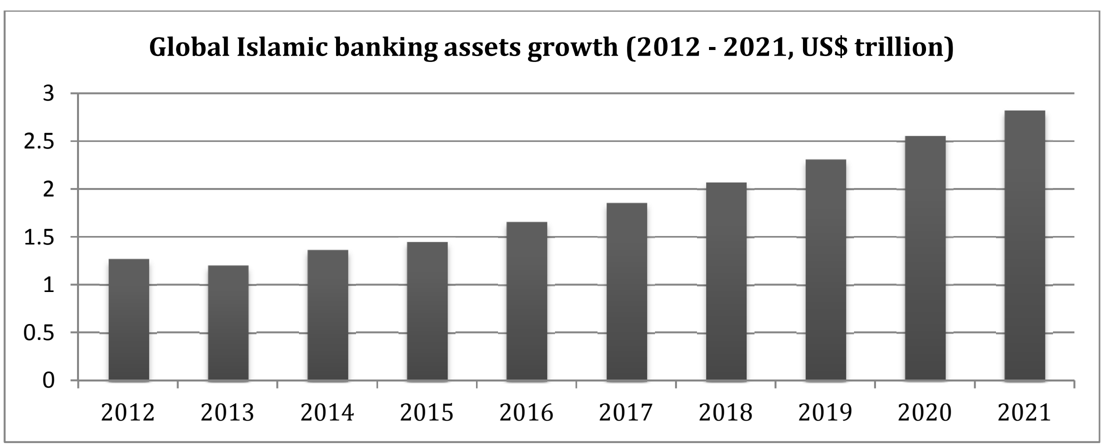
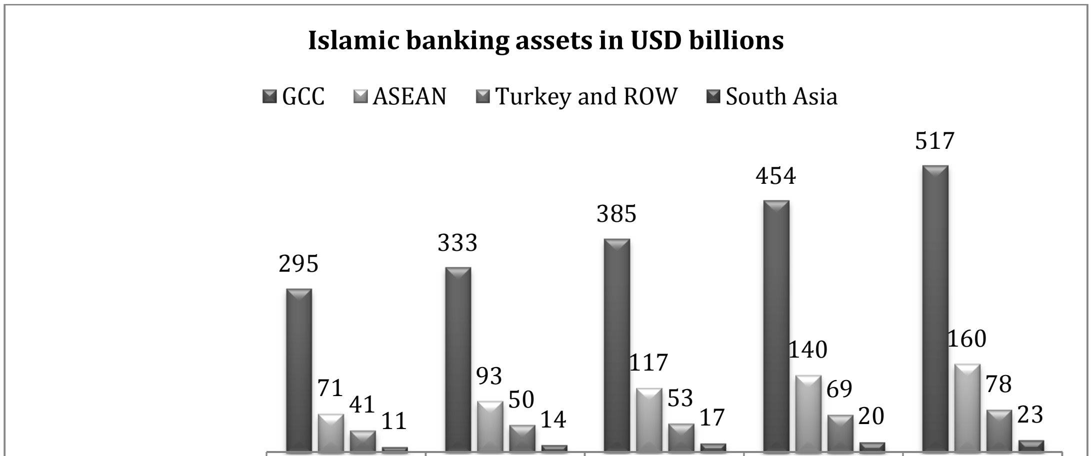


Chart 1. Expected Islamic assets globally

Source: Thomson Reuters' Islamic Finance Development Indicator

In geographic terms, Islamic banking is mostly concentrated in the Middle East and Asia.



	2009	2010	2011	2012	2013
GCC	295	333	385	454	517
ASEAN	71	93	117	140	160
Turkey and ROW	41	50	53	69	78
South Asia	11	14	17	20	23

Chart 2. Islamic banking assets

Source: EY World Islamic Banking Competitiveness Report 2014-15

When analyzing a countries profile, as a potential market for Islamic banking, "*Islamic Financial Country Index"* (IFCI) was launched in 2011 with total 45 countries involved. Variables that are included in the Index are presented in the next table.

Table 2. IFCI Variables and Their Weights

Variables	Description	Weights
Number of Islamic Banks	Full-fledged Islamic banks in local and foreign origin	21.8%
Number of Islamic Banking Financial Institutions (BFIs)	All Islamic banking and non-banking financial institutions including Islamic windows provided by conventional banks	20.3%
Shari'a Supervisory Regime	A central institution or body to look after the Shari'a-compliance process in all Islamic banking financial institutions in certain country	19.7%
Islamic Financial Assets	Islamic financial assets under management of Islamic and conventional institutions	13.9%
Muslim Population	Number of Muslims in absolute value	7.2%
Sukuk	Total sukuk outstanding in the country	6.6%
Education and Culture	Level of educational and cultural environment in the area of Islamic finance such as professional qualifications, degree courses, diplomas and other dedicated training programs	5.7%
Islamic Regulation & Law	Legal framework that regulates IBFIs in the country such as Islamic banking act or Islamic capital markets act, etc.	4.9%

Source: Global Islamic Finance Report 2015

When all of the variables are analyzed, the results of a countries ranking is given in the next table.

Table 3. IFCI ranking countries, top 10 and other countries in 2015

Country	Rank in 2015	Rank in 2014	Score 2015
Iran	1	1	85.6
Malaysia	2	2	80.3
Saudi Arabia	3	3	73.6
United Arab Emirates	4	6	38.0
Kuwait	5	5	36.7
Bahrain	6	4	26.3
Indonesia	7	7	24.7
Qatar	8	10	20.9
Sudan	9	8	15.7
Pakistan	10	9	14.7
Turkey	12	12	9.7
UK	14	13	6.7
Switzerland	24	-	2.3
France	38	35	0.9
Germany	40	36	0.6
China	42	39	0.6

Source: Global Islamic Finance Report 2015

Sharia in the fundamental basics of Islamic banking and finance and in some countries like Bahrain, Iran, Pakistan, Saudi Arabia and Sudan it is the official law of a country while in countries like Malaysia it is not a part of the legal framework (IMF, 2014). One very successful example of how to introduce Islamic banking into financial system is Malaysia. This country has a dual banking system where conventional and Islamic banking system operates in parallel. In 1983, Malaysia introduced the Islamic Banking Act that gave foundations for Islamic banking.

From the table above we can see that Serbia and Bosnia and Herzegovina are not on this list. The reason is that both countries do not fulfill these variables contained the IFCI. In the case of Bosnia and Herzegovina, BBI bank in 2012 was ranked in ninth place amongst the fastest growing banks in Bosnia and Herzegovina and in 2015 BBI had 5.6 millions of KM (apx. 2.83 millions of EUR) of revenue. Sarajevo Stock Exchange (SASE) and BBI signed a contract of implementation of Islamic Index, as the only Islamic Index in the region. According to the census in 2013, in B&H 50.7% population are Muslims what is a good foundation for the development of Islamic banking, but in practice conventional banking is more present among the customers in B&H, regardless of religion. Although, BBI started the process of public education by publishing articles on Islamic banking and finance where in association with Sarajevo School of Economics and Business, University of Sarajevo there are master programs for Islamic banking, the awareness of Islamic banking is still low.

In Serbia, banking system consists of the central bank (National Bank of Serbia) and commercial banks. At the end of March 2016, banking sector numbered 30 banks of which 17 banks operated with profit, while 13 banks reported a negative result. Four banks which posted the highest net profit together made up more than half of the total sector's profit, while one bank with the highest net losses accounted for one half of the total losses. "Mirabank", the only bank in Serbia from Arab area, which is not offering Islamic banking, on 30.9.2016 reported losses in value of RSD 320 million (apx. 2.583.040 EUR).

One of the key elements regarding development of Islamic banking in Serbia is regulation. The "*Law on banks*" doesn't recognize Islamic banking as a way of doing business but in the activities such as a) foreign exchange operations, foreign currency operations and exchange transactions; b) payment transactions; c) issuing payment cards; d) activities regarding securities (issuing securities, custody bank activities, etc.); e) brokerage-dealership activities; these operations are allowed. In that aspect if there is a demand for this types of services maybe in future the Law can create conditions for the Implementation of Islamic banking.

METHODOLOGY

This particular research was created to provide an insight into degree of familiarity of directors of commercial banks in Serbia with the principles of Islamic banking and the possibilities for the development of this financial activity and to provide an insight in further internationalization of Islamic banking in Serbia. The author created a short questionnaire containing only 7 questions. The questions were related to areas such as:

a) the rate of growth of assets of Islamic banks,
b) the level of informed about the principles of Islamic-banking,
c) the degree of acceptance of the establishment of Islamic banks by the public
d) percentage of the rate of return risk of Islamic banks compared to conventional banks,
e) level of interest of conventional banks to provide Islamic banking services through Islamic windows,
f) regulating the business of Islamic banks and
g) business ethics in Islamic banking

The questionnaire was delivered to banks in Serbia via their e-mail addresses and 12 banks answered the questionnaire. The survey questionnaire contained questions that included single response, multiple response, ranking response, and five-point scale questions. The survey was conducted during the September of 2016. It is important to note the research result provides very limited insight into the state and prospects of development of Islamic banking in Serbia, because the period of survey was short and the pattern is small, but it still provides an insight into the degree of internationalization of Islamic banking in Serbia.

RESULTS AND DISCUSSION

The research revealed that:

1) Based on the distribution of responses, on the indicative level, only one third of the members of the board of directors of commercial banks in Serbia know that the Islamic banking sector in 2008 achieved a higher rate of growth of assets.
2) Relating the level of informed about the principles of Islamic-banking, 83% of respondents answered negatively which is consistent with the answer to the first question, leading to conclusion that directors of commercial banks in Serbia are aware that public is not sufficiently informed about the principles of Islamic banking.
3) In aspect of establishing Islamic bank in Serbia, 65% of directors of commercial banks believe that Islamic bank would be well accepted by the public in Serbia, 25% have the opposite opinion while the remaining 10% were not able to comment on the matter.
4) If a client is late with repayment of the loan, the Islamic bank can't charge interest, as in the case of conventional banks, that suggests that Islamic banks, in most cases, are more exposed to return risk. The results of the research showed that 75% of directors of commercial banks in Serbia are sure that Islamic banks are not exposed more to the rate of return risk while 25% were not able to comment on the matter. This percentage is consist with the fact that public is not sufficiently informed about the principles of Islamic banking.
5) From a total of 12 directors who participated in the survey, 90% answered that they do not intend to offer Islamic banking through Islamic windows in the next five years, while only 10% said probably not.

6) Regarding regulation of Islamic banks, 58% of the respondents are aware that Islamic banks face a problem with the regulation in the countries like Serbia, 25% were not able to comment on the matter and 17% of the respondent participants answered that current regulation is not an obstacle to the development of Islamic banking in Serbia.
7) a) 50% of the of directors of commercial banks in Serbia strongly disagree that Islamic banking is applicable only in Muslim countries which is consisted with the statement that Islamic bank would be well accepted by the public in Serbia, 20% of the respondents disagree partially while 30% can't take a stand on this matter.
   b) Regarding the statement that Islamic banks are more profitable than commercial banks, 66% of directors of commercial banks in Serbia couldn't take a stand on this matter, 17% disagree partially with this statement and 17% partially agree.
   c) In the case of social responsibility, 67% of respondents takes a stand that Islamic banks are not more social responsible than commercial banks, 17% couldn't take a stand on this matter while the rest of 16% think Islamic banks are more social responsible.
   d) Regarding the question of ethics, 55% of directors of commercial banks in Serbia couldn't take a stand on this matter, 25% disagree with the statement and 20% think Islamic banks is more ethical.

CONCLUSION

Islamic banking is a financial activity that operates under the different conditions than commercial banking. This type of financial activity is present worldwide and it continues to expand. This process of internationalization gained importance after the outbreak of the global economic crisis in 2007 when Islamic banks, on average, showed stronger resilience than commercial banks. To examine the possibility of implementing the Islamic banking in Serbia, author did a research among the members of the board of directors of commercial banks in Serbia regarding: the rate of growth of assets in Islamic banks, the level of knowledge about Islamic banking, would the public in Serbia accept Islamic banking, what is the rate of return risk in Islamic banking compared to commercial banks, are commercial banks interested in providing Islamic banking services through Islamic windows, is the regulation of business of Islamic banks supported by the regulator and the ethics among commercial banks compared to Islamic.

The results show that only one third of the members of the board of directors of commercial banks in Serbia know that the Islamic banking sector in 2008 achieved a higher rate of growth of assets and where 83% of respondents answered negatively regarding their knowledge about the principles of Islamic banking which is consistent with the fact that public in Serbia is not sufficiently informed about the principles of Islamic banking. Although 65% of directors of commercial banks in Serbia believe that Islamic banking would be well accepted by the public in Serbia and where 50% of the of directors strongly disagree that Islamic banking is applicable only in Muslim countries, 90% of directors of commercial banks are not interested in offering Islamic banking in Serbia through Islamic windows. In the case of social responsibility, 67% of respondents take a stand that Islamic banks are not more social responsible than commercial banks while in the aspect of ethics, 55% of directors of commercial banks in Serbia couldn't take a stand on the matter are Islamic banks more ethical than commercial.

It is important to highlight that this research has a limit because the pattern is small and the period of research is short but also this is a good indicator is the Serbian financial sector ready for Islamic bank? The answer will depend on the demand of this type of financial product. On the other hand, process of internationalization of Islamic banking in Serbia might take a stand if future Islamic banks do a rebranding of their name, not to leave Shari'a rules, but to be more close to customers that are not Muslims especially in Non- Muslim countries

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