

## ISLAMIC FINANCES IN THE BALKANS: THE OPERATION OF THE ISLAMIC BOSNA BANK INTERNATIONAL

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### ABSTRACT

*During the 50 years since the formation of the Islamic bank system the bank operation of BBI has achieved huge successes. The authors in their study analyze the actions of the only Islamic bank of the Balkan Peninsula located in Sarajevo, namely Bosna Bank International. The essay contributes to the investigation of the Islamic bank system with the analysis of its balance sheet. The operation of the Bosna Bank International is interesting because the bank operates in a non-islamic financial environment. It seems to be a more real scenario in Hungary that instead of founding a clearly Islamic bank, a traditional bank would offer Islamic banking services (sc. "Islam window"). According to the opinion of the authors, the credit institution establishing the Islam window can acquire significant advantage in the field of getting clientele that is why we offer this strategy for the indigenous banks, too.*

Keywords: islamic bank system, islamic balance sheet, BBI

### INTRODUCTION: THE SPREAD OF THE ISLAMIC BANK SYSTEM

The first Islamic bank was founded in 1963 in Egypt. During the last 50 years the world's leading banks such as banks in the USA: Citybank, the JP Morgan/Chase, the Goldman Sach and the UBS Warburg, the British ones: HSBC, the Barclays Capital, ANZ Grindlays Bank, the Dutch ABN Amro, the French BNP Paribas and Societe Generale, the German Commerzbank and Deutsche Bank, the Russian Mežkobank, the Japanese Nomura Securities and the biggest Swiss bankgroup, the USB founded their own branch offices in Muslim countries (*Hadžić*, 2015). These are the so called „Islamic windows” in the framework of which these credit institutions provide their clients with bank products proper to Sharia.

Nowadays there are more than 300 Islamic banks all over the world. It is the tendency of last years that Islamic banks are founded not only in Islamic religious countries but also in other parts of the world. “For instance, 2 Islamic banks operate in Australia, 6 in the Bahamas and 38 in the USA. Both Denmark, France and Ireland have one banks whilst Germany and France have 5 Islamic banks. There is one in Bosnia and Herzegovina that operates according to the principles of Islamic banks” (*Hadžić*, 2015). In 2015 July the first clearly and completely Islamic-based Bank of the euro area was founded in Germany with the investment of Kuveyt Türk Bank. Kemal Ozan, leader of the Kuveyt Türk Bank, expects 1,6

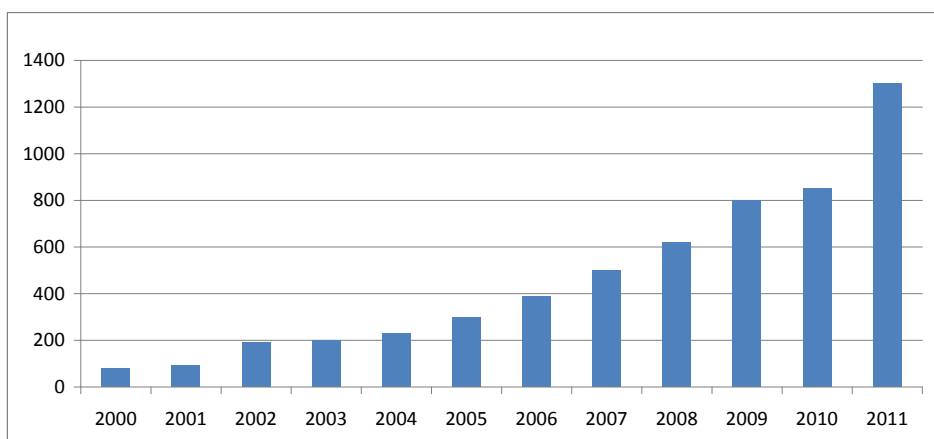
billion Euro (1,73 billion USD) market-volume on the basis of the preliminary market surveys among the Muslims in Germany.

According to Wilson Rodney, economic professor of the Scottish Durham University, the enlargement of Islamic banks in the last two decades is “prominently inspiring and there is no doubt that it will continue in the future as well. The reason of the assumption is the large clientele and the high number of workers and also the development of the qualification of the permanent staff, consequently, it is not a simple and short-term phenomenon.” - Professor Hadžić says and shares the opinion. (*Hadžić, 2015*)

The huge enlargement of the Islamic finance sector is measurable throughout the world. According to the indices made by the Islamic Financial Services Board (IFSB), Islamic banks showed a 38,4% growth in spite of the global crisis of 2004-2011 period. (*Islamic Financial Services Industry Report 2013*). In the 10 years from the millennium to 2011 cashes increased tenfold, reaching 1300 billion US dollars (*Figure 1*).

**Figure 1**

**Islamic Finance Assets Growth (2000-2011) in US Dollars Billion**



Source: *Tabash and Dhankar (2014)*

Many traditional banks in the world were deeply affected by the difficulties of the financial crisis of 2008. It is certainly true in respect of Islamic banks too, however, as opposed to this, the trans-border Islamic financial activities increased throughout the world, including the Balkan activity of BBI. The Islamic banks are more stable than traditional conventional banks due to the strict sharia regulation that affects their operational environment. The compelling growth rate of Islamic financing is due to these canonical regulations aiming at stability that is why it calls the attention of political decision-makers and financial experts as well throughout the world. The rapid growth in 2014 was worth about 2000 billion US dollars that was prevented by experts in the previous year. The division of the Islamic financing answered the

expectations, its 78% was Islamic bank investment, the more popular Sukuk shares showed 16% interest, the Takaful showed 1%, the Islamic funds 4% and the Islamic microfinancing also 1%. (Tabash and Dhanakar, 2014)

A significant part of global Islamic financing is concentrated in the Islamic world, especially in the region of the Middle East and the region of Indonesia and Malaysia. These areas can also be regarded as the centres of investment affecting other parts of the world, of which an example is the BBI banks whose parent branch centres (Islamic Development Bank, Abu Dhabi Islamic Bank, Dubai Islamic Bank) are also located in the area mentioned above and a similar example is the Islamic Bank of Britain (its parent branch is Qatar International Islamic Bank-QIIB). Since inferences can be drawn from the data of the central region, it is worth illustrating these in table as well (Table 1). Besides the detailed review due to expansion reasons, it is needed to state that the Islamic banks' number of cash is between 20% and 65% and the growth rate is between 10% and 38% in the whole bank system that has been continuous since 2008 and with which the data of BBI illustrated later show similarities as well.

**Table 1**

**Market Share and Growth in Assets of Islamic Banks and Conventional Banks in Selected Countries (In percent)**

Countries	Market share in 2008	Growth rate of assets		Periods
		Islamic banks	banking system	
Saudi Arabia	35.0	33.4	19.0	2003-2008
Bahrain	29.9	37.6	9.6	2000-2008
Kuwait	29.0	28.3	19.0	2002-2008
United Arab Emirates	13.5	59.8	38.1	2001-2008
Qatar	11.5	65.8	38.1	2002-2008
Gulf Cooperation Council (GCC)	23.8	45.0	24.8	-
Jordan	10.3	20.6	11.2	2001-2008
Turkey	3.5	41.0	19.0	2001-2008
Malaysia	17.4	20.0	14.0	2000-2008

The contents of the table includes the financial data of the bank's balance sheet of Islamic banks and Islamic windows.

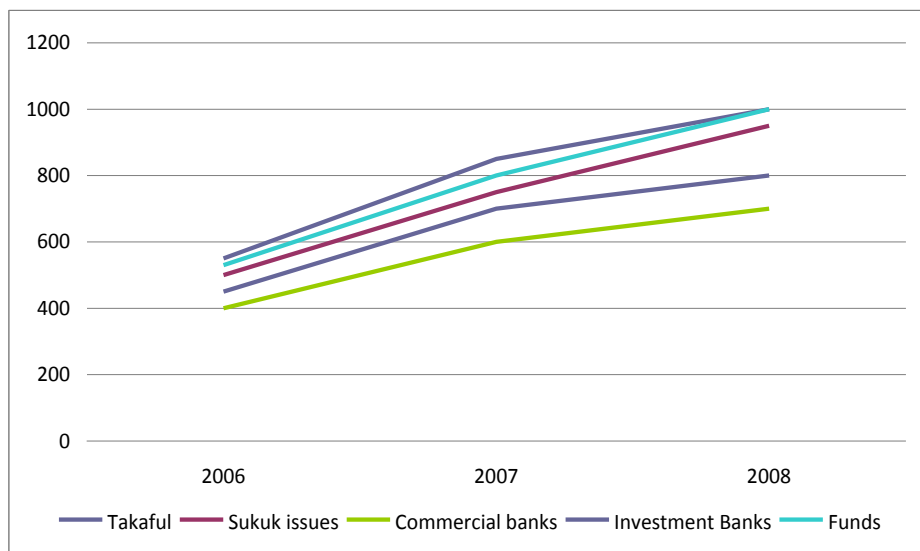
Source: Hasan and Dridi (2010)

The division of global tools of Islamic financing itself (Figure 2) showed unitary trends until 2008. The so-called Takaful is the insurance services observing the instructions of Islam in the structure of which reciprocity, solidarity and mutual aid have been essential parts in the agreement between the participating parties since the crisis but it grows in an undiminished way (similarly to the Islamic investment funds). However, from 2010, merchandising of Sukuk shares in the system of

Islamic banks and investing in shares are getting more popular and popular that produces the fastest growth (10-15% annual growth within the global financial markets) and brings the alteration of rates. This trend can be seen in the balance sheet of BBI analyzed in details later.

**Figure 2**

**Global Assets of Islamic Finance (2006-2008) in End-Year Billion US Dollars**



Source: On the basis of the research of International Financial Services London In: *Hasan and Dridi (2010)*

**GENERAL DESCRIPTION OF THE BOSNA BANK INTERNATIONAL (BBI)**

The Bosna Bank International d.d. (BBI) was founded in 2000 as the first bank in Europe operating according to Islamic principles. Its official seat is in Sarajevo. In 2012 it was already the bank with the country's largest paid-up capital with its registered capital of 47.52 million BAM (Bosnia and Herzegovina convertible mark). The registered capital of the credit institution increased up to 80 million BAM to 2014. In 2002 it acquired the authorization to deposit insurances and to domestic payment transactions. The bank's main range of activities includes the following services: lending to natural and legal persons, deposits, interbank transactions, foreign exchange trading, and other banking services.

The owners of the Bank are the Saudi Arabian Islamic Development Bank with 45.46% shareholders' ratio and two banks from the UAE with 27.27-27.27%, namely the Abu Dhabi Islamic Bank and Dubai Islamic Bank (*Bosna Bank International, 2012*). The current owners were also the founders. The numbers of the

BBI's annual evaluation report show the success of the owner and founder banks' investments, for example in 2012 the total assets of the bank showed a 27% increase, but there was 33% increase in total funding, 30% in retail financing, and 34% in business financing. Deposits increased by 21% and an increase of 17% were observed in the total sales revenue and 26% of the net profit. Numbers are similar to those experienced in 2013 and 2014 as well. Although the BBI bank operates in a different legal environment, but completely in accordance with Islamic principles, it operates in compliance with the rules of Sharia laws. András Kecskés draws attention to the fact that in the business and investment activities the differences between the legal systems should be considered and the possible application of foreign law is necessary to take into account during the investing process. Thus the adaptation of foreign law is necessary. (Kecskés, 2009)

In line with these as one reason for the success of BBI the application and proper harmonization of Sharia law and local legislation can be highlighted. An evidence for the compliance for legislation is the effective compliance on the audits by the supervisory authorities referred in the annual reports as well. The BBI's finances based on the Accounting Act of Bosnia and Herzegovina (*Official Journal of BiH Federation No. 83/09*), the Law on Banks and the Federal Banking Agency's decisions are controlled by the Bosnian authorities, in particular the FBA (Federal Banking Agency) and they must comply with International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS), in addition they are accountable to the parent banks on the basis of Sharia law as well, because various committees (eg. Sharia Committee) perform the supervising activities.

Among the banking activities mainly the Murabaha, the Musharaka, the Wakala and Iyar take a role, in respect of which the BBI itself advocates as well. According to the Murabaha agreement, the Bank gives so-called commodity goods or other assets to the client. It is such a Sharia compatible commodity purchase, during which the seller may inform the buyer in advance how much cost is going to be incurred because of the transaction and how much profit is required (as a sum), so at the moment of the deal this information is available for both of the partners. The commodity good is nothing else than something which is tangible. By Islamic banking lending precious metals or similar (silver, palladium, etc.) are such goods. Among the conditions it is stated that the selling price includes the cost of commodity prices and the shared profits.

In the case of the Musharaka agreement both parties get in capital, one of them does the job, they share the profit according to the pre-agreed ratio while losses are allocated on a percentage of the invested capital. In this case it is important that the property serving as a basis for the investment firm belongs to the client, as for example, because of the different ownership structure the risk increases excessively by the acquisition risk type of investment models – as András Kecskés pointed out (Kecskés, 2011) – and this is opposed to the prohibition of speculative transactions.

The Wakala is actually an agency contract. During the contracting by the occasion of opening of an account the depositor does not pay account maintenance fee but pays a certain fee for the professionalism of the bank because the client entrusts the bank as an agency responsible for his finances. The BBI bank stipulates

in the contract that the agent is obliged to return the invested amount in case of default or negligence or infringements of any term of the Wakala.

The Ijara is a transaction in which the bank buys property right or some tools, equipment, real estate, which is made available to the client for rental fee, so it is rented out. According to the financial reports conducted by BBI, except for the financing costs of the past the financing of the clients with whom the above mentioned type of agreements have been concluded have produced real results, both the investment and financial assets are returned. (*Bosna Bank International*, 2012)

## **THE ANALYSIS OF THE BBI'S BALANCE SHEET**

In the following phase we are going to analyse the structure of the BBI's balance sheet. Because of the easier overview the amounts of the balance sheets of the years 2013 and 2014 were exchanged from thousands of Bosnian convertible mark (BAM) to thousands of euro (EUR). The exchanges rate was 1,9558 BAM/EUR, which was valid on 27.07.2015.

The ratios in the percentage of the total asset show clearly the structure of the BBI's balance sheet (*Table 2*). The Bosna Bank International had a total asset of EUR 287 million at the end of 2013, and EUR 325 million at the end of 2014.

The global balance sheet analysis shows that the granted loans add up to the majority of the total assets, in 2013 nearly half of it and 59% of it in 2014 (*Table 3*). This line requires a separate analysis, in which the highlighting of the Islamic products' characteristics are important (*Varga and Wickert*, 2013).

Another huge item in the total assets is the liquidity assets. This includes cash and balances with banks; its amount was nearly one quarter of the bank's balance sheet, exactly 23%. The bank receivables can be classified into this group as well with a rate of 6% in 2013 and 10% in 2014.

The resources of the Islamic bank's balance sheet are the shareholders' equity and the liabilities. The two main sources of funding liabilities include transaction and investment deposits. Among the resources the liabilities make up a significant part of the balance sheet – typically for the credit institutions: 278.804 of the 325.408 thousands euros. Most of the liabilities are liabilities due to customers; it is 72% of total liabilities. Another big part of liabilities are borrowings, this is 21% of the liabilities. The fact that the level of the provisions is negligible, shows the high level of financial stability of the Bosna Bank International credit institution.

Transaction deposits are related directly to the transactions and payments. In the traditional banking system the demand deposits and the check account with automatic credit opportunity correspond to this type of deposits. The account holder disposes the amount on the check account; the bank is obliged to fulfil it immediately. A 100% reserve requirement is insured for the nominal value of these deposits. These deposits satisfy the sharia-compatibility for people with Islamic religion.

The investment deposits are more similar to companies' shares or rather to investment units of investment funds than to time deposits or to saving deposits of a traditional bank. Investment deposits issued by a bank have not got a guaranteed nominal value and a fixed return. The depositors are like the bank's shareholders,

therefore they can share the profit earned by the bank. The full loss from the operation of the bank is also shared between the depositors and the bank.

**Table 2**

**The structure of the BBI's balance sheet in 2013 and 2014**

<b>Bosna Bank International d.d., Sarajevo, Statement of financial position</b>	BAM/EUR	1,9558
	1000 EUR	1000 EUR
	<b>31.12.2014</b>	<b>31.12.2013</b>
<b>ASSETS</b>		
Cash and balances with banks	73 898	75 541
Cash and the balances with the Central Bank of Bosnia and Herzegovina	16 943	13 850
Placements to banks	31 686	18 809
Financial assets available for sale	24	23
Financial assets at fair value through profit or loss	306	277
Financing of customers	193 616	170 793
Other assets	1 345	2 669
Property and equipment	7 218	4 874
Intangible assets	371	410
<b>TOTAL ASSETS</b>	<b>325 408</b>	<b>287 246</b>
<b>LIABILITIES</b>		
Due to banks	15 002	18 037
Due to customers	199 726	182 887
Borrowings	59 091	39 679
Other liabilities	4 579	1 705
Provisions for liabilities and charges	405	388
<b>TOTAL LIABILITIES</b>	<b>278 804</b>	<b>242 695</b>
<b>SHAREHOLDERS' EQUITY</b>		
Share capital	40 934	40 934
Statutory reserves	1 193	889
Retained earnings	4 477	2 728
<b>TOTAL EQUITY</b>	<b>46 604</b>	<b>44 552</b>
<b>TOTAL EQUITY AND LIABILITIES</b>	<b>325 408</b>	<b>287 246</b>

Source: *Bosna Bank International*, 2014

Unlike the traditional banking system, where the nominal value of their deposits is guaranteed for the investors through the explicit or implicit deposit insurance of the banks or of the government, here in the contract between the bank and the investors only the profit or loss sharing ratio is determined. The profits sharing ratio of the investor and the bank is agreed before the contract. This ratio cannot

be changed until the expiry of the contract and it can be changed only by mutual consent. There are two important differences between the banking ordinary shareholders and investment depositors: on the one hand the depositor has no say to the bank management, on the other hand, the dividends of the ordinary shares from the banks' management are optional, while yields of investment are calculated based on the in advance fixed and constant profit rate.

The ratio of the equities is 14%, so the bank operates with sevenfold leverage. It provides prudent operation compared to the leverage of a classical bank (which is between 10 and 20).

**Table 3**

**The balance sheet structure of the BBI**

<b>Bosna Bank International d.d., Sarajevo, Statement of financial position</b>	<b>31.12.2014</b>	<b>31.12.2013</b>
<b>ASSETS</b>		
Cash and balances with banks	23%	23%
Cash and the balances with the Central Bank of Bosnia and Herzegovina	5%	4%
Placements to banks	10%	6%
Financial assets available for sale	0%	0%
Financial assets at fair value through profit or loss	0%	0%
Financing of customers	59%	52%
Other assets	0%	1%
Property and equipment	2%	1%
Intangible assets	0%	0%
<b>TOTAL ASSETS</b>	<b>100%</b>	<b>88%</b>
<b>LIABILITIES</b>		
Due to banks	5%	7%
Due to customers	72%	75%
Borrowings	21%	16%
Other liabilities	2%	1%
Provisions for liabilities and charges	0%	0%
<b>TOTAL LIABILITIES</b>	<b>100%</b>	<b>100%</b>
<b>SHAREHOLDERS' EQUITY</b>		
Share capital	88%	92%
Statutory reserves	3%	2%
Retained earnings	10%	6%
<b>TOTAL EQUITY</b>	<b>100%</b>	<b>100%</b>
<b>TOTAL EQUITY AND LIABILITIES</b>		

Source: *Bosna Bank International*, 2014



## CONCLUSIONS

Based on the bank balance sheet of the BBI we can talk definitely about successes in the recent years, which fit the observed trends on a global level. The Islamic banks and financial institutions operating according to Islamic principles were not only stable after the economic crisis, but they produced a significant increase as well. Their increasing number and volume of investment prove the popularity of Islamic banking at the same time.

During the 15 year long operation of the BBI, which is the first Islamic bank established in Europe, it has become the biggest bank of the country and has risen among the leading banks of the Balkan region. The authors analysing the bank balance sheets concluded that in the future development of the financial and economic life in the Balkans an outstanding role should be attributed to the Islamic banking institutions. The case of BBI and Bosnia and Herzegovina do not allow conclusions to be drawn only in the region but also it can be guidelines within the European Union. This is especially true for the cooperating opportunities among the Islamic banking system and conventional banks, and for the operation of the Islamic banking system and Islamic law in the shadow of external, continental legal systems.

The growing presence of Islamic banks in the global financial markets impacts the present and the future investments and regional economics towards alternative market economical opportunities, which are proved by the number and amount of such type of investments.

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