

FINANCIAL ENVIRONMENT IN KOSOVO CASE STUDY OF COMMERCIAL BANKS AND FINANCIAL ORGANIZATIONS

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Abstract

Among the major achievements of the post-war Kosovo is building of financial institutions, or the stable banking system and microfinance, functional for just created conditions.

Important role in the development of a financial environment within a national economy is the existence and functioning of a developed institutional structure and financial, that this structure is composed of central banks and banking institutions (which entered the banking network and microcredit institutions), non-banking institutions (microfinance) to offer loans in Kosovo, insurance companies and pension funds, exchanges, money transfer agencies, which create a financial system with a good organization and proper, creating conditions for businesses to operate successfully, both within and out of the country.

I. Introduction

One of the main objectives of this paper was to create a stable financial environment that will serve as the basis of the overall economic development of the country, thus, relying on the small and medium economy of motivated to work and doing so that enterprise congruent in the market thanks to financial support, starting from scratch in building legislation as well as legal bank regulations.

Thus, the existence and functioning of a financial environment as an important part of the economic system, represents one of the basic prerequisites for the successful functioning of any market economy. In the past until the late 80's our economy work based on the principles of socialist economy and legislation, which was stripped of principles and legislations of real economy. Subsequent period of years 1990/99 was characterized with violence and repression of the Serbian Invaders on everything which was Albanian thus destroying the financial environment which presents the national economy column of our country.

The issue of creation, establishment and organization of a financial environment in economy of Kosovo, the conditions created after the war, when our economy was independent from the former Yugoslavia Economy and simultaneously entered the building financial environment process based on the fundamental which will be established economic development of the national economy as the fundamental issue for the further development of the economy in general.

1.1 Research Question paper

In this paper, the main research question is:

As the financial environment affecting the development of SMEs and businesses in Kosovo?

The Answer will be found in the contents of this paper which comprises of extracted material from different websites taken from the Central Bank, other Financial Institutions and the Microfinance favorite literature etc.

1.2 Methods and Research Variables

In this paper mainly have been used descriptive research methods (descriptive) and comparative (comparative). Descriptive is used where when dealing with description economic phenomena, financial movements of different business organizations, where this financial indicator will appear as independent variables in this paper. While comparative method is used when comparing the economic parameters (micro and macro) within a sized firm within a specified period of time for certain economic

phenomenon, namely measurement's success based on financial indicators.

II. The Theoretical Part of the Paper, Banks and Financial Institutions

Financial institutions are financial intermediaries or microfinance organizations, different companies with financial activities, where the main goal of these companies or businesses is to offer customers and users of various financial services and products in diverse market type. These are banks, investment companies and insurance companies. Their products are accounts, commercial loans, mortgages, mutual funds, with a wide range of insurance policies and derivative financial instruments.

Financial institutions can adapt to a variety of different preferences of savers and investors, so that we can know many types and shapes of these institutions, and the allocation of these financial institutions into groups depending on their properties and characteristics.

The economy of our country from the last war has been inherited completely destroyed, therefore, after the war everything started from the very beginning. Development of a functional economy has been the duty and obligation of national and international institutions in the context of the creation of such economic development priority is the creation of the Banking and Payments Authority of Kosovo (BPK) later transformed into the Central Banking Authority of Kosovo (CBAK) and other financial institutions' which have the role of intermediaries in the transfer process was held between main transactors in the financial-economic system, population and the state.

Creation of these banking and financial institutions was preceded by the creation of a legislature and legal infrastructure based on the laws of a modern Western European Market Economy, thus, creating a healthy financial environment and stable in comparison with other countries in the region, to create so appropriate conditions for foreign financial institutions and loans to invest in Kosovo. The creation of these financial mechanisms irrespective of their stage of development, have enabled the creation of conditions for development of an economy within existing environmental of Kosovo conditions, so even though the offered terms by loan institutions were not favorable, they were necessary for the further development of NMV and different businesses.

II.1. – Banking System- Legislation and Banks of Kosovo

The banking system comprises of the Central Bank and other banks. Other banks comprise of Commercial banks,

which in Western Europe was titled business banks (commercial term is suitable, because commercial bank is a form of specialized bank) such as; the development, investment, trade, regional, multinational etc. Central banks are also often called the issuing bank, the National Bank, National Bank, the monetary bank or so-called a universal bank, which besides other activities (granting of loans and receiving deposits) deals with the of money issuance.

Due to thee aim of strengthening the economy of Kosovo in order to provide an efficient payments system and a sound banking system, Banking and Payments Authority of Kosovo (BPK) was established, which essentially is a legal person, public distinct. Since its establishment in 1999, the Banking and Payments Authority of Kosovo (BPK), transformed the 2006 Central Banking Authority of Kosovo (CBAK), has faced technical, institutional and human resources, thus requiring a commitment and dedication great to build a new institution, which requires firm engagement and commitment in the implementation of the highest international standards.

With the commitment of local and international staff positive results are achieved by creating very important developments during 2006, by constituting 6 banks, 8 Insurance Companies, a Universal Pension Fund, 16 micro-finance institutions and 12 Exchange Bureaus operating in Kosovo. As a result of this and relying on modern comprehensive package of Regulations (laws) and Rules, the financial industry has the capacity to support the economic development of Kosovo, Also during 2006 took place continuous transfer of competencies from UNMIK to Kosovo local institutions, which can be seen with delegated responsibilities by international experts to local authorities with, whereby there was a motion of the Board of Directors (where from foreign 5members, 3 are comprised of local institutions now). Soon the independence of the country we are expecting to transfer all powers until June 15, 2008 from internationals locals and to CBK (Central Bank of Kosovo)

III. Empirical Part of the Paper-Financial Intermediates in Kosovo

Among the greatest achievements in post-war is the construction of a stable banking system, fully functional and safe. Standards achieved in this area of Kosovo have ranked among the states with safer and more stable banking system. Currently in Kosovo operate a certain number of financial institutions and local and international microfinance in the form of commercial banks, microfinance institutions and non-banking organizations.

III.1. Commercial banks and credit conditions

Central Banking Authority of Kosovo (CBAK) as the successor to the BPK is responsible for the licensing of commercial banks and non-bank financial institutions (micro-financial) to offer loans in Kosovo. Commercial banks provide a full range of banking services, including loans, guarantees, applies for accounts, savings accounts, term deposits, local transfers and abroad, as well as services for preserving of worth items .

Commercial banks operating in Kosovo are:

1. Bank of Commerce - (EU),
2. Pro Credit Bank - (PCB)
3. Raiffeisen Bank Kosovo - (RFB)
4. New Bank of Kosovo - (BRK)
5. Private Business Bank - (BpB)
6. Kasa Bank - (KSB) now NLB (Nova Lublanska Bank, etc.).

III.2. Loan and Microfinance Institutions

Non-Banks in Kosovo

Non-bank microfinance institution means a financial institution that is not a bank, which is engaged in microfinance activities. These loan institutions operating in Kosovo do not provide large amounts of loan (starting with 1000.0o Euro), mainly in rural environments and to development of households economy, small businesses, etc. agricultural.

Micro-Loan operating Institutions in Kosovo are:

1. Agency for Finance in Kosovo-AFK,
2. Finca,
3. KEP-(Kosovo Enterprise Program),
4. Rural Credit Kosovo-Adie International,
5. Covenant Assistance (World)
6. Invest Yogurt World Vision etc.

III.3. Non-Banking Loan Institutions in Kosovo

Non-bank loan institutions in Kosovo are financial institutions that are not banks but to engage in microfinance as well as consulting and service.

Non-banking institutions operating in Kosovo are:

1. ABU Agri Business Unit,
2. PTK Post and Telecom of Kosovo,
3. Villa CO.,
4. E & Efficacy & Safety etc.

III.4. Pension Funds

The social security system is somewhat more complicated and almost outside the scope of government, but it is managed by third pillar of UNMIK (including pension contributions).

The pension system is comprised of two pillars:

The first is the basic social assistance schemes under the control of needs, which is applicable not only to the elderly. It is integrated in the Central Government, which means that it is part of the Government. Pension payments under this scheme are considered as social benefits included in the cost of current transfers to ESH, which is funded by the General Government Invoices.

The second is mandatory funded scheme, which was first implemented in a professional manner on August 1, 2002 and August 1, 2003, replaced with a comprehensive scheme applied by employers and employees and self-employed persons. This part is not managed by government, but by a separate institution. Pension Savings Trust (PSTK). PSTK receives current contributions 10% of gross salary split between employers and employees, whereas employees own 10% of earned income. PSTK supervises the investments of these funds, which are

managed by two private companies. Such a system is not as complicated because contributors may receive invoices from the date of their retirement capital. Statistical treatment implies that the main pension system, which is now in an embryonic form, will be more important in the years to come. This piece was recorded outside the Government.

Contributions to pension payments are flows between Households and the sector of financial corporate.

From an economic perspective it doesn't seem to be entirely satisfactory to the main system of compulsory retirement doesn't reflected in the government accounts. So ESK government accounts publications in principle contain a transcript, pro memory of the situation of the funded pillar (contributions, asset income, payments and assets).

Table 1: Main indicators for the 2nd pillar pension administration (expressed in million Euros, 2005)

Contributions	Incomes of finical means	Pension Payments	means(the end of the year)
51,95	10,64	:	62,58

Source: Pension Saving Trust of Kosovo

²In 2003, total pension contributions were about 29 million in 2004 there was an increase of contributions of more than 44.4 million, while in 2005 show an increase in contributions 51.95 million, whereas payments in 2005 were zero.

IV. Analysis of the paper: Commercial Banking Activity and Micro Institutions

The period 2001-2002 was characterized by significant changes to the banking and credit system in Kosovo. Besides the constitution of new banks in late 2001, Kosovo was included in the Euro-zone as a result of this operation comes to a stabilization of deposits around € 400-420 million. However, to establish a sustainable system of financing businesses, particular importance except overall deposit growth has the structure of deposits, or participates as term deposits and it is long-term saving.

Term deposits have increased and present 31.3% of total deposits in 2002. However, they are insufficient for increase

of the offer. Increase of deposits in time in 2002 was 3.9% compared with a year ago, but insufficient to bring about changes in policy for businesses.

From the perspective of international participation in Kosovo deposits to BPV (PBK) are significantly lower than in some other countries in transition, whereas this share in 2001 was 26.8%, in 2002 it dropped to 21.1%. In other countries the share of deposits to GDP is in direct conjunction with the level of economic development and the development of financial and capital market. Regarding the per capita deposits it is evident that Kosovo has the lowest level in the region (162 Euro Kosovo, Romania 189 Euro, 305 Euro Bulgaria, Macedonia and Albania EUR 314 519 EUR) .³ The above data indicates that despite trends overall positive development of the bank, the customer confidence remains to be tested under long-term savings.

Credit activity of banks, loan growth in commercial banks is presented in Table.2.

Table2: Deposits and loans by banks (in mil. €)

Banks	Deposits	Loans	Deposits (%)	Loans (%)	deposits Loans (%)
MEB	266.7	21.4	66.4	28.0	8.0
BRK	34.9	14.4	8.7	18.7	41.3
BpB	25.1	11.4	6.2	14.8	45.4
BE	11.5	5.4	2.9	7.0	46.9
BAK	41.7	11.7	10.4	15.2	28.0
BKP	8.7	5.8	2.1	7.5	67.0
KSB	11.5	6.6	2.9	8.6	57.4
Gjithsejt	401.8	76.9	100.0	100.0	19.1

Source: Monthly Macroeconomic Monitor Kosovo, December 2002, MEF

From the data on the relationship between deposits and loans in different banks considerable disproportion can be seen in relations between deposits and loans. These disproportions are observed especially in MEB (restrictive

approach) and the BKP and KSB (expansionist access to credit). The real causes of such a situation are not known and can range from lack of management capacity, interest rate policy, security / insecurity of placements. However, the

above-mentioned table could expect a more offensive lending by some banks in the existing conditions.

The participation of banks in the volume of deposits and loans in general in supporting of business has also created various reports between loans and deposits. Lower participation of loans to deposits is shown in MEB (8.0%), while the highest participation is shown to Loan Bank (67.0%), Kasabank (57.4), Commercial Bank (46.9%) and Private Business Bank (45.4 %). All these banks contributed to increased credit supply and the share of loans in term deposits from 19.9% in 2001 to 60.0% in 2002.

IV.1. Financial Instruments and Authentication Hypothesis

The activity of banks and institutions (organizations) is mainly focused on accomplishment of money transfer and payment within and outside the country, maintaining deposits and loans, primarily to businesses. In continuance we present the amount of allowed and outstanding loans see tab. 3

Tabela3: Amount of loans and outstanding (in million €)
Tabela3: The amount of allowed and non-discharged loans (in million €)

<i>Years</i>	<i>Banks</i>	<i>Financial Institutions</i>	<i>Total</i>
2001	25.2	21.4	46.6
2002	85.7	33.4	119.1
% increase 2001/02	240.0	56.1	155.6

Source: Monthly Bulletin of statistics, BPK, December 2002.

³From table 3, it can be seen that in 2002 comes to a sensitive increase in the volume of loans. The amount of loans granted by banks has tripled, while loans from non-banking financial institutions have increased by approximately 56%. Now the loan market banks dominated the other credit by more than 65% of the loan amount allowed. However, when assessing the dynamics of lending volume, keep in mind that credit activity in the previous year which was very low.

Otherwise, this volume of loan activity is in line with the predictions of loan organizations (survey of banks and non-bank financial institutions, June 2001).

However, the volume of lending can not be considered adequate in comparison with the needs of businesses, the demand for loan and experiences from other countries, especially to the needs of society for the creation of new jobs. Therefore, to increase the volume of credit supply should be one of the main concerns of economic policy in Kosovo. Kosovo is still very low participation loan Gross Domestic Product GDP - GDP (see tab. 2.). While in Kosovo in 2001 the share of loans to GDP was 2.7%, in 2002 this share had increased to 6%. The table below shows that in other countries this ratio is as follows: 6.8% in Bangladesh, 35% in Croatia and in the Czech Republic 46 %.

Tab.4. Participation of Loans in GDP (%)

Places	1999	2001
Kosovo	-	2.7
Albania	3.9	6.8
Croatia	38.2	35.6
Slovenia	36.0	41.3
Czech Republic	60.0	46.0
Poland	26.7	30.3
Place of Euro Zone	101.2	107.0

Source: Fundamental Trends in Financial Sector/Banking Sector Trends Through 2001, *Southeast Europe Financial Sector Conference*, Zagreb, Croatia, 2002.

Besides these difficulties in the area of loan, Kosovo enterprises almost never use other financial instruments as lease or ⁴franchise. An attempt to introduce innovation in investment practice has been KREF (Kosovo Reconstruction Equity Fund) supported by the European Bank for Reconstruction and Development (EBRD) with a capital of \$ 4.5 million.

It is assumed that the further development of the financial market and capital market will increase the importance of these financial instruments in the development of this sector (KfW and BPB).

IV.2. Structure of the Loan

Based on a survey conducted with six commercial Banks in Kosovo, five of them have allowed loan for expansion and modernization of existing businesses (KSB, BPB, BRK, Raiffeisen Bank, Bank of Commerce), and three-fifths of

these loans have also allowed for the creation of new businesses (BRK, ABK, Commerce Bank). See tab. 5.

Table 5: Loan Sector Structure

⁴Franchising is when a company which gives exclusive rights to an individual or firm the name of the firm to sell products or services of that firm.

<i>Sectors</i>	<i>2000</i>	<i>2001</i>	<i>2002</i>
<i>Trade</i>	<i>66.0</i>	<i>55.5</i>	<i>56.5</i>
<i>Industry</i>	<i>16.9</i>	<i>12.4</i>	<i>15.2</i>
<i>Services</i>	<i>17.0</i>	<i>15.8</i>	<i>18.5</i>
<i>Others</i>	<i>-</i>	<i>16.4</i>	<i>8.1</i>
<i>Total</i>	<i>100.0</i>	<i>100.0</i>	<i>100.0</i>

Source: Monthly Bulletin of statistics, BPK, December, 2002

⁵Attempts to change the structure of the loan in favor of production and service have not been favorable. Trade enterprises absorbed about 56% of loans in 2001 and 2002. Manufacturing activities have increased slightly, while the share of the agricultural sector is still worryingly low (only 1.7% in 2002).

Despite some efforts, such as: ABU Agri Business Unit, an appropriate financing system that would take into account the specificities of agriculture hasn't been established yet.

From the perspective of the distribution of loans by banks, there are also differences from bank to bank. Thus greater participation in trade loans is Kasabank (83%), New Bank of Kosovo (59.0%) and Bank of Commerce (63.0%).

Whereas in giving of loans the leading manufacturing enterprises are: Private Business Bank (72.0%), American Bank of Kosovo (70.0%) and MEB (51.0%). Distribution of loans by sector is mainly determined by the existing adverse credit.

These terms are particularly unaffordable for serious investment in the sector of manufacturing SMEs in the country, which require longer periods for repayment and lower interest rates. It is interesting that social enterprises have increased their share (5.3% in 2002), while all public enterprises are not present in the loan market.

IV.3. Credit conditions

Movements toward improving loan conditions in 2002 were slower. Interest rates have shown a significant reduction of not more 14-22% in about 10 -14%. According to a survey, conducted by banks, there is an occurrence of a predominance of short-term loans (less than a year) by about 90%.

Only ICU (Interim Loan Unit) as an interim loan organization led by World Bank Loans has allowed middle-term loans (in terms of up to 3 years).

Table 6: Interest rates for approved loans

<i>Norm of Interest</i>	<i>Number of Banks</i>
<i>Minimal</i>	
<i>10-12 %</i>	<i>2</i>
<i>12-15 %</i>	<i>5</i>
<i>Maximal</i>	
<i>14-18 %</i>	<i>2</i>
<i>18-24 %</i>	<i>5</i>

Source: Kosovo Banks Survey, 2001

From the survey data with commercial banks, it appears that when it comes to minimum standards, then here BpB and MEB the rate is 11.5% , respectively 10.0% , and five other banks is 12-15, whereas, the maximum interest rate of 14-18% is to Kasabank and BPB, 18% is BRK and ABK, and the higher is the MEB.

Microfinance institutions in Kosovo, also allow loans with high interest rates, which average rate estimated to be around 24%. Particular difficulty is the lack of grace period (the time between the moment when the free and the lender begins to turn) which creates difficulties because of this engulfed businesses with high production costs, also risking cash flow (cash flow). From this as consequence we have the attitudes arising in connection with lending conditions based on a survey conducted by a Riinvest in nearly 200 companies that followed each year.

According to the responses of the surveyed entrepreneurs shows that more than half of them (55%) overall loan conditions are considered unfavorable.

Compared to previous critical stand towards lending loan terms is softened, but still the majority of entrepreneurs consider lending conditions not suitable for serious investments. In creating these perceptions have greater influence three factors affecting loan terms: a) lack of grace period, b) high interest rates and c) short-term for repayment. Most of the surveyed companies prefer lower interest rates and more favorable terms of loan repayment as a condition for engaging in more serious investments, especially in production.

IV.4. New Financial Instruments

In the business community there is a stand that only grants, loans and microloans can be used to develop new businesses. With the completion of the development phase emergency grants have shown a significant reduction. This has all the ideas and projects to entrepreneurs who base their investment in these two financial instruments.

Existing bank legislation allows the possibility of using other financial instruments. Since 2001 the share of equity holdings has been implemented in (equity Investment Funds) by Kreft - Kosovo Reconstruction Equity Fund in volume of € 4.5 million, secured by the EBRD.

Experience has shown that this can be a useful tool for new initiatives. An important precondition for the activation of new financial instruments (instruments guarantee, leasing, factoring, scholarships) is the development of the financial market and the increasing role of foreign investment in business development.

Financial market development and incorporation of new institutions in the financial system, especially insurance companies, guarantee funds, pension funds and other financial income would significantly improve the financial environment affecting the growth of financial and loan supply.

V. Conclusions

Creating legal infrastructure and mechanisms for its operation, the formation of commercial banks, micro loan institutions (bank and non-bank) and other microfinance organizations is the basis of the creation of the Financial System in Kosovo. Without any real system of banking we would not have even developed national economy, because economic development of a country depends on the perfection of financial institutions in general, especially in the current conditions in Kosovo where development NVM is not possible without loan mechanisms.

To create such a system which currently exists in Kosovo a firm commitment of professional human resources at home and abroad was needed, with international cooperation in terms of sharing experiences among staff, thus creating such a structure is based the laws of European countries advanced in their modern legislation .

With a successful financial policy, with a prompt organization and respectable in general terms, based on the establishment of a sound financial and microfinance, will create conditions for NVM in the future to be as successful, these conditions will affect to create a secure financial environment in order to be loyal congruent and equal to regional and international markets.

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